



# ETHICS IN TODAY'S TOUGH CASES — BUDDY CAN YOU SPARE A DIME (OR LESS)?

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# ETHICS IN TODAY'S TOUGH CASES

## BUDDY CAN YOU SPARE A DIME (OR LESS)?



Moderator:

Harold L. Kaplan (Foley & Lardner LLP)

Panelists:

William A. Brandt, Jr. (Development Specialists, Inc.)

Daniel A Fliman (Kasowitz Benson Torres & Friedman LLP)

Christopher K. Kearns (BRG Capstone)

Jennifer L. Marines (Morrison & Foerster, LLP)

# Overview of the Marketplace and Energy Industry Trends

- Overview of the Marketplace and Energy Industry Trends – Depressed position of unsecured creditors in many recent chapter 11 cases resulting from:
  - Declining energy prices/value of assets
  - Increased second lien and other secured debt
  - Few or no unencumbered assets
  - Increasingly pre-negotiated sale/distribution scheme plans largely in for secured debt
  - Leaving unsecured creditors often largely or wholly out of the money on waterfall basis

# Recent Industry Trends and Representative Cases

- Recent industry trends and representative cases:
  - Oil & Gas
    - Midstates Petroleum Corp.: Under confirmed Plan, unsecured noteholder recovery consists of stock in reorganized debtor plus warrants (value of package = less than 3% recovery)
    - Sabine Oil & Gas: Under confirmed Plan, unsecured noteholder recovery consists of stock in reorganized debtor plus warrants (value of package = less than 2% recovery)
    - Quicksilver Resources: liquidation case, unsecured creditors received cash (including possible contingent recovery from Canadian Proceeds) valued at approximately 3% recovery

# Recent Industry Trends and Representative Cases



## – Coal

- Walter Energy: Pursuant to Global Settlement Motion and proposed structured dismissal, unsecured creditors received equity in purchaser of Debtor's assets valued at less than 1% recovery
- Alpha Natural Resources: Under confirmed Plan, unsecured creditors receive stock, warrants, contingent revenue payment, contingent reserve price asset sale proceeds; recovery valued at 1.5% – 3%
- Arch Coal
- Peabody

# Recent Industry Trends and Representative Cases



- Renewable Energy
  - Abengoa
  - SunEdison: unsecured notes trading in single digits
- Regulated Electric Power
  - Energy Future: T-Side second lien and unsecured debt receiving cash distributions of perhaps 6-7% based on fraudulent transfer settlement

# Duties and Exposure of Core Parites

- Duties and Exposure of Core Parites – Legal Duties and Ethical Constraints
  - Debtors and D&Os (pre/post-petition obligations)
    - Fiduciary Duties of Debtors and D&Os
      - Fiduciary duties that give rise to a cause of action for breach thereof are: (i) the duty of loyalty, and (ii) the duty of care. See *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 370 (Del. 2006)
      - Business Judgment Rule

# Duties and Exposure of Core Parites

- In bankruptcy, debtors (and their D&Os) may also owe fiduciary duties to creditors
  - “Because the creditors of an insolvent corporation join the class of residual claimants, equitable considerations give creditors standing to pursue derivative claims against the directors of an insolvent corporation.” *Quadrant Structured Products Co. v. Vertin*, CIV.A. 6990-VCL, 2014 WL 5099428 (Del. Ch. Oct. 1, 2014)



# Duties and Exposure of Core Parites

- Official Committee of Unsecured Creditors
  - The UCC owes a fiduciary duty to the class of unsecured creditors as a whole:
    - “Members of the Committee are fiduciaries who represent all unsecured creditors as a group without regard to the types of claims which individual unsecured creditors hold against the debtor. Creditors wishing to serve as fiduciaries on any official committee are advised that they may not purchase, sell or otherwise trade in or transfer claims against the Debtor while they are committee members absent an order of the Court.”  
*Official Committee of Unsecured Creditors’ Committee Information Sheet, Office to the United States Trustee.*

# Duties and Exposure of Core Parites

- Secured & Unsecured Creditors
- Legal Ethics Rules Applicable to All Counsel
  - Fed. R. Civ. P. 11 / Fed. R. Bankr. P. 9011
    - *By presenting to the court a pleading, written motion, or other paper—whether by signing, filing, submitting, or later advocating it—an attorney or unrepresented party certifies that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances: (1) it is not being presented for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation; (2) the claims, defenses, and other legal contentions are warranted by existing law or by a nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law; (3) the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery; and (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on belief or a lack of information.*

# Negotiating From Behind

- Negotiating From Behind -- Cash, Stock, Warrants, Litigation/Liquidation Trusts
  - Strategies and goals with respect to maximizing recoveries and the type of consideration creditors may receive:
    - Cash and Debt Swaps. In a reorganization case, while there may be some cash, stock in the reorganized debtor is often the main consideration available for distribution to creditors.
      - Debt swapped for equity. In the case of deeply insolvent debtors, the vast majority of stock is sometimes allocated to secured creditors, while unsecured creditors receive only a small percentage of the stock.

# Negotiating From Behind

- Warrants are sometimes issued in addition to stock, providing junior creditors with additional recovery at a future date, if the reorganized company's stock attains sufficient value. Warrants can help to preserve junior creditors' rights to share in the eventual upside of the reorganized company, and reduce the risk that senior creditors will take unfair advantage of a temporary dip in the company's value to wipe out lower tranches of debt.


# Negotiating From Behind

- Cash recoveries are often preferred by creditors, especially trade creditors and smaller noteholders who don't want to deal with ownership of the sometimes illiquid or volatile shares of a reorganized company. Debtors wishing to emerge as non-reporting companies may need to restrict the number of holders of their equity securities, or restrict their stock to qualified institutional buyers, in order to comply with securities regulations, and therefore may choose to offer cash to small "mom and pop" creditors.


# Negotiating From Behind

- Liquidation Trusts or Litigation Trusts are sometimes established to distribute an estate's illiquid or to be litigated assets to creditors following the effective date of a plan. A creditor representative usually serves as trustee of the Liquidation/Litigation Trust and determines the strategy and timing to be pursued to maximize return on the trust assets. Avoidance actions, D&O actions, and other litigation claims are sometimes placed in litigation trusts for the benefit of creditors. Such trusts often need a certain amount of cash at their inception to fund the litigation and cover initial expenses.

# Challenges to Secured Creditors, D&Os and Other Parties

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- Challenges to Secured Creditors, D&Os and Other Parties -- Obligations and Limits
    - Challenges to the DIP Financing; Including Adequate Protection Claims
      - Under section 364 of the Bankruptcy Code, a chapter 11 debtor in possession can incur postpetition debt (“DIP Financing”) outside of the ordinary course of business upon notice and a hearing.

# Challenges to Secured Creditors, D&Os and Other Parties

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- If the debtor can prove that such protections were necessary in order to obtain DIP financing, the DIP lender can be granted certain protections, including:
    - A superpriority administrative expense claim;
    - A lien on unencumbered estate assets;
    - A junior lien on encumbered estate assets; and/or
    - A priming lien on encumbered estate assets (provided there is adequate protection of the existing secured party).



# Challenges to Secured Creditors, D&Os and Other Parties

- Adequate Protection” can include periodic cash payments, additional or replacement liens, or other forms of protection. See 11 U.S.C. § 361. It may eat into unsecured asset values otherwise available to unsecureds.

# Challenges to Secured Creditors, D&Os and Other Parties

- Lien And Other Challenges To Secured Debt
  - While most commercial secured lending transactions can be properly perfected through the simple filing of a UCC-1 financing statement. However, in oil and gas cases, where a debtor's assets often consist of thousands of individual wells, leases, or other mineral rights, located in numerous different jurisdictions, the perfection of a lender's security interest can become very complicated. Unsecured creditors may find opportunities to argue that certain assets pledged to a secured lender are actually unencumbered, and therefore available for distribution to unsecured creditors.

# Challenges to Secured Creditors, D&Os and Other Parties

- Midstates Petroleum: The Debtors and their secured creditors entered a Plan Support Agreement pursuant to which they agreed that 98.8% of the value of the Debtors' assets were encumbered by valid, perfected, and enforceable liens in favor of the secured creditors. The UCC alleged certain deficiencies in the perfection of these security interests, and filed an adversary proceeding seeking a declaratory judgment that certain assets were actually unencumbered. A settlement was reached under which unsecured creditors obtained a somewhat larger recovery.

# Challenges to Secured Creditors, D&Os and Other Parties

- Quicksilver Resources: The UCC obtained standing to challenge the extent and validity of the second lien creditors' mortgage, and brought an adversary proceeding seeking to declare certain property unencumbered. The UCC argued that the mortgage in question did not create a valid blanket lien on all of the Debtor's real property, and numerous properties were unencumbered because they were not specifically listed on Exhibit A to the mortgage. The court ruled against the UCC, holding that the second lien lenders held valid blanket lien on all of the debtors' real property assets.

# Challenges to Secured Creditors, D&Os and Other Parties

- Challenges to Pre-Petition Piling on of Senior/Secured Debt; Exchange Offers; RSAs
  - A common pattern in recent cases is that, prior to the bankruptcy filing, the Debtor and certain of its creditors will engage in transactions that elevate certain debt from unsecured to secured status, or will issue additional secured debt ahead of existing unsecured debt. Each of these tactics has the effect of pushing the remaining unsecured debt further down in the capital stack, and eventually out of the money entirely.

# Challenges to Secured Creditors, D&Os and Other Parties

- SunEdison: in January 2016, SunEdison exchanged \$225 million in new second-lien secured notes for \$336 million in outstanding unsecured notes. When SunEdison entered chapter 11 just over three months later, the remaining unsecured noteholders who had not been part of the exchange were now behind the new additional second lien notes. In October 2016, the UCC filed a complaint asserting fraudulent transfer claims and other causes of action against certain secured creditors in connection with this prepetition issuance of additional second lien notes (among other things).

# Challenges to Secured Creditors, D&Os and Other Parties

- Walter Energy: in March 2014, the company issued \$350 million in new second lien notes, ahead of its existing unsecured notes. Less than a year and half later, the company entered chapter 11, with the unsecured notes largely out of the money.

# Challenges to Secured Creditors, D&Os and Other Parties

- Fraudulent Transfer, etc. Litigation
  - Sabine: Unsecured Creditors Committee sought derivative standing to prosecute certain claims on behalf of the debtors over several matters, including a complex fraudulent conveyance stemming from a pre-bankruptcy merger of Forest Oil Corporation and Sabine. The bankruptcy court, however, denied the Unsecured Creditors Committee standing to assert the claims.



# Challenges to Secured Creditors, D&Os and Other Parties

- SunEdison: The Unsecured Creditors Committee is pursuing several claims related to alleged prepetition fraudulent transfers.
  - In October 2016, the UCC brought fraudulent transfer claims and other causes of action against secured creditors in connection with prepetition transactions that improved secured creditors' position at the expense of unsecured creditors.

# Challenges to Secured Creditors, D&Os and Other Parties

- In November 2016, the UCC filed a motion requesting standing to bring fraudulent transfer actions against two publicly traded “YieldCo” subsidiaries of the debtor (TerraForm Power, Inc. and TerraForm Global, Inc.). The proposed complaint alleges that the YieldCos each received from SUNE, in connection with the YieldCos’ initial public offerings and after, completed energy projects, services and payments worth hundreds of millions, if not billions, of dollars, for which SUNE did not receive reasonably equivalent value.

# Challenges to Secured Creditors, D&Os and Other Parties

## – D&O Litigation and Releases

- SunEdison: The Unsecured Creditors Committee has requested permission of the court to bring claims against the company's D&Os, alleging that they breached their fiduciary duties by knowingly abdicating their responsibility to oversee the Company's business, operations, internal controls and financial reporting practices. Also, the UCC has filed an adversary seeking to stay claims by other parties against the D&Os in order to prevent the depletion of the company's D&O policies in those other actions.

# Attempts to Block Sales, Credit Bids or Other Case Progress

- Attempts to Block Sales, Credit Bids or Other Case Progress
  - Walter

# Structured Dismissals

## ■ Structured Dismissals

### – Jevic Holding Corp.

- *Czyzewski v. Jevic Holding Corp.*, is currently before the Supreme Court, testing whether a bankruptcy court may dismiss a case that has been settled through an agreement that gives payment to lower-ranking creditors ahead of more senior-ranked creditors. Accepting the suggestion of the Solicitor General, the Court agreed to hear the case. The case involved the alleged failure to follow the priority due to former workers' benefit claims when their New Jersey trucking company filed for bankruptcy after it was taken over by investors in a leveraged buyout. Nineteen states joined in urging the Justices to decide the case. The case raises a major legal question over how bankruptcy courts are to deal with so-called “structural dismissals” — apparently, an increasing phenomenon in bankruptcy practice.

# Death Traps

## ■ Death Traps


- Coercion to force Vote for Plan
- Discriminatory treatment or penalization/loss of recovery if class or individual creditors vote against Plan

# Resulting Fee Fights/Issues

## ■ Resulting Fee Fights/Issues

- All Retained Professionals (Debtor’s Advisors, Committee’s Advisors)
  - Bankruptcy Code provides for payment of “reasonable compensation for actual, necessary services”
  - In determining whether fees are reasonable, court will consider, among other factors, “whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case ...” 11 U.S.C. s. 330
    - Excessive fees incurred through scorched earth litigation tactics may not be compensable
    - Fees incurred with no reasonable expectation of benefit to creditors may not be compensable

# Resulting Fee Fights/Issues

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- Indenture Trustee fees
  - RSA and other settlement provisions paying fees of supporting creditors – even undersecured or unsecured creditors



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Harold L. Kaplan

Partner

Foley & Lardner LLP  
321 N. Clark Street, Suite 2800  
Chicago, IL 60675-5313  
Tel: (312) 832-4393  
Fax: (312) 832-4700  
Email: [hkaplan@foley.com](mailto:hkaplan@foley.com)

Christopher K. Kearns

Executive Director

BRG Capstone  
104 West 40<sup>th</sup> Street, 16<sup>th</sup> Floor  
New York, NY 10018  
Tel: (212) 782-1409  
Fax: (212) 782-1478  
Email: [ckearns@thinkbrg.com](mailto:ckearns@thinkbrg.com)

Jennifer L. Marines

Partner

Morrison & Foerster, LLP  
250 West 55<sup>th</sup> Street  
New York, NY 10019  
Tel: (212) 336-4491  
Fax: (212) 468-7900  
Email: [jmarines@mofocom](mailto:jmarines@mofocom)

Daniel A. Fliman

Partner

Kasowitz Benson Torres & Friedman LLP  
1633 Broadway  
New York, N.Y. 10019  
Tel: (212) 506-1713  
Fax: (212) 506-1800  
Email: [dfliman@kasowitz.com](mailto:dfliman@kasowitz.com)

William A. Brandt, Jr.

President & CEO

Development Specialists, Inc.  
3 First National Plaza, Suite 2300  
70 West Madison Street  
Chicago, IL 60602-4250  
Tel: (312) 263-4141  
Fax: (312) 263-1180  
Email: [bbrandt@dsi.biz](mailto:bbrandt@dsi.biz)