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Deconstructing *EFH*

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DECONSTRUCTING EFH

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INTRODUCTION

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Why Are We Deconstructing EFH?

- Chapter 11 Cases Are More Than Three Years Old
- During That Time, There Have Been Numerous
  - “Pivots” In Reorganization Strategy
  - Restructuring/Plan Support Agreements
  - DIP Financings
  - Creditors’ Committees
  - Filed Plans And Amended Plans
  - Confirmed Plans
  - Confirmed Plans That Have Not Been Not Consummated
  - Shifting Alliances
  - Settlements

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Why Are We Deconstructing EFH?

- Key Rulings
  - Make Whole Claims
  - Pre-Plan Settlements
  - Impairment/Post-Petition Interest On Unsecured Claims
  - Regulator’s Rulings (Primarily Texas PUC)
- Other Issues
  - “Surprise” Intercompany Claims
  - Corporate Governance
  - Alternatives To DIP Financings And Asset Sales
  - Venue Fight
  - State Court Litigation Amongst Creditors
  - Valuation Disputes
  - Attack On LBO
  - Mediation

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Background

- In 2007, a sponsor group consisting of KKR, TPG and Goldman Sachs acquired the former TXU Corp. in a $45 billion buyout
  - Remains the largest private buy-out in history
  - After the buyout, the newly formed EFH had over $41 billion in debt
- Two distinct businesses
  - “T-Side”: Unregulated generation, mining and commodity trading owned by Texas Competitive Holdings Co.
    - Owned Luminant, the largest electricity generator in Texas, and TXU Energy, the largest certified retail provider in Texas
  - “E-Side”: Nearly 80% ownership of Oncor, a regulated electrical utility owned by Energy Future Intermediate Holding Co. (“EFIH”)

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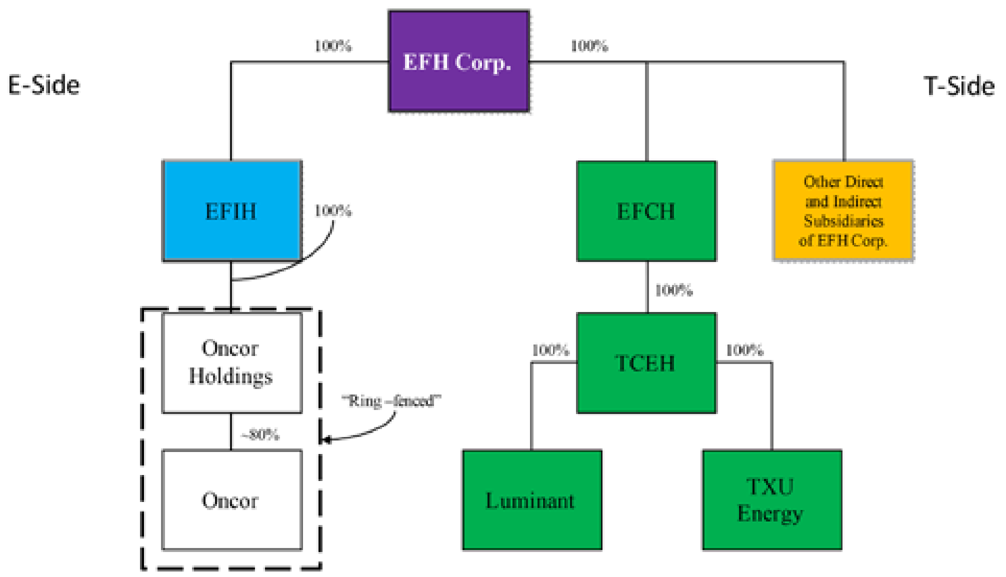
EFH – Corporate Structure



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EFH Corp. (Parent Company) Unsecured Debt

Security	Debt Obligation	Approx. Amount Outstanding as of the Petition Date	Interest Payment Due Dates	Original Maturity/Payoff Date	Obligors
EFH Corp. Debt					
EFH Corp. Unsecured	EFH Legacy Notes	$1.864 billion	May 15; November 15	Varies by series, November 2014, November 2024, and November 2034	EFH Corp. as issuer
	EFH LBO Notes	$60 million	May 1; November 1	November 2017	EFH Corp. as issuer EFCH as unsecured guarantor EFIH as unsecured guarantor
	EFH Unexchanged Notes	$5 million	Varies	Varies	EFH Corp. as issuer

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T-Side Pre-Petition Debt

Security	Debt Obligation	Approx. Amount Outstanding as of the Petition Date	Interest or Other Payment Due Dates	Original Maturity/Payoff Date	Debtor Obligors
TCEH First Lien Secured	TCEH Credit Agreement	$22.635 billion	Varies	Varies	All TCEH Debtors
	TCEH First Lien Notes	$1.750 billion	Jan. 1; April 1; July 1; Oct. 1	October 2020	All TCEH Debtors
	TCEH First Lien Commodity Hedges TCEH First Lien Interest Rate Swaps	No less than $1.235 billion[34]	Varies	Varies	All TCEH Debtors
TCEH Second Lien Secured	TCEH Second Lien Notes	$1.571 billion	Jan. 1; April 1; July 1; Oct. 1	April 2021	All TCEH Debtors
TCEH Unsecured	TCEH 2015 Unsecured Notes	$3.488 billion	May 1; Nov. 1	November 2015	All TCEH Debtors
	TCEH Senior Toggle Notes	$1.749 billion	May 1; Nov. 1	November 2016	
	Pollution Control Revenue Bonds	$875 million	Varies	Varies	TCEH

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E-Side Pre-Petition Debt

Security	Debt Obligation	Approx. Amount Outstanding as of the Petition Date	Interest Payment Due Dates	Original Maturity/Payoff Date	Obligors
EFIH Debt					
EFIH First Lien Secured	EFIH First Lien 2017 Notes	$503 million	February 15; August 15	August 2017	EFIH and EFIH Finance as issuers
	EFIH First Lien 2020 Notes	$3.482 billion	June 1; December 1	December 2020	
EFIH Second Lien Secured	EFIH Second Lien 2021 Notes	$406 million	May 15; November 15	October 2021	EFIH and EFIH Finance as issuers
	EFIH Second Lien 2022 Notes	$1.750 billion	March 1; September 1	March 2022	
EFIH Unsecured	EFIH Senior Toggle Notes	$1.566 billion	June 1; December 1	December 2018	EFIH and EFIH Finance as issuers
	EFIH Unexchanged Notes	$2 million	April 15; October 15	October 2019	

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E-Side Plan Timeline

- Jan 14, 2015—E-Side bid procedures approved
- Apr 14, 2015—Filing of original plan, contemplating either a sale or equitization
- Aug 9, 2015—Agreement to sell Oncor to Hunt Group, contingent upon obtaining approvals necessary to convert Oncor to a REIT—**values Oncor at ~$19.5 Bn**
- Dec 9, 2015—Plan contemplating Hunt sale confirmed
- Mar 24, 2016—PUCT approves sale to Hunt Group, **contingent upon** sharing substantially all tax savings with ratepayers
  - This ruling substantially reduced the value of the utility and constituted a termination event under the merger agreement
- Apr 30, 2016—Hunt sale agreement terminated
- Sept 18, 2016—Agreement to sell Oncor to NextEra—**values Oncor at ~$18.9 Bn**
- Feb 17, 2017—Plan contemplating NextEra sale confirmed
- Mar 30, 2017—PUCT indicates that it will **not** approve the NextEra sale, finding it not in the public interest

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Agency or Entity	Area(s) of Authority
Commodity Futures Trading Commission (the "CFTC")	Futures market derivatives and over-the-counter derivatives (including interest rate swaps and commodity swaps)
ERCOT	Ensure reliable operation of transmission and distribution grid in the ERCOT market Dispatch generation to satisfy electricity requirements in the ERCOT market Manage real-time and day-ahead markets and financial settlement process in wholesale electricity markets in the ERCOT market
Environmental Protection Agency (the "EPA")	Air and water quality Solid waste disposal
Equal Employment Opportunity Commission (the "EEOC")	Labor relations
Federal Communications Commission (the "FCC")	Wireless radio licenses for emergency radio communication
Federal Energy Regulatory Commission (the "FERC")	FERC has nationwide electricity reliability authority, including with respect to the ERCOT market. The ERCOT market, however, is not subject to the plenary jurisdiction of the FERC and electricity sales within the ERCOT market are not within the FERC's jurisdiction. FERC does have jurisdiction over imports and exports of wholesale electricity to and from the ERCOT market, and over Oncor Electric's facilities and agreements that provide for electrical interconnection to non-ERCOT utilities.
Mine Safety and Health Administration (the "MSHA")	Mine safety
North American Electric Reliability Corporation (the "NERC"), in conjunction with the Texas Reliability Entity (the "TRE")	National electricity grid reliability standards
Nuclear Regulatory Commission (the "NRC")	Nuclear operating licenses Nuclear waste disposal
Occupational Safety and Health Administration (the "OSHA")	Workplace safety
Office of Surface Mining Reclamation and Enforcement (the "OSM")	Enforces federal surface mining and environmental standards
PUCT	Wide-ranging oversight over the Texas electricity market including, among other things, ensuring customer protection and regulating the rates and services, as well as certain "change of control" transactions, of transmission and distribution utilities such as Oncor Electric
RCT	Permits, enforces, and oversees Texas surface mining and land reclamation process
TCEQ	Air quality Water quality Waste management

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CORPORATE GOVERNANCE

Restructuring Support Agreement

- EFH's chapter 11 filing was accompanied by a Restructuring Support Agreement ("RSA") and Plan Term Sheet that contemplated an overall restructuring
  - Many of the key court rulings in the case, including those related to the make-whole dispute and the pre-plan settlement, arose out of litigation initiated in opposition to the initial RSA
- RSA proposed a tax-free spinoff that would provide T-Side first lien lenders with 100% ownership (as reduced by a MIP) of Luminant and TXU Energy
  - Opposed by T-Side junior creditors, who would receive little or no recovery
    - Although perception was that junior creditors were out of the money on an absolute priority basis, the RSA did not rely on a formal valuation
- E-Side would be recapitalized with new money from EFIH PIK noteholders, giving them control of Oncor
  - E-Side refinancing required to close within 45 days of filing
  - E-Side first and second lien creditors would be cashed out, but without payment of make-whole premium
    - These groups opposed the plan (as did T-Side unsecured creditors)
  - DIP loan from PIK holders that would mandatorily convert into 64% of equity of reorganized equity
  - Implied a roughly $16.5 billion enterprise value for Oncor, also without a formal valuation or auction
- EFIH planned to use the proceeds of DIP financings to pay off its first lien notes in full, and that a second round of DIP financing would be used to repay the second lien notes
  - Second round of DIP financing ultimately not sought

Corporate Governance and Fiduciary Duties

- EFH sought court approval of the RSA, which was the subject of vigorous opposition
  - Primary objections based on insufficient Oncor valuation and solicitation of alternative E-Side DIP financings
- While the motion was being contested, alternative offers for the second lien DIP emerged, implying a higher valuation for Oncor
- Debtors' board initially refused to consider these higher offers and chose to go ahead with the transactions outlined in the RSA

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Corporate Governance and Insolvency – Fiduciary Duties

- Business and affairs of a corporation are governed by the company's board of directors; majority of companies are organized under Delaware Law
- Fiduciary obligations of due care and loyalty apply to board decisions
  - Duty of care requires that director decisions be informed and consider all relevant facts
  - Directors can rely on information provided by management and outside consultants, but must act in good faith
  - Directors must follow reasonable decision making process
  - Duty of loyalty requires directors to act in good faith, in the best interests of the company

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Corporate Governance and Insolvency -- Standard of Review

- Courts typically apply business judgment rule to directors' decisions
  - Legal presumption that board's decision was made in good faith and in the best interests of the company and its stakeholders, even if the outcome is not as anticipated or ultimately results in harm to the company;
  - Directors must satisfy their fiduciary obligations of care and loyalty to qualify for the protection of the business judgment rule;
  - Clear, informed decision making is key, as is detailed record of the process
- If directors are shown to have a conflict of interest, there is a failure in decision making process or nondisclosure of material facts, or breach of fiduciary duty, the decision will be judged by stricter entire fairness standard unless the decision is approved by a committee of disinterested directors

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Corporate Governance and Insolvency: Whose Interests are Protected?

- When Company is solvent, directors' owe fiduciary obligations to the shareholders; creditors' rights are contractual
- In the Insolvency Context, the directors' obligations expand to include creditors and other stakeholders
- Conflicts of interest can arise when directors make decisions that have a disparate impact on different groups of creditors/stakeholders or which benefit shareholders at expense of creditors
- Agreements that appear to benefit one group of stakeholders may draw criticism from others, calling into question the directors judgment

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EFH – Sale Process Revised

- After discussions with stakeholders, EFH sought approval of revised bidding procedures for a new restructuring transaction
- Creditors objected, raising concerns with corporate governance that lead to new proposal and questioning Debtors' business judgment
- Bankruptcy Court found the proposed transaction was a result of flawed and insufficient corporate governance and raised conflicts of interest within the Debtors' estates
- Bankruptcy Court required Debtors to obtain formal approval of proposed bidding procedures from the independent directors on both the E and T sides before it would approve the procedures as modified by his ruling, and urged those directors to play an active role in the case
- Bankruptcy Court's ruling highlights importance of effective corporate governance processes and need to ensure that decisions are in best interests of company as a whole and do not favor one group over another

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EFH – Corporate Governance Challenges

- Post-Petition, creditors on both the T-and E-sides objected to the RSA
- On the E-side, the Debtors received several DIP proposals offering significantly higher values for the business
- Debtors' board initially refused to consider these higher offers and chose to go ahead with the transactions outlined in the RSA
- Bankruptcy Court indicated that Debtors had not met their burden to show the sale price was proper in light of competing higher proposals, and that he had concerns as to whether sale proposed in the RSA was a proper exercise of business judgment
- Debtors ultimately terminated the RSA in light of these concerns

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EFH – Sale Process Revised

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MAKE-WHOLE LITIGATION

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First Lien Make-Whole Litigation

- Proceeds of the proposed EFIH First-Lien and Second-Lien DIP financings were to be used to repay the outstanding EFIH First Lien notes, including the claims of the noteholders agreeing to settle their make-whole claims at a discount
- The First Lien indenture trustee objected to the DIP financing on the grounds that
  - Repayment of the Notes would result in an Optional Redemption that triggered the right to the Applicable Premium
  - The EFIH debtors intentionally defaulted by filing bankruptcy to avoid paying the Applicable Premium
  - Repayment would breach the noteholders' right to rescind the acceleration
- Trustee initiated an adversary proceeding against the EFIH debtors, re-stating the arguments included in the DIP objection
  - Asserted an unsecured claim for breach of a purported no-call covenant in the indenture
  - Sought declaratory relief that trustee could decelerate the Notes without violating the automatic stay (or, alternatively, that the stay should be lifted to permit rescission of the acceleration)
- When the Bankruptcy Court did not act immediately, the First-Lien Notes sent a (post-petition) notice rescinding the acceleration, contingent on stay relief
- The Bankruptcy Court approved the refinancing of the First Lien notes from proceeds of DIP financings, but ruled that the refinancing would not prejudice the First-Lien Indenture Trustee's make-whole claims
- Bankruptcy Court bifurcated the adversary proceeding
  - Phase One would address liability for make-whole and intentional default issues
  - If there was liability for a make-whole, Phase Two would address whether Debtors were insolvent (and whether that creates any defenses) and the amount of the make-whole claim

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Make-Whole Litigation—Key Indenture Provisions (First Lien Notes)

- Section 3.07 Optional Redemption – "At any time prior to December 1, 2015, the Issuer may redeem all or a part of the Notes at a redemption price equal to 100% of the principal amount of the notes redeemed plus the Applicable Premium as of, and accrued and unpaid interest to, the date of redemption (emphasis in original).
- Section 1.01 "Applicable Premium" means, with respect to any Note on any Redemption Date, the greater of: (1) 1.0% of the principal amount of such Note; and (2) the excess, if any, of (a) the present value at such Redemption Date of (i) the redemption price of such Note at December 1, 2015 (such redemption price as set forth in the table appearing under Section 3.07(d) hereof), plus (ii) all required interest payments due on such Note through December 1, 2015 (excluding accrued but unpaid interest to the Redemption Date), computed using a discount rate equal to the Treasury Rate as of such Redemption Date plus 50 basis points; over (b) the principal amount of such Note.
- Section 6.02 Acceleration – Upon a bankruptcy filing, "all outstanding Notes [are] due and payable immediately."
- Section 6.02 Rescission - The Holders of at least a majority in aggregate principal amount of the Notes by written notice to the Trustee may on behalf of all the Holders waive any existing Default and its consequences under the Indenture except a continuing Default in the payment of interest on, premium, if any, or the principal of any Note (held by a non consenting Holder) and rescind any acceleration with respect to the Notes and its consequences (so long as such rescission would not conflict with any judgment of a court of competent jurisdiction).

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Second Lien Make-Whole Litigation

- Approximately one month after the First Lien Trustee initiated its adversary proceeding, the Second Lien Indenture Trustee filed a complaint seeking declaratory judgment on the same issues in regard to the Second Lien Notes
- Nine months into its bankruptcy case, EFIH used proceeds of its DIP financing to repay $750 million of principal and accrued interest under its Second Lien Notes
  - Second Lien Trustee filed a complaint asserting that the partial paydown triggered the noteholders' right to receive the Applicable Premium
  - Second Lien Trustee also sought a declaration that any future paydown of the notes prior to their call dates gave rise to a secured claim for the premium
- Second Lien Noteholders also issued a notice rescinding acceleration and requested retroactive relief from the automatic stay to effectuate the rescission
- Court noted that the relevant provisions of the second lien indenture were substantially similar to those of the first lien indenture, except that the acceleration provision stated that "[I]n the case of an Event of Default arising under clause (6) or (7) of Section 6.01(a) hereof, all principal of ***and premium, if any***, interest (including Additional Interest, if any) ***and any other monetary obligations*** on the outstanding Notes shall be due and payable immediately without further action or notice"

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First Lien Make-Whole Opinion—Bankruptcy Court 527 B.R. 178 (Bankr. D. Del. 2015)

- The plain language of the First-Lien indenture does not require payment of an Applicable Premium upon repayment of the Notes after an acceleration under Section 6.02
  - Indenture is not ambiguous
  - Begins analysis with Section 6.02, "the most relevant provision," the acceleration provision
  - Section 6.02 contains no reference to payment of the Applicable Premium upon acceleration, nor is Section 3.07 incorporated into Section 6.02 (nor anywhere else in the indenture)
  - Under New York law, an indenture must contain express language requiring payment of a prepayment premium upon acceleration; otherwise, it is not owed
    - Other indentures specifically require post-acceleration payment of a make-whole
  - Court cites other cases in which other courts found no make-whole was due despite similar contractual language
    - *Calpine, Premier, Momentive, Solutia*

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First-Lien Make-Whole Opinion—Bankruptcy Court 527 B.R. 178 (Bankr. D. Del. 2015)

- Rejects First-Lien Trustee's argument that Section 3.07 is an absolute bar to repayment before December 1, 2015
  - Canons of contractual interpretation require that Article 6, "Default and Remedies," determine the trustee's obligations upon default, not Article 3, "Redemption"
  - Optional Redemption under Section 3.07 is an act separate from automatic acceleration
    - The indenture contains a specific noticing scheme to achieve a redemption, but no part of this process is implicated when the notes become immediately due and payable under Section 6.02
  - Under NY law, a borrower's repayment after acceleration is not considered voluntary—acceleration date becomes the new maturity date
    - Prepayment can only occur prior to the maturity date
- Rejects argument that EFIH Debtors filed to avoid paying the Applicable Premium
    - Filed because they were facing a severe liquidity crisis
- Automatic stay bars the sending of a rescission notice, and a genuine issue of material fact exists as to whether cause exists to lift the automatic stay
    - After a trial, the Bankruptcy Court ruled that cause did not exist to lift the automatic stay. *In re Energy Future Holdings Corp.*, 533 B.R. 106 (Bankr. D. Del. 2015).
- Trustee has no claim for breach of "no call" because Notes were not optionally redeemed

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Second Lien Make-Whole Opinion—Bankruptcy Court 539 B.R. 723 (Bankr. D. Del. 2015)

- Bankruptcy Court ruled that nothing in the Second Lien indenture would lead it to a different conclusion than it had reached regarding the First-Lien indenture
- The Bankruptcy Court also rejected the argument that the different language in the Second-Lien indenture's acceleration provision should change its analysis
- Cited *Momentive*, 2014 WL 4436335 at 14 (Bankr. S.D.N.Y 2014), which held that "[I]t is "well-settled law," that, unless the parties have clearly and specifically provided for payment of a make-whole (in this case the Applicable Premium), notwithstanding the acceleration or advancement of the original maturity date of the notes, a make-whole will not be owed. Such language is lacking in the relevant sections of the [indentures]; therefore, they do not create a claim for Applicable Premium following the automatic acceleration of the debt pursuant to Section 6.02 of the indentures."
- The *Momentive* court held that the "premium, if any" to be paid upon prepayment was not specific enough to meet the specificity requirement of New York law in order for the make-whole or prepayment claim to be payable post-acceleration.
  - Even if the "if any" language referred back to the indenture provisions providing for a specific premium, those provisions do not suffice to require payment after acceleration under New York law.
- The *Momentive* court stated that there are only two ways to receive a make-whole upon acceleration under New York law: (i) explicit recognition that the make-whole would be payable notwithstanding the acceleration, or (ii) a provision that requires the borrower to pay a make-whole whenever debt is repaid prior to the *original* maturity.
- Judge Sontchi ruled that the language in the EFIH Second-Lien indenture was identical to that in *Momentive* and does not explicitly provide for payment of the premiums notwithstanding acceleration nor does it provide for payment of the make-whole any time prior to the original due date

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Make-Whole Litigation—District Court Opinions 2016 WL 627343 (D. Del. 2016) and 2016 WL 627343 (D. Del. 2016)

- In February 2016, the District Court affirmed, at the end of oral argument, the Bankruptcy Court's rulings that the First-Lien noteholders were not entitled to a make-whole premium and that it properly refused to lift the automatic stay *nunc pro tunc* to allow the First-Lien Trustee's earlier notice of rescission to take effect
  - Issued a written opinion affirming that the automatic stay prevented the First-Lien indenture trustee from exercising its contractual right to rescind acceleration or to seek damages for breach of that right
- In April 2016, the District Court affirmed the Bankruptcy Court's rulings on the claims brought by the Second-Lien Indenture Trustee
  - Incorporated its rulings from the First-Lien make-whole litigation, in which the Second-Lien Indenture Trustee had participated as an intervenor
  - Affirmed the Bankruptcy Court's rulings regarding the additional language in the Second Lien indenture
  - Cites *Momentive* favorably

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Make-Whole Litigation—Third Circuit Opinion 842 F.3d 247 (3d Cir. 2016)

- Third Circuit the consolidated the appeals of First-Lien and Second-Lien trustees
- Unlike the Bankruptcy Court, which began its analysis with Section 6.02, the Third Circuit stated that "[a]ny duty to pay the make-whole comes from Section 3.07. It leaves us with three questions:"
  - Was there a redemption?
  - Was it optional?
  - If yes to both, did it occur before December 1, 2015?
    - Obviously, yes

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Make-Whole Litigation—Third Circuit Opinion
842 F.3d 247 (3d Cir. 2016)

- Was there a redemption? YES
  - The Third Circuit notes that Section 3.07 does not define "redemption"
    - Black's Law Dictionary: "usu[ally] refers to the repurchase of a bond before maturity."
  - Holds New York and federal courts deem redemption to include post-maturity repayments, citing
    - *Chesapeake Energy Corp. v. Bank of New York Mellon Trust Co.,* 773 F.3d 110, 116 (2d Cir. 2014), which in turn cites *Barron's Dictionary of Finance and Investment Terms* 587 (8th ed.2010) (defining "redemption" as "repayment of a debt security or preferred stock issue, at or before maturity")
      - *Chesapeake* also notes that Black's Law Dictionary defines "redemption" as "[t]he reacquisition of a security by the issuer"
    - *Treasurer of New Jersey v. U.S. Dep't of Treasury*, 684 F.3d 382, 388 (3d. Cir. 2012), which discusses regulations permitting bondholders to "present … long-matured savings bond[s] for redemption"
      - Case involves federal savings bond regime, not New York law
    - *Federal Nat. Mortg. Ass'n v. Miller*, 123 Misc.2d 431, 473 N.Y.S.2d 743, 744 (N.Y. Sup. Ct. 1984) ("debtor may redeem" mortgage by "pay [ing] … accelerated debt")
      - Lower court decision dealing with a mortgage, without analysis of meaning of "redeem"
    - N.Y. U.C.C. Sec. 9-623 Official Comment No. 2 ("To redeem the collateral … of a secured obligation [that] has been accelerated, it would be necessary to tender the entire balance.").
- The Third Circuit distinguished a "redemption," which can occur at or before maturity, from a "prepayment," which cannot occur once the debt is accelerated

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Make-Whole Litigation—Third Circuit Opinion
842 F.3d 247 (3d Cir. 2016)

- Was the redemption OPTIONAL? YES
- EFIH argued that refinancing the Notes was not optional because Section 6.02 made them "due and payable immediately without further action or notice" once it was in bankruptcy.
  - The Third Circuit noted, however, that EFIH filed for Chapter 11 protection voluntarily. Once there, it had the option to reinstate the accelerated Notes' original maturity date rather than paying them off immediately. It chose not to do so.
  - A "chapter 11 debtor that has the capacity to refinance secured debt on better terms … is in the same position within bankruptcy as it would be outside bankruptcy, and cannot reasonably assert that its repayment of debt is not 'voluntary'" (*quoting* " Scott K. Charles & Emil A. Kleinhaus, *Prepayment Clauses in Bankruptcy*, 15 Am. Bankr. Inst. L. Rev. 537, 552 (2007)).
  - Third Circuit also cites EFIH's repeated pre- and post-bankruptcy statements that it planned to redeem the Notes
  - The Third Circuit also noted the "irony" that the noteholders did not want to be paid back and attempted to rescind acceleration, but were blocked by the automatic stay
    - "When EFIH redeemed the Notes, it did so 'on a non-consensual basis,' that is, over the Noteholders' objection. Logic leaves no doubt this redemption of the Notes was "[o]ptional" under § 3.07."

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Make-Whole Litigation—Third Circuit Opinion 842 F.3d 247 (3d Cir. 2016)

- The Third Circuit analyzed the interplay of Sections 3.07 and 6.02 of the Indentures
  - The two provisions "address different things"
    - Section 6.02 causes the maturity of EFIH's debt to accelerate on its bankruptcy, and Section 3.07 causes a make-whole to become due when there is an optional redemption before December 1, 2015
    - Section 6.02 does not mention the Applicable Premium at all
  - Distinguished the *AMR* decision, in which the accceleration provision made it express that no make whole was due following acceleration. *In re AMR Corp.*, 730 F.3d 88 (2d Cir. 2013).
    - *AMR* involved a EETC security, the indentures for which typically contain provisions that expressly state that make-wholes are not payable post-acceleration
    - Query whether issuers like EFIH should have adopted such a specific approach
  - EFIH's interpretation conflicts with the New York Court of Appeals' statement that "[w]hile it is understood that acceleration advances the maturity date of the debt," there is no "rule of New York law declaring that other terms of the contract not necessarily impacted by acceleration ... automatically cease to be enforceable after acceleration." *NML Capital v. Republic of Argentina*, 17 N.Y.3d 250, 928 N.Y.S.2d 666, 952 N.E.2d 482, 492 (N.Y. 2011).

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Make-Whole Litigation—Third Circuit Opinion 842 F.3d 247 (3d Cir. 2016)

- In *NML Capital*, New York's highest Court addressed "whether Argentina's obligation to make [certain contractually established interest] payments to bondholders continued after maturity or acceleration of the indebtedness [.]"
  - Argentina contended that, after the maturity of its debt had accelerated, bondholders were entitled only to their principal and any accrued interest.
  - Acceleration, it argued, terminated its duty to make biannual interest payments mandated by the bond documents.
- In rejecting those assertions, the New York Court of Appeals held that "in New York the consequences of acceleration of the debt depend on the language chosen by the parties in the pertinent loan agreement." *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 492. "Had Argentina ... intended that its responsibility to pay interest twice a year cease upon maturity, it could easily have clarified that intent in any number of ways." *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 490.
  - Because the bond language that Argentina pay biannual interest payments made no reference to acceleration or maturity, it remained effective following the bonds' acceleration.
- The takeaway for EFIH is that Section 3.07 applies no less following acceleration of the Notes' maturity than it would to a pre-acceleration redemption.

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Make-Whole Litigation—Third Circuit Opinion 842 F.3d 247 (3d Cir. 2016)

- The additional language in the Second Lien Indenture's acceleration provision makes explicit the link between acceleration under section 6.02 and the make-whole for an optional redemption per section 3.07.
  - Sections 3.07 and 6.02 are not merely compatible but complementary.
  - When EFIH filed its bankruptcy petition, section 6.02 caused “all principal of and *premium, if any*, interest ... [,] and any other monetary obligations on the outstanding [Second Lien] Notes [to] be[come] due and payable immediately” (emphasis added).
    - The words “premium, if any,” are most naturally read to reference section 3.07's “Applicable Premium”
    - In any event, the result is the same no matter the Indenture—there were optional redemptions before a date certain, thereby triggering make-whole premiums

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Make-Whole Litigation—Third Circuit Opinion 842 F.3d 247 (3d Cir. 2016)

- Citing *NML* Capital, the Third Circuit reiterated that it was unaware of any provision of New York law which dictated that terms of a contract not necessarily impacted by acceleration automatically are unenforceable after acceleration.
- Unlike prepayment, “redemption” of a debt security may occur *at* or before maturity.
  - A premium contingent on “prepayment” could not take effect after the debt's maturity, a premium tied to a “redemption” would be unaffected by acceleration of a debt's maturity.
- The Third Circuit finds that New York law follows a logical path: prepayments cannot occur when payment becomes due by acceleration of the debt's maturity, and that If parties want to mandate a “prepayment” premium following acceleration, they must clearly state it in their agreement. *Nw. Mut. Life Ins. Co. v. Uniondale Realty Assocs.*, 11 Misc.3d 980, 816 N.Y.S.2d 831, 836 (N.Y. Sup. Ct. 2006) (“*Northwestern*”)
- Relying on its distinction between a “prepayment” and a “redemption,” the Third Circuit criticized bankruptcy courts (including the courts deciding *EFH* and *Momentive*) for stretching the *Northwestern* rule (i.e., an indenture must clearly provide for post-acceleration payment of a “prepayment” premium) and applying that rule to “yield-protection premiums not styled as prepayment premiums.”
  - A premium contingent on “prepayment” could not take effect after the debt's maturity, a premium tied to a “redemption” would be unaffected by acceleration of a debt's maturity.

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IMPAIRMENT

Amended Plan

- In July 2015, the Debtors filed an amended plan of reorganization which contemplated a dual track process that was based on converting Oncor into a REIT
  – Oncor would be owned by either E-Side creditors or certain T-Side creditors (partnered with the Hunt family)
  – The T-Side "merger option," which was ultimately pursued, contemplated that the T-Side investors would provide new money to take out E-Side creditors
    - Plan was conditioned on receiving approval from the Texas Public Utility Commission ("PUC") and IRS approval of a REIT reorganization of Oncor
      – PUC approval required by April 30, 2016
      – REIT would split Oncor into a "PropCo" that held real estate and an "OpCo" that held remaining assets and operations
  – The E-Side "standalone option" would distribute stock in reorganized parent company EFH to various constituencies
    - REIT conversion was not a condition to confirmation; parties would also receive Contingent Value Rights that would become effective if Oncor was converted to a REIT within two years of the effective date
    - TCEH would be spun off in a tax-free transaction

Amended Plan

- When the Debtors filed their schedules in July 2014 they included, to the surprise of many constituencies, a $773 million payable from parent EFH Corp. to TCEH
  - That obligation gave T-Side creditors the potential to extract value from Oncor, as TCEH was now the parent's largest unsecured creditor and Oncor may have been solvent
- The Amended Plan was conditioned upon a settlement that resolved this and other intercompany claims
  - Importantly, the settlement was not conditioned upon, and was independent from, the Amended Plan and would bind the settling parties even if the Amended Plan wasn't consummated
- The Amended Plan proposed to pay the E-Side PIK unsecured bondholders the full amount of their claims in cash.
  - The bonds had a specific contractual rates of interest, but the plan proposed to pay post-petition interest at the much lower federal judgment rate.
  - Indenture Trustee argued that that treatment constituted impairment was conditioned upon a settlement that resolved this and other intercompany claims

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IMPAIRMENT

- Under section 1124, a claim is impaired under a plan of reorganization unless either:
  - The claim is reinstated under the plan (section 1124(2)), or
  - The plan "leaves unaltered the legal, equitable and contractual rights" of such claim (section 1124(1)).
- If a class of claims is unimpaired under a plan it is deemed to accept the plan. As a result, the claims in that class are not entitled to vote on the plan and do not get the protections of sections 1129(a)(7)(best interests test), 1129(a)(8)(at least one impaired accepting class) or 1129(b)(cramdown).

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IMPAIRMENT

- Prior to 1994, pursuant to then-extant section 1124(3), a claim was also unimpaired if the plan provided a cash payment to the claim equal to the allowed amount of such claim.
- In *New Valley* a solvent debtor proposed a plan that paid unsecured claims in their full allowed amount – without post-petition interest. The court determined that the class of unsecured claims was unimpaired under a plan. Thus, the return to equity was increased off the backs of the unsecured creditors who could theoretically have received a higher return in a liquidation.
- Congress reacted to *New Valley* by deleting section 1124(3). Thus, payment in full of the allowed amount of a claim is no longer automatically unimpairment
- Payment of a claim may still be unimpairment if such payment is consistent with the legal, equitable and contractual rights of such claim.

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IMPAIRMENT
PPI Enterprises, 324 F.3d 197 (3rd Cir. 2003)

- Statutory impairment vs. plan impairment
  - *PPI* involved a landlord rejection claim capped under section 502(b)(6). Does the capping of the claim "alter" the "legal, equitable and contractual rights" of the claim, such that the claim is impaired under a plan that proposes to pay the full amount of the (capped) claim?
  - Third Circuit held that the impact of section 502(b)(6) was part and parcel of the landlord's "legal, contractual and equitable" rights.
  - "Impairment" under section 1124(1) looks solely to how the plan treats a claim and not how provisions of the Bankruptcy Code affects the claim, and thus "statutory impairment" is not relevant for impairment purposes.
  - The deletion of 1124(3) following *New Valley* solely addressed the issue of post-petition interest; unsecured creditors in a solvent estate must receive post-petition interest to be unimpaired.
    - But why, under the Third Circuit analysis, is section 502(b)(2) any different from section 502(b)(6)?

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IMPAIRMENT
Energy Future Holdings Corp., 540 B.R. 109 (Bankr. D. Del. 2015)

- Statutory impairment of an unsecured claim.
  - Bankruptcy Court, relying on analysis in *PPI Enterprises*, held that section 502(b)(2) is no different from section 502(b)(6)
    - An "allowed claim for post-petition interest" cannot exist under section 502(b)(2)
      - A failure to pay post-petition interest does not alter the claim's legal or contractual rights, and thus does not constitute impairment
  - "A finding that the exclusion of post-petition interest at the contract rate on the PIK Noteholders' claims under the plan in this case is a result of the statute, i.e., section 502(b)(2), and not the plan
    - Thus, the plan does not impair their claim is the logical and, indeed, unavoidable extension of the holding in both *PPI* cases that the limit on rejection damages under section 502(b)(6) is statutory impairment not plan impairment. Such a ruling, however, appears to create an irreconcilable conflict with the findings in both *PPI* cases that the holder of an unsecured claim against a solvent debtor can only be deemed unimpaired if the cash payment is both equal to the claim and includes post-petition interest."
  - Such a ruling, however, appears to create an irreconcilable conflict with the findings in both *PPI* cases that the holder of an unsecured claim against a solvent debtor can only be deemed unimpaired if the cash payment is both equal to the claim and includes post-petition interest."

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IMPAIRMENT
Energy Future Holdings Corp., 540 B.R. 109 (Bankr. D. Del. 2015)

- Statutory impairment of an unsecured claim; how did the Bankruptcy Court reconcile the "irreconcilable conflict"?
  - The Bankruptcy Court looked to the claim's "equitable" rights. Relying on the analysis in *Washington Mutual* of sections 1129(a)(7) and 726(a)(5), the court held that in a solvent estate unsecured creditors are entitled to post-petition interest as a matter of equity, though only at the federal judgment rate and not the contract rate.
  - "In the end, the only way to reconcile the Third Circuit's decision in *PPI* II is to hold that the plan in this case need not provide for the payment in cash on the effective date of post-petition interest at the contract rate in order for the PIK Noteholders to be unimpaired. Indeed, the plan need not provide for any payment of interest at all, even at the Federal judgement rate, as what would be the basis for the payment of post-petition interest other than the contract? But the plan must allow for the PIK Noteholders to be awarded post-petition interest at an appropriate rate under equitable principles."

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PRE-PLAN SETTLEMENT AND TENDER OFFER

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Tender Offer

- As noted above, the EFIH debtors had issued two series of First Lien notes
- The EFIH Debtors sought approval of DIP financing, in part, to repay all of the outstanding First Lien notes and settle the claims of the noteholders, including claims for the make-whole premium
  - The interest rate under the DIP financing was lower than the rates under the Notes, resulting in a potential interest savings of tens of millions of dollars per month
- The Debtors also launched a tender offer by which the First Lien noteholders would exchange their notes for (i) First Lien DIP loans in a principal amount greater than the principal amount of the exchanged notes and (ii) 101% of accrued interest
  - Holders exchanging earlier received a greater premium (5%) than those who exchanged later (3.25%)
- Exchanging noteholders released make-whole claims
  - Exchange documents informed holders that debtors would sue to disallow the make-whole premium
  - Non-tendering holders retained their rights to litigate their make-whole claims
- The interest rates and redemption dates under the indentures varied, causing the 5% premium to provide a higher percentage recovery on the make whole claims of the 6-7/8% Notes (64%) than on the 10% Notes (27%)
  - Unsurprisingly, the percentage of accepting 6-7/8% Notes (97%) was higher than that the 10% Notes (34%)
- Debtors moved to approve the settlement built in to the tender offer

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Tender Offer

- The Indenture Trustee for the 10% Notes challenged the settlement on the grounds that
  - Use of a tender offer was improper
  - The settlement resulted in different percentage recoveries on the make-whole claims of the two series of Notes, even though the parties had agreed that the contractual language governing the make-whole premiums was identical
  - The settlement was a *sub rosa* plan
- The Bankruptcy Court approved the settlement, which the District Court and Third Circuit both affirmed on appeal
  - "Tender offer" was merely a means to convey a settlement offer to creditors and was equivalent to a detailed settlement memorandum
    - No section of Bankruptcy Code prohibits tender offers
    - Disclosure, solicitation rules apply to reorganization plans, not pre-confirmation settlements
    - Bankruptcy court was within its discretion to approve settlement of complex issue

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Tender Offer

- The different percentage recovery on the make-whole claims of the two series of notes did not violate the "equal treatment" rule of Bankruptcy Code section 1123(a)(4)
  - The different percentage recovery on the make-whole claims of the two series of notes did not violate the "equal treatment" rule of Bankruptcy Code section 1123(a)(4)
    - Under its plain language, 1123(a)(4) only applies to plans of reorganization
    - Core bankruptcy principles, such as the absolute priority rule and the equal treatment rule, which apply to plans, are not categorically applied in the settlement context
    - There was in fact equal treatment—each holder was offered 105% of principal and 101% of interest, and could decline and retain its rights in the make-whole litigation
  - Relied in part on the Third Circuit's decision in *Jevic*, which has since been reversed
    - In *Jevic*, the Supreme Court held that bankruptcy courts may not approve structured dismissals that provide for distributions contrary to the rules of priority without the consent of the affected creditors
    - Third Circuit notes that, unlike *Jevic*, which affected an entire class of creditors, no group of eligible creditors was excluded from the tender offer
- The settlement was not a *sub rosa* plan because, outside of the settling noteholders, there is no evidence that any other creditor's recovery is impacted by the settlement

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COMMITTEES

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Conflicts, Representation and Official Committees

- Section 1102(a) provides that the US Trustee shall appoint an official committee of unsecured creditors as soon as practical after the order for relief is filed, and may appoint additional committees of creditors/equity holders as the US Trustee deems appropriate
- Despite this, committees are not appointed in every case:
  - Lack of interest from creditors
  - Pre-packaged plan with full payout to unsecured class
- Committee is supposed to be comprised of largest unsecured creditors; in cases involving multiple levels/types of debt, be representative of each constituency

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EFH Committees

- At the outset of the EFH cases, the US Trustee solicited interest in an unsecured creditors committee from largest creditors of various debtors in the company structure
- Official Committee appointed included T-side creditors only
- E side unsecured creditors had no official representation; US Trustee apparently considered that most of the E-Side Notes were concentrated in limited group of creditors that already had representation in the case so no committee representation necessary
- Indenture trustee on the E-side filed motion seeking appointment of an official committee for its debtor; debtors and others opposed the motion
- US Trustee initially asked for more time to consider whether a second committee was warranted; Court let the process play out
- US Trustee eventually appointed second committee for the E-side rather than adding E-side creditors to the existing committee
  - Inherent conflicts between two sides of the debtors would have made adding E-side creditors to the existing committee problematic

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IMPACT OF REGULATORS

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Regulatory Issues—Amended Plan

- In April 2015, EFH filed a plan contemplating a tax-free spinoff of TCEH paired with one of (i) an Oncor merger with a third party, (ii) an equity investment in Oncor or (iii) a standalone E-Side reorganization
  - Plan also contemplated a $700 million settlement of the EFH-TCEH intercompany claim
  - Parties enter mediation over disputed issues
- In July 2015, an Amended Plan was filed that provided for a two-track process
  - Oncor would be converted into a REIT, which would be owned either by E-Side creditors or certain TCEH creditors partnered with the Hunt Group
  - The T-Side investors would provide new money to take out E-Side debt
- Importantly, the Amended Plan was conditioned upon PUC approval and IRS approval of Oncor's reorganization as a REIT
  - The REIT structure would split Oncor into two entities: a "PropCo" that held real estate and an "OpCo" that held remaining assets and conducted operations
- PUC approval had to be obtained by April 30, 2016
  - If obtained, the deadline for the effective date would be extended to June 30
- The Amended Plan was conditioned on a settlement that resolved intercompany claim issues and which would bind the parties regardless of whether the Amended Plan was confirmed
- The Amended Plan (which dealt with the impairment dispute) was confirmed in December 2015

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Regulatory Issues—Amended Plan

- In September 2015, the Hunt Group filed its application to purchase Oncor with Texas regulatory authorities, including the PUC
  - Expected at least a 6-month review process
- In February 2016, the PUC staff preliminarily announced that the Oncor sale should not be approved because it would increase costs to ratepayers by $295 million and did not account for potential risks
  - Rejected the Hunt Group's claim that rates could decrease by half a billion dollars over five years
  - PUC staff also criticized the Hunt Group for failing to make any significant changes to the deal to win PUC approval, especially refusing to share any of the $250 million in annual tax savings from the REIT structure
  - Hunt Group did not agree that the majority of Oncor's board should consist of disinterested directors, even though Oncor had had such a board since 2008
  - Investors did not commit that Oncor would remain investment grade
- In March 2016, the PUC approved the sale, but its approval deferred the sharing of tax benefits with ratepayers to its next rate setting period (which would have been post-closing)
- During this time, the bankruptcy court ruled in EFH's favor that it could enforce its "drag along" rights against Oncor's minority investor and require it to sell its interest

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Regulatory Issues—Amended Plan

- In April 2016, EFH announced that the Oncor sale would not close and that EFH would pursue an alternative plan
  - The debtors argued that the PUC order was insufficient to trigger the 60-day extension
  - Shortly thereafter, the Hunt Group dropped its bid for Oncor
- The new plan provided for separate reorganizations for the T-Side and E-Side
  - Tax free spinoff of T-Side; equitization and new money investments on E-Side
- The new plan provided for separate reorganizations for the T-Side and E-Side
  - Tax free spinoff of T-Side; equitization and new money investments on E-Side
  - After the plan was filed, the debtors started receiving new bids for Oncor
- In July 2016, NextEra Energy—which had offered the first alternative to the initial EFIH second lien DIP financing at the outset of the case—announced an agreement to acquire 100% of Oncor
  - Following the TCEH spinoff, E-Side creditors would either be cashed out or receive equity in a combined NextEra/Oncor entity
  - Subject to FERC and PUC approvals
- The TCEH spinoff plan was confirmed in August, 2016 and went effective in October

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Regulatory Issues—Amended Plan

- In November of 2016, the Third Circuit reversed the lower courts' make-whole rulings while the Supreme Court denied certiorari on the appeal of the pre-plan tender offer-settlement
- By February 2017, the parties to the make-whole litigation had reached a settlement and the E-Side plan was confirmed
- In April 2017, the PUC rejected NextEra's offer for Oncor
  - Oncor was not sufficiently ring-fenced from Next-Era's other operations
  - Concerned about the leverage on the combined entity.

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Value Implications of Regulatory Action

- Hunt
  - Value offered based on substantial value of REIT tax savings
  - Substantial execution risk
    - Hunt-sponsored InfraREIT had been approved by PUCT, but on a much smaller scale and without retail ratepayers
- NextEra
  - Value offered was based on availability of corporate level tax shields
  - Headquartered out of state
  - Owned non-regulated assets in Texas
- Spin-off Equitization
  - Ability to achieve tax savings on a stand-alone basis
    - If REIT tax savings were available on stand-alone basis, substantial value would inure to PIK and/or EFH creditors
    - Difficult to value on a REIT conversion basis due to lack of any comparable company
    - Difficult to assess probability to successful REIT conversion
  - PUCT receptivity to ownership by distressed holder group (*i.e.*, hedge funds)