AMERICAN BANKRUPTCY INSTITUTE

2018 Annual Spring Meeting

CONCURRENT SESSION

Rights Offering Introduction and Overview

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Rights Offerings in Bankruptcy

ABI SPRING MEETING
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Overview

- A rights offering provides creditors or equity holders with the option (or right) to purchase new securities in a reorganized company at a set subscription price, often at a discount, during a set subscription period.
- Rights offerings can benefit both debtors and creditors/equity holders
  - Debtor increases liquidity and fortifies the balance sheet
  - Reduces reorganized debtor's leverage
  - Liquidity supports plan feasibility to avoid subsequent bankruptcy filing
  - Creditor has investment opportunity usually on favorable terms
  - Enhanced recovery on claims
  - Potential to resolve valuation disputes among constituents

Overview (cont'd)

- Key Components of a Rights Offering:
  - Backstop: One or more parties commit to subscribe for a minimum amount, in return for a commitment/backstop fee and other consideration (e.g., break-up fee, expense reimbursement).
  - Price: Participants are offered the right to purchase securities, normally at discount to plan equity value. A larger discount increases the attractiveness, but it also increases the dilutive effect of the issuance on the parties unable or unwilling to participate.
  - Eligibility: Potential participants are typically a limited pool of creditors. Wide eligibility may increase support for the chapter 11 plan, but could also increase regulatory and administrative concerns.
  - Section 1145 Exemption: If the rights offering complies with §1145 of the Bankruptcy Code, no SEC registration is required. Debtors may use other exemptions in conjunction with § 1145 to avoid registration.
  - Oversubscription Right: The right to subscribe for unsold rights remaining after subscription period.
  - Overallotment Right: The right to purchase an additional, predetermined amount of interests should offering be fully subscribed.
  - Transferability: Rights offerings are typically non-transferable (except together with the underlying claim) to avoid jeopardizing registration exemptions.

Securities Law Exemptions

- Registration with the SEC is a lengthy and expensive process. Debtors proposing a rights offering pursuant to a chapter 11 plan in bankruptcy have two options to avoid registration.
- Debtors may utilize Section 4(2) of the Securities Act of 1933, the "private placement" exemption for accredited investors, if certain conditions are met.
  - Securities issued to the backstop parties will often be issued pursuant to this exemption, but private placements could raise unfair discrimination issues under section 1123(a)(4) of the Bankruptcy Code.

Securities Law Exemptions (cont.)

- Section 1145 of the Bankruptcy Code provides that new securities may be exempt from registration requirements and freely tradeable (except by affiliates and statutory underwriters) if issued (1) pursuant to a plan of reorganization, (2) by the debtor (or its affiliate/successor), (3) in exchange for claims against or interests in the debtor **or** "principally" in exchange for such claims or interests and "partly" for cash or property.
  - In concept, the principal purpose of a rights offering should not be to raise new capital but to satisfy claims or interests.
  - The principally/partly test requires that securities be sold or exchanged principally in exchange for existing claims and partly for new cash paid by the offeree.
  - The SEC has historically taken the position that the value of the claim in respect of which the rights were received must exceed the maximum amount of cash payable on exercise of the rights. SEC no-action letters suggest that the maximum amount of cash payable to exercise the rights must not exceed 50% of the value of the consideration otherwise received.
  - Securities issued to backstop parties may be ineligible for exemption under section 1145.
  - Rights offerings made to holders of old equity of the debtor often fail the principally/partly test; the equity has only nominal value, which will be exceeded by the subscription price in the offering.
  - In addition, a fact-specific analysis should be done for rights offerings with an oversubscription option and for backstopped rights offerings. For example, for oversubscription rights, the analysis should consider whether the maximum amount of securities that can be purchased under an oversubscription right would exceed the > 50% claim value test.

Relevant Agreements

- Backstop agreements are routinely used in rights offerings to ensure that the Debtor benefits from the full amount of the investment regardless of subscription.
- Typically, when Section 4(a)(2) is used or some purchasers will become affiliates, the purchasers will require registration rights pursuant to a registration rights agreement.
- Backstop agreements (also known as equity commitment agreements) typically include:
  - Commitment fee
    - Frequently 2-7% of total commitment amount, but varies
    - May be payable even if rights offering and plan are not consummated
    - Frequently payable in equity but can be structured as a cash fee (e.g., if the plan is not consummated)
  - Sometimes a separate break-up fee in the event of an alternative transaction
  - Expense reimbursement
  - Termination rights
- Restructuring Support Agreements are typically coupled with a backstop agreement.
  - This locks in the creditors providing the backstop to vote in favor of the plan
  - Provides the debtors with certainty that the plan and restructuring transactions will have necessary support to be consummated or expedited through a prepackaged filing

Value Creation for Investors

The following levers are frequently utilized to generate value for participating investors:

Discounted Equity Purchase	• Rights to purchase equity are granted at a discount to transaction value (or the transaction value can be set at a discount to market value) • Allows participants in a RO to obtain a disproportionate share of ownership in exchange for their willingness to invest new capital
Backstop Fee	• Fee paid to certain specified investors (the "Backstop Parties") who agree to fund any shortfall due to other parties' failing to exercise their rights • Backstop Parties are paid a fee in exchange for their commitment, which can be in the form of cash, equity or note
Allocation / Holdback	• Can be allocated entirely to one tranche of stakeholders or multiple tranches • Certain investors in the rights offering are guaranteed a specific allocation of the new money investment, regardless of their pre-transaction positions
Backstop Waterfall Structure	• Structure in which Backstop Parties agree to the order in which they will fulfill their backstop commitments, such that certain investors are more likely to fund a shortfall than others • Can be combined with a tiered backstop fee in which certain Backstop Parties get paid a larger fee in exchange for a greater probability of funding

Select Rights Offering Comps

($ in millions)

		Rights Offering		Backstope Fee	
	Emergence Date	RO Size	RO Discount to Equity Value[1]	Backstop Fee Formulation	Form of Payment
Key Energy Services	Dec-16	$85	16.0% [3]	6.0% of New Equity	Common Stock
Magnum Hunter Resources[2]	May-16	200	21.9% [4]	3.0% of New Equity	Common Stock
New Gulf Resources	May-16	125 [5]	13.8%	7% Fee and 3% OID	1L Convertible Notes
Swift Energy[2]	May-16	75	68.8%	7.5% of New Equity	Common Stock
Penn Virginia Corp.	Sep-16	50	30.4%	6.0% of R.O. Amount	Common Stock
Linn Energy	Feb-17	530	20.0%	4.0% of R.O. Amount	Cash & Common Stock
CHC Group Ltd.	Mar-17	300	30.8% [6]	$30.8 million	2L Convertible Notes
Chaparral	Mar-17	50	25.0%	8.75% of R.O. Amount	Common Stock
Comps Average		**$177**	**28.3%**		
Comps Median		**$105**	**23.4%**		

★ *Rights offering economics detailed on the following page*

Note: Discounts calculated before impact of MIP dilution.
(1) Based upon Disclosure Statement valuation unless otherwise noted.
(2) Structured as a DIP that was converted to equity upon emergence.
(3) Based upon publicly filed equity value post rights offering of $235 million. Discount does not include the additional $25 million Incremental Liquidity Facility that may be funded if certain minimum liquidity thresholds are not satisfied.
(4) Based upon TEV for settlement purposes of $900 million and $11 million of pro forma net debt.
(5) $75 million was associated with the initial DIP (converted to equity upon emergence), and the remaining $50 million was part of the rights offering.
(6) Calculated as 1 – $300 million investment / $433.3 million of equity value received.

Case Study: Chaparral Energy

The below overview highlights the main value drivers for the Chaparral rights offering investors.

	Rights Offering Summary Terms
Amount	> $50 million
RO Discount	> 25% to pre-new money equity value
Backstop Fee	> 8.75% of rights offering amount, paid in common equity at the discounted rights offering price
Backstop Parties	> Ad Hoc Group of Noteholders
RO Participants	> Open to all Chaparral unsecured note claims

Rights Offering Assumptions	
RO Size	$50.0
Discount	25.0%
Value Purchased	$66.7
RO Discount Value	(1) $16.7
Backstop Fee (% of RO)	8.75%
Backstop Fee ($) (Pre-Discount)	$4.4
Discount	25.0%
Backstop Value	(2) $5.8

(3) Illustrative Value Assumptions	
Total Enterprise Value	$1,000
Less: Net Debt	($300)
Equity	$700
Memo: % Equity Purchased by RO	*9.5%*
Memo: % Backstop Equity Received	*0.8%*

Commentary

1. *The rights offering discount created $16.7mm of value for rights offering participants*
2. *The backstop fee created $5.8mm of value for backstop parties*
   - *The backstop fee was 8.75% of the rights offering amount ($4.4mm), but also received the benefit of the 25% rights offering investment discount*
3. *A rights offering can generate additional value for participants if the transaction value is set below the market value*

Case Study: Expro International Group Holdings Ltd.

- Case Overview
  - $1.4 billion restructuring through the prepackaged chapter 11 bankruptcy of Expro International Group Holdings Limited, a provider of oilfield exploration and optimization and enhancement services around the world. Expro and certain of its affiliates filed for chapter 11 protection in the Southern District of Texas on December 18, 2017 and emerged from bankruptcy less than two months later, on February 5, 2018
  - Prepackaged plan of reorganization provided for (i) a full equitization of the Expro's prepetition credit facility and (ii) a new investment through a $200 million rights offering backstopped by the ad hoc lender group
  - Lenders received all of the equity in the reorganized company, subject to dilution by a management incentive plan and the issuance to junior stakeholders of warrants for up to 7% of the new equity

Pre-Bankruptcy Capital Structure	Post-Emergence Capital Structure

• $1.417 billion secured credit facility consisting of:
  • $175 mm revolver due 2021 ($125 mm drawn as of the petition date)
  • $1.267 billion term loan due 2021
	• $200 mm new equity capital raised through backstopped rights offering

Expro International Group Holdings Ltd. (cont'd)

- Rights Offering Terms
  - $200 million equity rights offering backstopped by members of the ad hoc lender group
  - Backstop parties received (i) exclusive allocation of 25% of rights (i.e., $50 million of investment opportunity) and (ii) a 5% backstop fee payable in equity
  - Opportunity to participate and subscribe for remaining 75% of rights was available to backstop parties and lenders signing the restructuring support agreement within 5 business days of its execution by the backstop parties and announcement to other lenders. Rights were offered on pro rata based on amount of participating lenders' claims as reported under the RSA
  - Rights offering equity was offered at $12.50 (a 36% discount based on the midpoint of the debtors' valuation analysis)

Expro International Group Holdings Ltd. (cont'd)

- Key Advantages of Rights Offering and Structure
  - Allowed debtors to raise working capital and emerge with substantially no leverage
  - Discounted price of rights offering shares and risk of dilution incentivized broad participation
  - Tying rights offering participation to RSA and providing only a 5 business-day sign-up period incentivized participation (and, accordingly, locked in support for the plan) providing path for speedy prepackaged process with minimal controversy
  - 25% exclusive equity allocation and equity backstop fee provided mechanism for backstop parties to receive enhanced economics relative to claim size
- Process Issues and Challenges
  - Benefits to backstop parties (fee and exclusive allocation) at high end of market and short sign-up period created risk of pushback from non-backstop lenders (though lenders ultimately gave overwhelming support)
  - Some legal risk associated with tying rights offering to RSA and not making rights available to all members of the class
  - Because rights offering was not tied to the plan, shares were not subject to registration exemption under section 1145 and were instead exempt from registration under Section 4(a)(2) of the Securities Act

Case Study: C&J Energy Services Ltd.

C&J Energy Services

- Case Overview
  - $1.75 billion restructuring through the pre-arranged chapter 11 bankruptcy of C&J Energy Services, a leading provider of oilfield services to North American E&P companies. C&J and certain of its affiliates filed for chapter 11 protection in the Southern District of Texas on July 20, 2016 and emerged from bankruptcy on January 6, 2017
  - The restructuring resulted in the almost complete deleveraging of C&J's capital structure through the conversion of C&J's secured debt to equity and provided additional new liquidity to the company through a $200 million equity rights offering backstopped by the steering committee and a new $100 million ABL facility
  - Plan was initially subject to significant objection by junior stakeholders, but objections ultimately settled
  - Unsecured creditors received a mix of cash and warrants, and shareholders also received a warrant distribution

Pre-Bankruptcy Capital Structure	Post-Emergence Capital Structure

• $1.35 billion secured credit facility consisting of:
  • $300 mm revolver due 2020
  • $569 mm term loan due 2020
  • $480 mm term loan due 2022
	• $100 mm ABL facility due 2022
	• $200 mm new equity capital raised through backstopped rights offering

C&J Energy Services Ltd. (cont'd)

C&J Energy Services

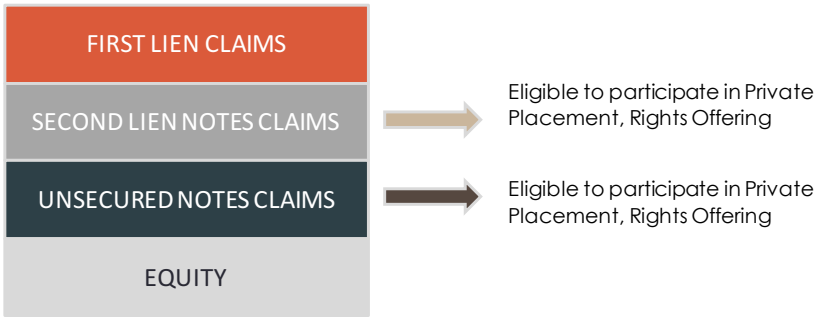
- Rights Offering Terms
  - $200 million equity rights offering backstopped by members of lender steering committee and certain others
  - Backstop parties received 5% fee, payable in equity at rights offering price
  - Rights offered to all members of secured lender class as part of plan treatment
  - Rights offering shares priced at a 20% discount to expected plan value (a 33% discount to plan value presented at confirmation)

C&J Energy Services Ltd. (cont'd)

- Key Advantages of Rights Offering and Structure
  - Allowed debtors to raise working capital with little leverage and brought capital structure in line with market expectations and peer companies also restructuring
  - Discounted share price and risk of dilution incentivized broad participation
  - Rights offering was open to entire class and occurred entirely within the scope of the plan process, minimizing controversy among prepetition lenders
- Process Issues and Challenges
  - Rights offering became central target for attacks by junior stakeholders even though it only caused dilution of equity already allocated to secured lenders
    - Shareholder objections called the rights offering "extraordinarily onerous," "coercive" and "a sweetheart deal for the Lenders, to the detriment of . . . [prepetition] equityholders"
    - Majority shareholder made several attempts prior to the bankruptcy to make a new-money investment in the post-emergence company in exchange for a significant portion of equity; lenders chose instead to make their own investment through the rights offering process
  - Debtors' enterprise valuation increased by 20% between disclosure statement filing and confirmation but rights offering share price stayed the same, resulting in discount at high end of market and potential for further controversy (junior stakeholder objections settled before valuation was fully litigated)

Case Study: Peabody Energy Corporation

- $1.5 billion equity capital raise:
  - $750 million Rights Offering, participants receive common equity
  - $750 million Private Placement, participants receive convertible preferred equity
- Relevant classes of prepetition capital structure (simplified):



Peabody Energy Corporation – Rights Offering

- *Rights distributed*:
  - Reorganized PEC Common Stock
  - Rights Offering Penny Warrants, exercisable for 2.5% of fully diluted Reorganized PEC Common Stock
- *Purchase price*: 55% of Plan Equity Value
- *Eligible participants*:
  - Allowed Second Lien Notes Claims
  - Allowed Unsecured Notes Claims
- *Backstop*: Parties to Rights Offering Backstop Commitment Agreement ("BCA")
- *Allocation*: Rights distributed *pro rata* on account of claims in the above classes
- *Requirements for participation*: none*; rights distributed on account of claims

*Participation subject to certain securities law qualifications

Peabody Energy Corporation – Private Placement

- *Rights distributed*:
  - Convertible preferred equity of Reorganized PEC (convertible to Reorganized PEC Common Stock) (the "Preferred Equity")
- *Purchase price*: 65% of Plan Equity Value
- *Eligible participants*:
  - Allowed Second Lien Notes Claims
  - Allowed Unsecured Notes Claims
- *Allocation*: Determined by Private Placement Agreement ("PPA")
- *Requirements for participation*: All participants* must become parties to each of:
  - the PPA,
  - the BCA, and
  - the Plan Support Agreement ("PSA")

*Participation subject to certain securities law qualifications

Peabody Energy Corporation – PSA, BCA, PPA Motion

- On December 22-23, 2016, the PEC Debtors filed a motion to approve the BCA and PPA and to authorize the Debtors to enter into a PSA, the BCA, and the PPA (the "Motion")
  - At the time the Motion was filed, the PSA, BCA, and PPA had already been agreed to by a group of supporting noteholders (including both Second Lien Notes and Unsecured Notes) (the "Noteholder Co-Proponents")
- Contemporaneously with the filing of the Motion, a motion to approve the disclosure statement and a chapter 11 plan also were filed (over 1,500 pages total)
  - The hearing on the Motion was set for the same date as the hearing on the approval of the disclosure statement (such hearing, the "Hearing")
- The Motion, disclosure statement, and plan were linked in that all parties who desired to participate in the Private Placement were required:
  - To execute the PPA (to enable them to participate in the Private Placement)
  - To execute the PSA (to vote in favor of the Plan and not object to the Disclosure Statement)
  - To execute the BCA (to backstop the Rights Offering)
  - To exercise their full *pro rata* allocation of the Rights Offering

Peabody Energy Corporation – PSA, BCA, PPA Motion (cont'd)

- The PPA, filed on December 22-23, 2016, provided for the following allocation of the Preferred Equity:
- Phase I: 22.5% of the Preferred Equity available only to the Noteholder Co-Proponents
- Phase II: 5% of the Preferred Equity available to the Noteholder Co-Proponents and additional holders that signed on to the PPA by the Phase II deadline on a *pro rata* basis (such additional holders, the "Phase II Parties")
  - Phase II deadline: 5pm, December 28, 2016 *(later extended to 5pm, December 30, 2016)*; certain holders obtained a court order holding the deadline open to 3pm, January 6, 2017
- Phase III: 72.5% of the Preferred Equity available to the Noteholder Co-Proponents, the Phase II Parties, and additional holders that signed on to the PPA by the Phase III deadline on a *pro rata* basis (such additional holders, the "Phase III Parties")
  - Phase III deadline: January 25, 2016 *(the day before the Hearing)*

Peabody Energy Corporation – PSA, BCA, PPA Motion (cont'd)

- The PPA and BCA also contained several premiums for the participating parties, including:
- Commitment Premiums
  - The PPA contained a "Private Placement Commitment Premium" of 8% of the $750 million the PPA parties committed to purchase ($60 million total), payable in Reorganized PEC Common Stock to the PPA parties
  - The BCA contained a "Rights Offering Backstop Commitment Premium" of 8% of the $750 million the BCA parties committed to backstop ($60 million total), payable in Reorganized PEC Common Stock to the BCA parties
- Ticking Premiums
  - Each of the PPA and the BCA contained a 2.5% monthly ticking premium beginning April 7, 2017 through the Effective Date, payable in Reorganized PEC Common Stock to the PPA parties or BCA parties, respectively
- Conversion Premiums
  - The Preferred Equity issued through the Private Placement contained conversion features that resulted in the payment of additional premiums upon conversion of the Preferred Equity to Reorganized PEC Common Stock

Peabody Energy Corporation – PSA, BCA, PPA Motion (cont'd)

- Holders of Second Lien Notes Claims and Unsecured Notes Claims that elected ***not*** to execute the PSA ("Non-PSA Parties") were ***unable***:
  - To execute the PPA or BCA
  - To participate in the Private Placement or to purchase any Preferred Equity
  - To backstop the Rights Offering
  - To share in any of the premiums associated with the PPA and BCA
- Non-PSA Parties were able, along with all holders of Second Lien Notes Claims and Unsecured Notes Claims, to exercise their *pro rata* allocation in the Rights Offering

Peabody Energy Corporation – Creditor Recoveries

- Illustrative* creditor recoveries assuming a PEC Common Stock price of **$41.47** (actual price on Feb. 26, 2018):

Recoveries on PEC Common Stock			
	Agreed Plan Value	35% Discount (Private Placement)	45% Discount (Rights Offering)
Plan Valuation	$25	$16.25	$13.75
Delta to Plan Value	+66%	+155%	+202%

* Excludes value obtained through Commitment Premiums, Ticking Premiums, Conversion Premiums, and other compensation; recoveries on PEC Common Stock alone

Peabody Energy Corporation – Challenges Raised

- 11 U.S.C. § 1123(a)(4): Same treatment for claims in the same class
  - Holders of identical claims received different recoveries due to whether, and when, such holder determined to execute the PSA/PPA/BCA
  - Issue: Whether the distribution received on account of participation in the PSA/PPA/BCA was a distribution on account of the participant's claim against the debtor (such that all claims must be treated equally), or on account of new money (in which case different treatment is permissible)
    - *Compare* Plan IV.B.3
      - "[A]ny Preferred Equity purchased by the Private Placement Parties in the Private Placement pursuant to the Private Placement Agreement shall be solely on account of the new money provided in the Private Placement and not on account of any purchaser's Second Lien Notes Claims or Unsecured [] Notes Claims."
    - *with Bank of Am. Nat. Trust and Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 451 (1999)
      - "[T]he better reading of ["on account of such claim"] recognizes that a causal relationship between holding the prior claim or interest and receiving or retaining property is what activates the absolute priority rule [of 1129(b)]."
  - Debtors claimed they were not obligated to offer the opportunity to purchase Preferred Equity to all members of a class, but legally entitled to offer the opportunity to only certain class members
  - *Note*: 1129(b) is inapplicable to the classes of Second Lien Notes Claims and Unsecured Notes Claims because each of these impaired classes voted to accept the Plan

Peabody Energy Corporation – Challenges Raised (cont'd)

- 11 U.S.C. § 1129(a)(3): Good faith & lawful means – Failure to maximize value
  - If the Preferred Equity was not distributed "on account of" claims, the Debtors were obligated to maximize the value received for the Preferred Equity
    - *See LaSalle* at 456:
      - "If the price to be paid for the equity interest is the best obtainable, [existing claimholders putting up new money] do[] not need the protection of exclusiveness (unless to trump an equal offer from someone else); if it is not the best, there is no apparent reason for giving [existing claimholders] a bargain. There is no reason, that is, unless the very purpose of the whole transaction is, at least in part, to do [existing claimholders] a favor. And that, of course, is to say that [existing claimholders] would obtain [their] opportunity, and the resulting benefit, because of [their] prior interest . . . ."
  - Because the Preferred Equity was sold at an acknowledged 35% discount to Plan Equity Value, the Debtors failed to secure the maximum price they could have received for the Preferred Equity

Peabody Energy Corporation – Challenges Raised (cont'd)

- 11 U.S.C. § 1129(a)(3): Good faith & lawful means – Process failures
  - Parties negotiating for class-wide resolution of inter-class disputes received greater recoveries than other class members merely by virtue of having been at the negotiating table
    - *See Young v. Higbee Co.*, 324 U.S. 204, 213-14 (1945):
      - "The money [negotiating parties] received in excess of their own interest as stockholders was not paid for anything they owned. It came to them in settlement of litigation which if carried to a successful conclusion would have added to the value of other preferred stockholders of the common debtor . . . . [The settlement's] fruit properly belongs to all the preferred stockholders. One creditor, therefore, cannot make that fruit his own by simple appropriation of it."
  - The voting process was manipulated to ensure confirmation, for agreeing to support the Plan (by executing the PSA) was a threshold requirement for a creditor to participate in the Private Placement and receive the attendant benefits
    - *See Am. United Mut. Life Ins. Co. v. City of Avon Park, Fla.*, 311 U.S. 138, 147 (1940):
      - "[I]f a vote is influenced by the expectation of advantage, though without any positive promise, it cannot be considered an honest and unbiased vote."
    - *and In re Quigley Co., Inc.*, 437 B.R. 102, 127 (Bankr. S.D.N.Y. 2010):
      - "In a nutshell, Pfizer bought enough votes to assure that any plan would be accepted."

Common Objections to Bankruptcy Rights Offerings

- Unfair Discrimination
  - Section 1123(a)(4) of the Bankruptcy Code requires creditors to receive the same treatment on account of their claims.
  - Objecting parties may argue that section 1123(a)(4) is not met if not all creditors are allowed to participate in the rights offering or if the economic benefits are disproportionately allocated to the backstop parties.
    - *In re Washington Mutual, Inc.,* 442 B.R. 314 (Bankr. D. Del. 2011) (holding that § 1123(a)(4) does not permit discrimination for administrative convenience).
  - A debtor may avoid some unfair discrimination challenges by structuring the rights offering to (a) include all willing participants and/or (b) provide alternative compensation to ineligible holders.
    - The debtors in *In re Eastman Kodak Company*, No. 12-10202 (Bankr. S.D.N.Y.) proposed a rights offering with two components: (i) a section 1145 offering for general unsecured creditors and (ii) a Section 4(a)(2) private placement for the backstop parties. The debtors also paid cash of equivalent value to any non-eligible general unsecured creditor.
    - The debtors were able to avoid an unfair discrimination challenge by utilizing similar constructs in *Genco Shipping & Trading Ltd.*, No. 14-11108 (Bankr. S.D.N.Y.), *In re Excel Maritime*, No. 13-23060 (Bankr. S.D.N.Y.), *In re MPM Silicones, LLC*, No. 14-22503 (Bankr. S.D.N.Y.).
    - Creation of a cash pot for ineligible holders is also becoming commonplace. *See In re CHC Group, Ltd.*, No. 16-31854 (Bankr. N.D. Tex.), and *In re Seadrill* Limited, No. 16-60079 (Bankr. S.D. Tex.).

Common Objections to Bankruptcy Rights Offerings (cont.)

- As a corollary to unfair discrimination arguments, rights offering share price (including valuation and discount) may be challenged as artificially low.
- Investor Protections Excessive and/or Improper
  - Creditors may object to excessive or improper protections provided to the backstop party, which may render the backstop too costly, illusory, or provide the backstop party with undue influence over a reorganized debtor.
  - Components of a rights offering that are subject to challenge include:
    - Fees: commitment/backstop fees and break-up fees are frequently characterized as being excessive or unnecessary given the size and circumstances of the rights offering (e.g. when a steep discount is expected to incentivize broad participation).
    - Termination Provisions: when a backstop party has overly flexible or unilateral rights to terminate the rights offering, the transaction can be characterized as illusory because there is no true obligation to consummate the transaction.
    - Releases, Indemnity, Exculpation: when an insider or related party is a backstop party, these provisions can be challenged if the insider or related party is abusing its status for an improper advantage.
    - Governance Rights: challenges will focus on limiting the backstop parties' control over the reorganized debtor by reducing the number of board seats allocated to certain backstop parties, limiting control rights over management, and veto or voting rights over governance documents.

Common Objections to Bankruptcy Rights Offerings (cont.)

- Other Objections
  - Lack of Market Testing
    - Argument: the value of the securities being issued are artificially low, and that a market test (i.e. *GGP*-style competitive bidding process) of the securities is necessary to determine their true value.
  - Improper Lock-Up
    - Argument: the backstop agreement chills alternative proposals which depresses value; especially important if an RSA is a component of the overall deal.
  - Self-Dealing
    - Argument: an insider is the backstop party and is receiving (i) equity at an unwarranted discount to assumed plan value and (ii) excessive backstop/commitment fees
    - *In re Horsehead Holding Corp.*, No. 16-10287 (Bankr. D. Del.) [Dckt. No. 972] (committee argued that debtors' projections undervalued the debtors' business when fully operational, thereby providing excess value to noteholder backstop parties).

Common Objections to Bankruptcy Rights Offerings (cont.)

- Lack of Good Faith
  - Argument: Plan fails to maximize value, backstop parties receiving disproportionate value through rights offering, improper solicitation by linking participation in backstop with agreement to vote in favor of the plan
- Sub Rosa Plan
  - Argument: If backstop agreement is approved separate from the plan, then similar to sub rosa arguments in a section 363 sale, the agreement could dictate the terms of a chapter 11 plan
- Best Interests Test
  - Argument: Individual creditors may argue that value provided under plan on the effective date is less than what such creditor would have obtained in a chapter 7 liquidation