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Del. District Court Upholds Use of Pre-Confirmation Tender Offers

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Outside of bankruptcy, many companies utilize exchange programs to repurchase outstanding loans at a discount or to renegotiate debt on more favorable terms. Depending upon the nature of the obligation involved, compliance with federal securities laws may be required. Within a bankruptcy proceeding, however, there has been some question as to whether such debt exchange programs can be used apart from, and prior to, plan confirmation. Recently, at least one court has answered that question in the affirmative, in *In re Energy Future Holdings* (Civil Case No. 1:14-cv-00723; Bankruptcy Case No. 14-bk-10979).

In *Energy Future*, the U.S. District Court for the District of Delaware upheld a bankruptcy court order approving a debt exchange settlement (the first lien settlement) between Energy Future Holdings Corp. and its subsidiaries (the debtors), and certain holders of two issues of first lien notes (the noteholders). In doing so, this decision, at least in Delaware, confirms that a debtor, even while under bankruptcy court supervision, may utilize a tender offer process as part of a pre-plan confirmation settlement strategy.

As a general matter, a tender offer is a limited-time solicitation by a company or a third party to purchase a substantial percentage of the company's registered equity shares or publicly traded debt. The offer price is usually set at a premium over the current market price and contingent upon shareholders or debt holders tendering a fixed number of shares or amount of debt. In addition, a tender offer requires compliance with the Securities Exchange Act of 1934, as amended.

The debtors, who ran power generating and distribution businesses, commenced bankruptcy proceedings in April 2014. On the petition date, they filed a restructuring support agreement that contained global settlements between the debtors and various creditor constituencies. Among other agreements, the debtors offered the first lien settlement through a tender offer that allowed the exchange of existing first lien notes for new debt obligations issued under a $5.4 billion debtor-in-possession (DIP) financing facility (with substantially lower interest rates). The debtors projected the deal would save them tens of millions of dollars each month in interest payments.

The debtors' tender offer compensated accepting noteholders by providing them 105 percent of their outstanding principal and 101 percent of their accrued interest. In exchange, the accepting noteholders released their rights to receive a "make-whole" premium that would have been triggered by the premature redemption. Per the note's terms, the value of the make-whole premium was dependent upon the remaining time to maturity and the stated interest rate. The noteholders who rejected the tender offer could continue litigating the legal issue of whether such make-whole claims constitute allowable bankruptcy claims.

In response to the tender offer, 42 percent of the noteholders, representing (a) 97 percent of holders of first lien notes composed of $500 million of 6 7/8 percent notes due in 2017 and (b) 34 percent of holders of first lien notes composed of $3.5 billion of 10 percent notes due in 2010, accepted. The U.S. Bankruptcy Court for the District of Delaware approved the

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first lien settlement in June 2014, triggering an appeal by the indenture trustee for the 10 percent noteholders. Although the global settlement was initially pending at the time the debtors sought bankruptcy court approval, they subsequently withdrew it with the exception of the first lien settlement.

On appeal, the trustee challenged the first lien settlement on various grounds. First, the trustee argued that it was improper for the debtors to utilize the U.S. Securities and Exchange Commission-governed tender offer procedure in Chapter 11. The district court found, however, that, despite the SEC's limited oversight role over a debtor, the Bankruptcy Code does not limit a debtor's ability to use a tender offer in the context of a pre-confirmation settlement agreement. Moreover, although Section 1145 of the Bankruptcy Code carves out specific circumstances under which the debtor and other parties need not comply with securities laws, such a carve-out does not include pre-confirmation settlement offers, suggesting that the debtors were not exempt from SEC compliance and that a tender offer could be made within a bankruptcy proceeding.

The trustee next argued that the tender offer was improper because the first lien settlement was made outside of a plan confirmation process and offered unequal treatment to the holders of the two different issues of first lien notes. In particular, the debtors' offer of a 5 percent premium in exchange for the noteholders' release of their make-whole claims translated into different recoveries for each class's make-whole claim: for the 6 7/8 percent noteholders, the 5 percent premium represented 64 percent of the maximum potential value of their make-whole claims, while the 5 percent premium for the 10 percent noteholders represented only 27 percent of the potential make-whole claim value.

The trustee argued that only through a confirmed Chapter 11 plan could the debtors accomplish a classwide debt exchange that resulted in unequal treatment within the same class of creditors. The district court rejected this position as well, noting that reorganization plans are not the sole vehicle for exchanging debt or paying off creditors; rather, the first lien settlement, which was simply a roll-up of the first lien notes with new DIP financing, was an appropriate method by which to settle with creditors and was not improper under bankruptcy law.

Next, in regard to the allegedly disparate treatment, the trustee argued that the first lien settlement, and the differing recoveries posed to the two groups of noteholders, violated Section 1123(a)(4) of the Bankruptcy Code. Section 1123(a)(4) provides that "notwithstanding any otherwise applicable non-bankruptcy law, a plan shall provide the same treatment for each claim or interest of a particular class, unless the holder of a particular class or interest agrees to a less favorable treatment of such particular claim or interest."

The district court also rejected this argument by declining to extend Section 1123(a)(4)'s equal treatment principle to pre-confirmation settlements. Further, according to the district court, even if Section 1123(a)(4) did apply, the first lien settlement was not in violation because, while the tender offer afforded different proportional recoveries on the make-whole claims as to the two noteholder groups, the accepting noteholders had voluntarily agreed to less favorable treatment and each noteholder had the opportunity to reject the tender offer.

Lastly, the district court addressed the trustee's argument that the first lien settlement constituted an improper sub rosa plan. A settlement may be deemed an improper sub rosa plan if it dictates plan terms by either disposing of all claims against the estate or restricting creditors' voting rights. Because the debtors withdrew the global settlement, the court refused to evaluate the trustee's sub rosa claim as if the first lien settlement was still part of a larger settlement scheme (which was pending at the time when the bankruptcy court approved the first lien settlement). Standing alone, the first lien settlement did not dispose of all claims against the estate and did not restrict creditors' voting rights. The district court thus found that the bankruptcy court did not err in concluding that the first lien settlement was not a sub rosa plan.

The *Energy Future* decision offers an intriguing path for securing settlements with key groups of creditors during Chapter 11, but prior to plan confirmation. This will no doubt be a useful tool for staging complicated debt restructurings during bankruptcy. By achieving finality as to a significant class of creditors prior to confirmation, this decision affords greater certainty for debtors seeking to accomplish the larger goal of a global restructuring through a plan. Whether *Energy Future* will be impacted on appeal remains an open question for now. Either way, however, the interplay between the Securities Exchange Act and the Bankruptcy Code will no doubt remain an important issue.