

# NOTEHOLDERS IN THE AGE OF PREPACKS

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# DEBT FOR EQUITY EXCHANGES

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# Debt for Equity Exchanges vs. In Court Process

- Will an exchange offer sufficiently address the company's restructuring needs?
  - Does the company need more than de-levering? If conversion of debt to equity not enough to “fix” company issues, creditors may require an in court process
  - Are there any significant pension liabilities, leases, contracts etc. that will need to be rejected?
  - Are there any unknown liabilities that senior creditors are worried about since there will not be a bar date

# Debt for Equity Exchanges vs. In Court Process

- Is out of court a feasible option? Or is chapter 11 necessary?
  - What is the composition of the debt holders? Do they have flexibility to participate in an out of court debt for equity exchange?
  - Does the company have NOLs to cover cancellation of indebtedness income? If not, then an in court process must be pursued
  - Do credit default swaps skew creditor incentives toward chapter 11?
  - Will the senior creditors support a plan that leaves the trade unimpaired?

# Debt for Equity Exchanges vs. In Court Process

If the issues outlined above become problematic, should a pre negotiated deal be pursued as an alternative to a pre pack or exchange offer?

- Can different classes of senior creditors agree on a valuation and related capital structure issues?
- Assuming a creditors' committee is appointed, how will that impact the ability to consummate an expedited plan process?
- Will a pre negotiated or a traditional plan include a provision to market test the plan?
- Will the senior creditors attempt to buy the company through a 363 process and credit bid their debt?

# Navigating an In Court or Out of Court Restructuring

## Structuring Considerations

- How stressed is the underlying business? Is the company generating positive cash flow from operations? Is it able to cover its capital expenditures (maintenance vs. growth)? What is the nature of competition in the marketplace? Will a levered company be at a competitive disadvantage? What type of investment is required for the company to remain competitive?
- These factors will affect how much debt is converted into equity, in an in court or out of court restructuring

# Navigating an In Court or Out of Court Restructuring

## Structuring Considerations (cont'd)

- Valuation is critical:
  - Determines the fulcrum security, however if there's a need for new money, junior classes may invest to obtain equity or additional equity
  - Determines exchange consideration and distributions to creditors under a plan or exchange offer
  - Valuation is the limiting factor on the amount of debt that can remain on the company balance sheet
  - If valuation too low, might not be able to achieve consensual exchange



# Navigating an In Court or Out of Court Restructuring

## Structuring Considerations (cont'd)

- Formulating a capital structure:
  - The business plan will have a significant impact on the capital structure; an overly conservative business plan could result in a plan with little or no leverage
  - Does the capital structure reflect the industry average or is it more of a negotiated capital structure? How will this affect vendors and customers when the company consummates the restructuring?

# Navigating an In Court or Out of Court Restructuring

## Obtaining Financing to Implement Restructuring

- Does the company require incremental liquidity?
- What type of new money will be needed? The type of capital required will create different negotiating dynamics. Is there a need for only an exit revolver or is longer term capital needed (debt or equity)?
- Who will provide liquidity/DIP/exit facility?
  - Will the existing senior lenders providing? What type of facility will be provided? Priming? One that supports a plan process or a 363 process with a credit bid?
- What type of support can the company expect from the trade during the restructuring and post restructuring?
  - Less support will require longer term capital/less leverage
  - Less support may trigger a chapter 11 instead of exchange offer, as the company needs bankruptcy related protections to stabilize trade

# Navigating an In Court or Out of Court Restructuring

## Governance Considerations

- Will the reorganized company be public or private? Can the company “go dark”?
- Have the reorganized company equity holders allocated enough time to complete all the relevant documents (shareholder agreements etc.) and recruit new board members?
- What will be the composition of the board? Do individual holders want to hold board seats? Will their institutions allow them to hold board seats?
- If independents directors will be recruited for the board, how will they be recruited (by the holders or using a search firm). Will all the holders participate in the process or will a subcommittee be formed?

# Navigating an In Court or Out of Court Restructuring

## Governance Considerations (cont'd)

- Are the new equity holders going to replace the CEO? Has a search firm been hired and what is the expected timeline? Is there a need for interim management until a new CEO is identified?
- What type of post exit management incentive plan will be put in place? Will the new equity holders determine this or wait for the new board? What issues will this create if it takes time to recruit the new board or CEO?
- How much equity that will be offered to management will be influenced by whether this is an all equity plan or if debt remains in the company's capital structure?

# PREPACKAGED CHAPTER 11

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# History of the Prepackaged Chapter 11

- Thirty years ago, there was no such thing as a prepack or prearranged restructuring
  - Back then, restructuring typically meant multi-year, heavily litigated and highly structured chapter 11 cases
- In the 80's, a couple of key factors led to the advent of prepacks:
  - The use of high-yield financing created larger, more complex capital structures that could not be resolved via out-of-court exchange offers
  - The onset of significant claims trading

# History of the Prepackaged Chapter 11

- The first successful prepack for an operating company was Memorex Telex in 1991
  - This case established the format that is commonplace today for prepacks

# Prepackaged Chapter 11

- What is a “prepackaged chapter 11” case?
  - Involves pre-bankruptcy negotiation between and among debtor and stakeholders, agreement on key terms of a chapter 11 plan and pre-bankruptcy solicitation on such plan
  - Bankruptcy provides means to include and bind stakeholders that did not participate in pre-bankruptcy negotiation and those that vote against the plan
  - Parties’ commitments conditioned on confirmation of chapter 11 plan, including approval of key underlying agreements (e.g., amended debt documents)



# Prepackaged Chapter 11

- Key Bankruptcy Concepts

- Bankruptcy imposes an automatic stay over property of the estate
- Bankruptcy plans require that stakeholders be grouped into classes
  - Rights of those in same class must be similar; but not all similar claims are required to be in same class
  - Absent consent, all stakeholders in same class must get same treatment
  - Voting is by class; creditors entitled to vote if the plan's treatment of the class impairs creditors' legal, contractual or equitable rights
  - Generally need at least one accepting impaired class to confirm a plan
  - Class acceptance achieved by consent of  $\frac{2}{3}$  in amount and more than  $\frac{1}{2}$  in number of those voting in that class. If a class accepts, then the vote is binding on all members of that class

# Benefits of Restructuring By Prepackaged Chapter 11

- Maximizing Control and Speed, with Minimal Cost
  - Maintaining control and building on momentum:
    - Prepackaged Chapter 11 is a consensus oriented process, with pre-bankruptcy agreements providing momentum and direction
  - Chapter 11 tools and protections allow the company to maintain control:
    - Automatic stay
    - Ability to reject executory contracts/leases and potentially cap damages; and
    - Ability to bind holdouts
  - Quick execution: prepackaged bankruptcy is typically effectuated within 30-60 days
    - A debtor in a prepack avoids delay associated with timeline to reject leases of non-residential real property and 18-month exclusive period

# Benefits of Prepackaged Chapter 11 (cont'd)

- Greater certainty of outcome/reduces risks compared to traditional “free-fall” bankruptcy:
  - Reduced risk of loss of control (e.g., avoid appointment of trustee)
  - Reduced costs – administrative expenses are materially reduced and there is less need for the appointment of debtor-financed creditor or equity committees
- Better for business: maintains creditor goodwill and avoids interruption of operations if unsecured creditors “ride-through” the bankruptcy unaffected

*Outcome of the bankruptcy case is largely predetermined with as much certainty as possible; more certainty than in a traditional chapter 11 case*

# Challenges Associated with Prepackaged Chapter 11

- Consensus might not be possible
  - Unable to reach consensus among Board/ Management/ Controlling Shareholder, with Controlling Shareholder retaining ultimate control over process
    - No worse for having explored
    - Media speculation of same anyway
- Outstanding legal issues could frustrate timeline (e.g. avoidance action litigation; disputes over valuation)
- Opponents could frustrate bankruptcy approval of restructuring
  - Mitigate this risk by adhering to process and obtaining threshold level of support at outset

# How to Implement a Prepackaged Chapter 11

- Develop and refine restructuring options and parameters
- Negotiate with key creditor groups on terms of restructuring and chapter 11 plan terms
- Assuming requisite creditor support marshaled, negotiation and execution of restructuring support agreements by key stakeholders
- Commence exchange offer with a “prepack backstop”: if out of court minimum consent thresholds not achieved (but bankruptcy level consent obtained), commence chapter 11
- File plan and disclosure statement day one, set hearing for court to approve solicitation and confirm prepackaged plan

# Recent Prepacks

Lead Debtor	Industry	Court/Case No.	Filing date	Exit Date
GateHouse Media Inc.	Media; Media - Newspapers	Del. (13-12503)	9/27/2013	11/26/2013
Anchor Bancorp Wisconsin Inc.	Financial Services; Financial Services - Commercial banking	WD Wis. (13-14003)	8/12/2013	9/27/2013
American Roads LLC	Transportation	SDNY (13-12412)	7/25/2013	9/3/2013
Newland International Properties Corp.	Real Estate	SDNY (13-11396)	4/30/2013	7/5/2013
Central European Distribution Corp.	Manufacturing; Food - Beverage; Food	Del. (13-10738)	4/7/2013	6/5/2013
Revel AC Inc.	Leisure; Real Estate; Leisure - Gaming; Leisure - Lodging	NJ (13-16253)	3/25/2013	5/21/2013
Otelco Inc.	Telecommunication; Telecommunication - Telecom Services	Del. (13-10593)	3/24/2013	5/24/2013
Dex One Corp.	Business Communication; Business Communication - Marketing	Del. (13-10533)	3/18/2013	4/30/2013
SuperMedia Inc.	Business Communication; Media; Business Communication - Advertising	Del. (13-10545)	3/18/2013	4/30/2013
Geokinetics Inc.	Technology; Energy; Services	Del. (13-10472)	3/10/2013	5/10/2013
LodgeNet Interactive Corp.	Media; Telecommunication - Telecom Services; Telecommunication	SDNY (13-10238)	1/27/2013	3/28/2013
Homer City Funding LLC	Energy; Financial Services; Energy - Utilities	Del. (12-13024)	11/6/2012	2/6/2013
205 East 45 LLC	Real Estate; Leisure - Lodging	SDNY (12-12208)	5/21/2012	
Franklin Credit Holding Corp.	Financial Services; Financial Services - Consumer Lending	NJ (12-24411)	6/4/2012	8/10/2012
William Lyon Homes	Construction; Construction - Homebuilding	Del. (11-14019)	12/19/2011	2/25/2012
Lee Enterprises Inc.	Media; Media - Newspapers	Del. (11-13918)	12/12/2011	1/30/2012