

## Articles

### "Bond Defaults: Critical Issues & Strategies"

Jeffrey E. Spiers

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This outline and the accompanying presentation were designed to identify various bankruptcy and work-out issues that may arise in the context of indentured debt. If you are confronted with any of the issues noted above, it is recommended that you seek competent counsel to advise you regarding the particular circumstances at hand.

The following outline focuses on bankruptcy and work-out issues arising with holders of indentured debt by corporate debtors.

#### Typical Structures for Bond Debt

#### The Indenture, the Trustee Concept and the Trust Indenture Act

##### The Indenture

Source of bondholder rights

Provides convenient remedies mechanism through trustee

Trust Indenture Act

Indentures governing SEC registered debt required to be qualified under Act

Provides for minimum bondholder rights under indenture

Requires disclosures regarding indenture and trustee

Addresses trustee conflicts

The Role of the Trustee

Trustee as a fiduciary

Powers and duties

Influence by major bondholders

Role in a work-out/default - differing philosophies

Covenants

"Standard" covenants

Covenant to pay

Maintenance of payment offices

Covenants regarding corporate maintenance

Collateral maintenance for secured bonds

Financial covenants

High yield versus investment grade covenant packages

Restrictive negative covenants - incurrence versus maintenance tests

Restrictive affirmative covenants

Reporting covenants

Repurchase covenants

Repurchase upon change in control

Repurchase with asset sale proceeds

## Articles

Remedies

Events of default

Payment defaults

Covenant defaults

Grace periods

Notice based defaults - requires notice to debtor before event of default

Cure provisions

Rights of acceleration

Action by bondholders

Action by Trustee

Right of reinstatement after acceleration

Suits for enforcement

Action against guarantors

Action against collateral for secured bonds

Subordination provisions and their effect - the standstill period

Guarantees and Collateral

Subsidiary guarantees

Parent guarantees

Secured debt

Enforcement issues in bankruptcy/workout

Fraudulent transfers and preferences

Perfection requirements

Substantive consolidation

Bond Sales Transactions

The registered public offering

Rule 144A private offerings

Purchaser requirements

Qualified institutional purchasers

Institutional accredited investors

Regulation S offshore purchasers

A/B exchange rights

Registered offer to exchange original restricted bonds with substantially identical registered

Purpose: liquidity - no securities law restrictions on transfer

Liquidated damages (i.e., additional interest) payable if exchange offer not completed

Creditors` rights issue: are exchanged bonds a separate class?

Institutional private placements

Regulation S offshore offerings

## Articles

Role of investment bankers

Role of rating agencies

Trading in the bond aftermarket

Markets and liquidity issues

Stock exchange listing

Over the counter trading

BORTAL trading - for 144A offered restricted securities

Market maker dominated trading

Effect of imminent or perceived default or restructuring

Rating issues

Distressed debt buyers

The "insider" and restricted trading issues

Players in a Bond Workout/Bankruptcy

The company

Major bondholders

Institutional purchasers

Distressed debt buyers

"Ad hoc" committees

Other creditors

Secured creditors

Trade creditors

Subordinated versus senior creditors

Others

The trustee

Financial advisors

Issuer restructuring advisor

Bondholder advisors

The interested investment banker - may have sold bonds to key customers

Counsel

Company restructuring/bankruptcy counsel

Company corporate counsel

Counsel to trustee

Counsel to major bondholders and ad hoc committees

Counsel to other major creditors (i.e., banks)

Securities Law Issues

Disclosure duties and their impact - duty to disclose material corporate developments

Source of duty

## Articles

Securities exchange rules

1934 Act periodic disclosure requirements

MD&A disclosure

Requirements to disclose liquidity issues

1933 Act disclosure issues

Disclosure required in registered exchange offer

Disclosure required when raising equity capital

Financial statement disclosures under GAAP

the "going concern" opinion

Liquidity and default disclosures

Indenture reporting requirements

Methods of Disclosure

Press Releases

Warning Releases

Notice of Defaults

1934 Act periodic filings - 10-K's, 10-Q's and 8-K's

Reports to indenture trustees and bondholders

Notices of defaults

Periodic reports required by indenture - many indentures require 1934 Act filings and financial statements even if issuer has no 1934 Act obligation

Disclosures by third parties

Rating agency downgrades and reports

Analyst reports

Industry publications

Interested party disclosures

The "rumor mill" and chat rooms

Issues with company response

Selective disclosure issues

Dealing with analysts

Dealing with major creditors and stockholders

Disclosure and the impact on workout negotiations - insider trading

Bankruptcy/workout negotiations as confidential, non-public information

The "restricted" bondholder - disclose or abstain from trading

The role of confidentiality letters

Purposes

Permit frank discussions with creditors using non-public information

Avoid premature public disclosure

## Articles

Provide framework for providing non-public information

In some cases, provide breathing room and permit focus on negotiations through standstill agreement to delay taking specific actions

Defining confidential information

Addressing reluctance of bondholders to become "insiders" yet satisfy desire to be involved

Standstill provisions

"Come clean" disclosure provisions

Exchange offers for debt - an offer of securities

Compliance with securities laws

The "3(a)(9) exemption" - 1933 Act exemption for exchanges of securities solely by an issuer

Cannot involve investment bankers or other soliciting agents

Must be exchange for securities of the same legal issuer

Private exchange

Impractical in view of numerous holders, trading and need for high acceptance threshold

Should be considered with only a handful of holders

Holder receive "restricted" securities

1933 Act Registration

Requires a registration statement

SEC review

Extensive time requirements

No contractual commitments prior to effectiveness

The bankruptcy exemption - Sec. 1145 of the Federal Bankruptcy Code

Minimum exchange offer periods - 20 business days if viewed as a public tender offer

Issues with exchange offers out of bankruptcy

Need for high acceptance thresholds - 95% or above is common

Holding the deal together

Limitations on legally binding commitments prior to close of offer

Losing participants through the trading markets

Preliminary negotiation issues

Negotiations as material non-public information

Negotiations as prohibited "jumping the gun" for registered exchange offer

Negotiations as prohibited "general solicitation" for private exchange offers

Preparing for Bond Defaults and Workouts

Understanding default triggers and timing

Understanding subordination - the layering of debt and creditor and debtor differentiation

Practical issues in avoiding indenture defaults

Finding the holders to negotiate with

## Articles

Limited ability to modify payment terms

Waiving or modifying covenants on publicly held debt

Impact on other creditor negotiations

Who really takes action for collection and when?

Bankruptcy as an Alternative and Related Issues

The Involuntary Filing

Bondholders` Objectives

Create a forum for orderly disposition of debtor`s assets

Move debtor/issuer to action

Provide a "seat at the table"

Force debtor and other creditors to organize and negotiate

Timing Concerns for Creditor

Generally advantageous to pursue at earliest time permitted by law

Senior lender may fund interest payments (on a senior secured basis) to forestall involuntary bankruptcy filing

The Voluntary Filing

Issuer`s Objectives

Forces creditors to organize to negotiate

Forces unwilling creditors and equity holders to negotiate or be "crammed down"

Take advantage of the stay of creditor enforcement actions

Issuer`s Concerns

Fiduciary issues with equity holders

Loss of control and court supervision

Costs and timing

Creditor Organization in Bankruptcy

Official Committee of Unsecured Creditors

Typically - a mixture of trade creditors and unsecured bondholders

Legal and financial advisors compensated by the estate

Significant voice in bankruptcy process

Official Committee of Secured Bondholders - rarely appointed; only in larger cases

Unofficial Committees

Bondholders steering or "ad hoc" committee

Professional advisors not compensated by the estate

Selected Workout/Bankruptcy Issues

Lender Liability Issues in Workouts/Bankruptcies

Standard of conduct - Exercise of dominion and control

## Articles

Actual, participatory control of the debtor typically required

Suggestions by lender coupled with threat to exercise legal rights - generally insufficient to impose lender liability

Effect of exercising control

Lender/borrower relationship transformed into fiduciary one: giving rise to a duty by the lender to act in the best interest of the borrower

Fiduciary relationship may arise even if loan agreement authorizes lender to exercise control

Setoff Rights for Oil and Gas Receivables

Bankruptcy Code preserves setoff rights

Decreases impetus for creditors to file involuntary proceedings

Unsecured trade creditor entitled to setoff possesses a right equivalent to secured creditor (to disadvantage of bondholder)

Conflicting Subordination/Lien Priority Issues

Competing lien claimants

Mortgage lenders - blanket liens over various properties

Trade creditors - mechanics' liens against assets in the field

Secured bondholders - generally subordinated to mortgage lenders

Governing law

State law - governs priority

Federal law - deep offshore properties subject to federal law

Marshaling assets

Secured bondholder with junior security interest - generally requests marshaling

Unsecured bondholder - typically opposes marshaling; desires senior secured creditors to satisfy their liens in a manner that expunges junior liens(1)