

# ACIC 2018 Fall Meeting and Education Conference:

## Restructuring Mini Debates

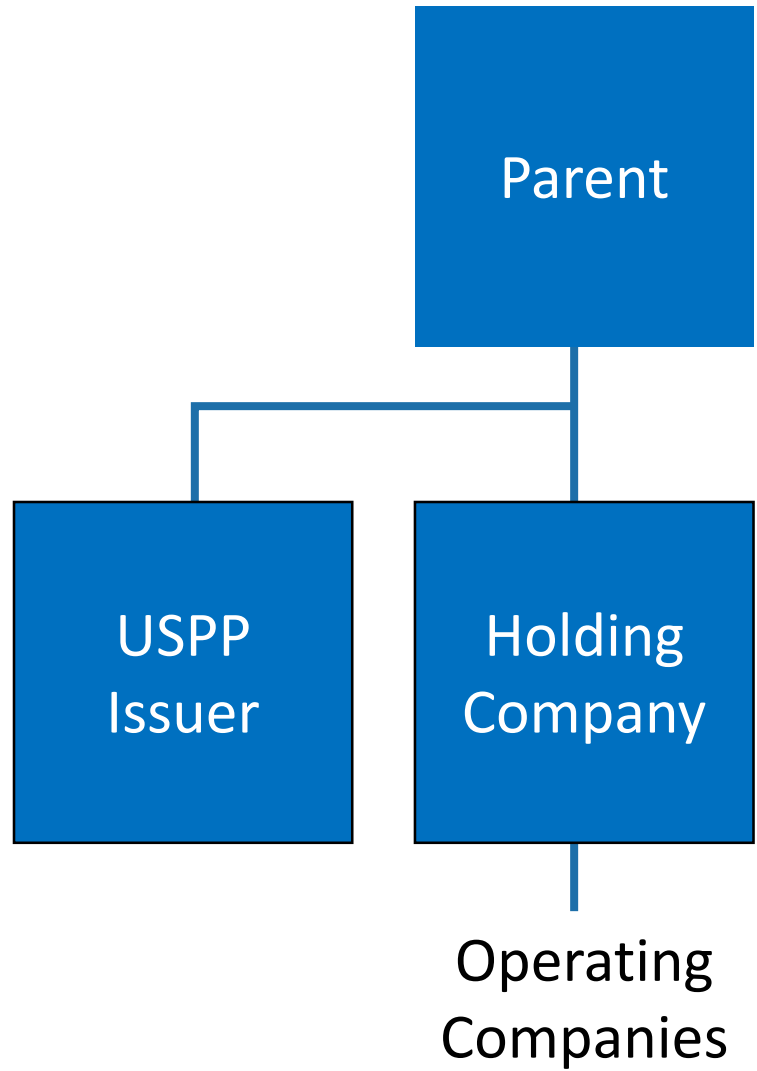
Jeffrey L. Jonas, Brown Rudnick LLP, Moderator

# Long-Short Issues in Restructuring Negotiations

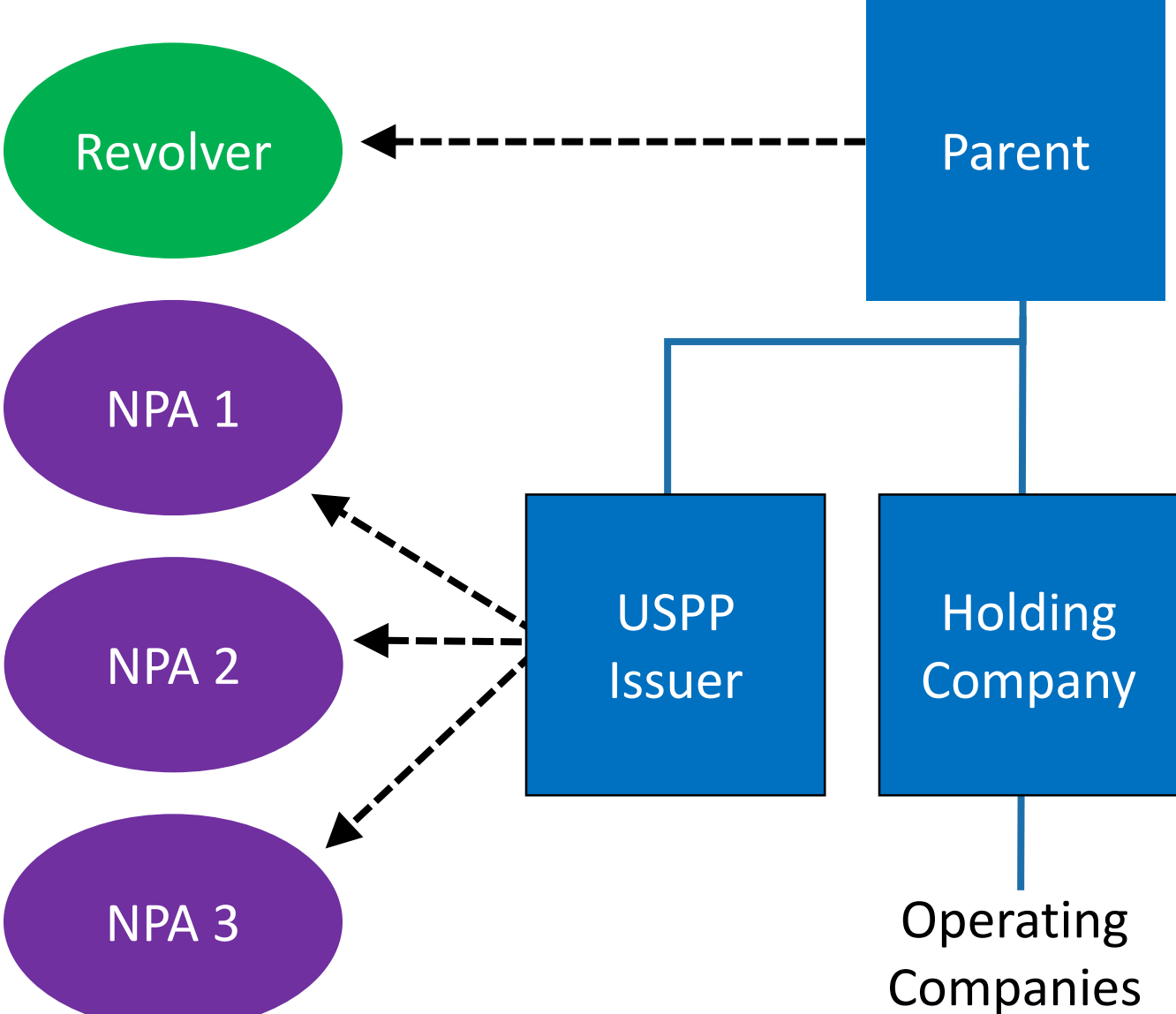
Katherine Lindsay, Morgan Lewis & Bockius LLP

Barry Russell, Akin Gump Strauss Hauer & Feld

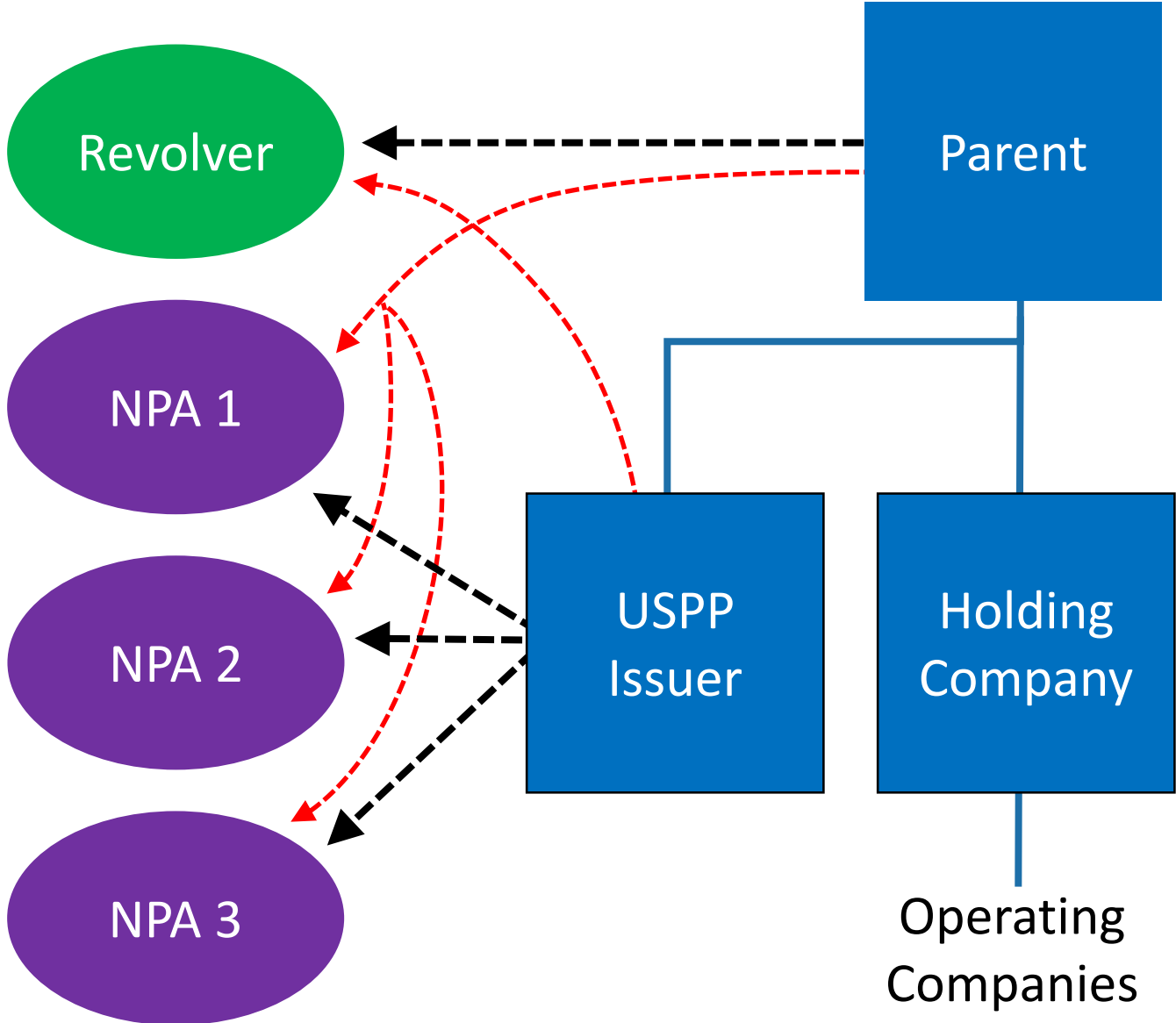
# The Structure



# Debt Structure



# Guarantee Structure



Revolver

- \$500 million
- Due 2023

NPA 1

- \$50 million
- Due 2019
- 3.08%

NPA 2

- \$100 million
- Due 2021
- 3.80%

NPA 3

- \$100 million
- Due 2027
- 4.68%

Revolver and Notes  
are Pari Passu and  
Unsecured

# The Scenario



# The Scenario

- The Noteholders have been monitoring the Company closely, and are increasingly concerned it will breach its financial covenants by year end.
- There is a difference of opinion as to whether the Company is experiencing a long-term decline in its business or a short term “blip”, from which it will recover.
- The Noteholders recently organized and retained their trusted restructuring counsel.
- Some Noteholders only hold the 2019 Notes, 2023 Notes or 2027 Notes. Others hold Notes of each of the maturities.

# The Company's Proposal

# The Company's Proposal

- The Company meets with Noteholders and tells them it wants to tap the equity markets with an underwritten equity issue. It has been advised that it will need financial covenant relief and additional liquidity.
- The Banks have agreed to increase the Revolver by \$200 million on the following conditions:
  - New Revolver Tranche 2 ranks senior to the Notes and existing Revolver Tranche 1
  - Revolver maturity (both tranches) shortens from 2023 to 2021
  - No other debt can be repaid until the new Revolver Tranche 2 has been repaid and cancelled.

# Amendment Request

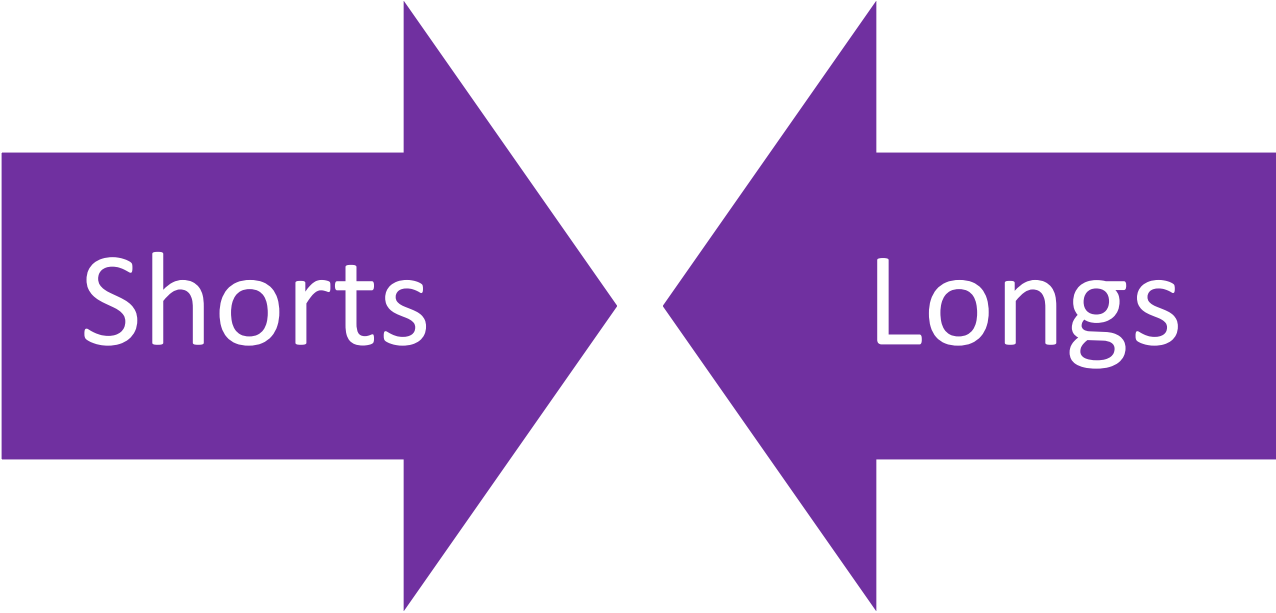
- All Noteholders are asked to:
  - Amend and loosen financial covenants for a 2 year period (to the end of 2020), after which they reset to current levels
  - Consent to the priority status for the new Revolver Tranche 2
- With no liquidity available to repay them and restrictions on repayment while the new Revolver Tranche 2 is outstanding, the 2019 Notes are asked to extend their maturity until 2021

# Compensation

- The Company has offered the following compensation:
  - For all Noteholders, a 25 bps work fee
  - For the 2019 Noteholders, a 25 bps extension fee

# Resulting Intercreditor Issues

- Proposed priority of Revolver Tranche 2 requires intercreditor negotiation between Notes and Banks to agree the terms and conditions of such priority
- Existing \$500 million Revolver Tranche 1 and Notes to remain pari passu
  - However, application of equity proceeds to be negotiated
- Loss-sharing and equalization arrangements to be agreed



Shorts

Longs

# Key Noteholder Issues

- Will the Company's business stabilize when the covenant tests reset?
- Willingness of 2019 Notes to extend their maturity
- Reaction of 2027 Notes
  - What legal arguments can be advanced to support their position?
  - Will they seek to shorten their own maturity?
  - If so, what position will they take with respect to treatment of make-whole?
- New maturity wall in 2021



# Key Noteholder Issues

- Allocation of additional compensation
- Should the 2019 Notes receive additional compensation?
- Amount and timing of anticipated equity proceeds
- Application of equity proceeds

# Poll Question # 1

When faced with a long-short negotiation, what matters most to your institution?

1. Economic outcome in the current situation
2. Setting a positive, consistent precedent (or avoiding a negative one) for future deals

# Poll Question # 2

Has your institution considered hiring separate outside counsel to assist with a long-short negotiation?

1. Yes
2. No, and I don't think it's constructive to do so
3. No, but I wouldn't rule it out

# Poll Question # 3

Would you prefer that investors continue to approach long-short issues on a strictly case-by-case basis or, in an effort to promote efficiency, should the investor community try to develop a consistent approach and even a set of guidelines for dealing with these issues?

1. I prefer a case-by-case approach
2. I like the idea of developing a consistent approach and guidelines

# Show Me The Money

**Corporate Valuation Disputes in  
Bankruptcy Court**

# VALUATION DISPUTES IN BANKRUPTCY

## PANELISTS

INTRODUCTION

POLLS

MARKET

EXPERT

MIDDLE GROUND

RESULTS

FURTHER READING

## **Aleks Zivanovic**

- Senior Counsel - John Hancock / Manulife

## **Anders J Maxwell**

- Managing Director - PJ Solomon  
amaxwell@pjsolomon.com

# VALUATION DISPUTES IN BANKRUPTCY

PANELISTS

**INTRODUCTION**

POLLS

MARKET

EXPERT

MIDDLE GROUND

RESULTS

FURTHER READING

- **Valuation Disputes & Judicial Valuation**  
**Decisions are key drivers of Chapter 11 outcomes**
  - Code says a lot about how value is to be apportioned
  - Code says very little about how that value is best determined
  
- **Schools of thought**
  - Market evidence
  - Expert opinion
  - Middle ground?

# VALUATION DISPUTES IN BANKRUPTCY

PANELISTS  
INTRODUCTION  
**POLLS**  
MARKET  
EXPERT  
MIDDLE GROUND  
RESULTS  
FURTHER READING

- **POLL QUESTION #4**
- Should Bankruptcy Judges Place More Emphasis on market data or expert testimony in determining corporate valuations in Chapter 11 cases?
  - A. Markets know best
  - B. Judges need experts to guide them



# VALUATION DISPUTES IN BANKRUPTCY

PANELISTS  
INTRODUCTION  
**POLLS**  
MARKET  
EXPERT  
MIDDLE GROUND  
RESULTS  
FURTHER READING

- **POLL QUESTION #5**
- Which of these methods do you believe offer bankruptcy judges better guidance on corporate valuations:
  - A. Comparable Transactions
  - B. Comparable Multiples
  - C. Discounted Cash Flow
  - D. Market Trading Data – Subject Co.
  - E. None or all the above

# VALUATION DISPUTES IN BANKRUPTCY

PANELISTS

INTRODUCTION

POLLS

**MARKET**

EXPERT

MIDDLE GROUND

RESULTS

FURTHER READING

- For Market evidence
  - Belief in efficient markets
  - Criticism of expert bias
  - Inconsistency with Finance Theory
  - Too Many Variables
  - Efficiency of Process

# VALUATION DISPUTES IN BANKRUPTCY

PANELISTS

INTRODUCTION

POLLS

**MARKET**

EXPERT

MIDDLE GROUND

RESULTS

FURTHER READING

- Efficient markets
  - Are distressed markets as efficient?
- Expert bias
  - Extremes vs Most Credible?
- Inconsistency with Finance Theory
  - Anna Karenina Problem
  - Only Systemic Risk Compensated
- Too Many Variables
  - DCF Particularly Problematic
- Efficiency of Process
  - Time & Money

# VALUATION DISPUTES IN BANKRUPTCY

PANELISTS  
INTRODUCTION  
POLLS  
MARKET  
**EXPERT**  
MIDDLE GROUND  
RESULTS  
FURTHER READING

- For Expert evidence
  - Inherently Subjectivity (Damodaran's Six Myths)
  - Inefficient market, particularly for 'Distressed' enterprises
  - Afford balanced judgement based on countervailing argument

# VALUATION DISPUTES IN BANKRUPTCY

PANELISTS

INTRODUCTION

POLLS

MARKET

**EXPERT**

MIDDLE GROUND

RESULTS

FURTHER READING

- For Expert evidence
  - Stakes in bankruptcy proceeding
  - Inevitable divergence of opinion
  - Acknowledged shortcomings of DCF
  - Legal precedent

# VALUATION DISPUTES IN BANKRUPTCY

- For Expert evidence
  - Case Study: “National Gypped-sum”

PANELISTS  
INTRODUCTION  
POLLS  
MARKET  
**EXPERT**  
MIDDLE GROUND  
RESULTS  
FURTHER READING

Total Enterprise Value<sup>(a)</sup> of National Gypsum: August 15, 1993<sup>(b)</sup> to January 1995  
(\$ millions)



Source: Bloomberg and Company Public Documents.

(a) Enterprise Value = Market Cap + Total Debt at Carrying Value - Cash + Minority Interest + Preferred Equity.

(b) National Gypsum emerged from bankruptcy on July 1, 1993, trading since August 15, 1993 is recorded.

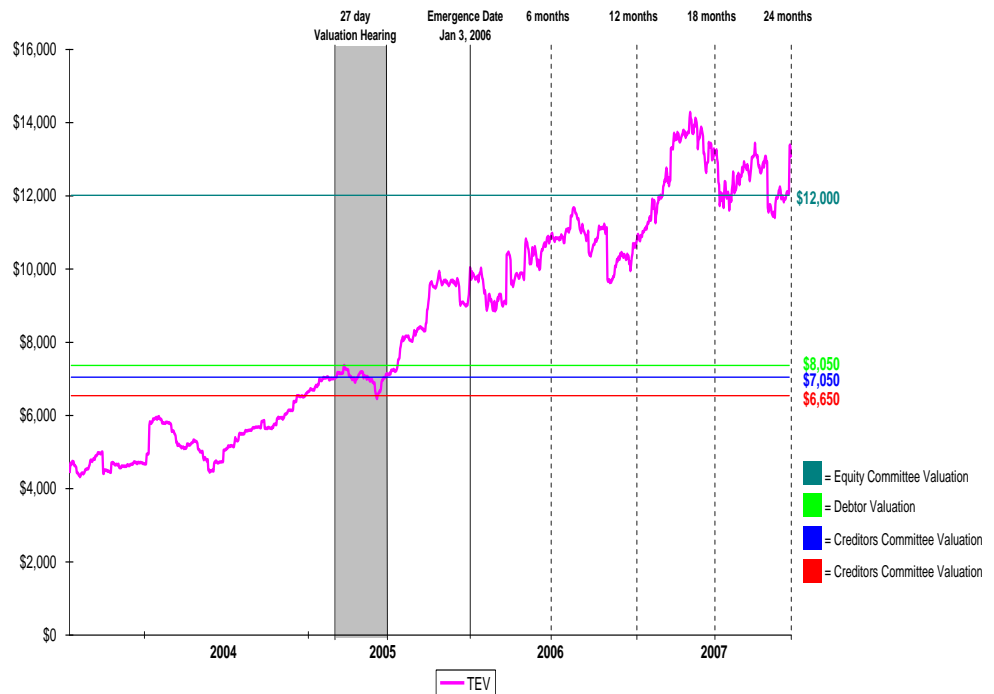
# VALUATION DISPUTES IN BANKRUPTCY

- For Expert evidence
  - Case Study: Roll Forward:  
Mirant 2005

Total Enterprise Value of Mirant Corp.: Chapter 11 Filing (July 2003) to January 2008

(\$ millions)

- PANELISTS
- INTRODUCTION
- POLLS
- MARKET
- EXPERT**
- MIDDLE GROUND
- RESULTS
- FURTHER READING



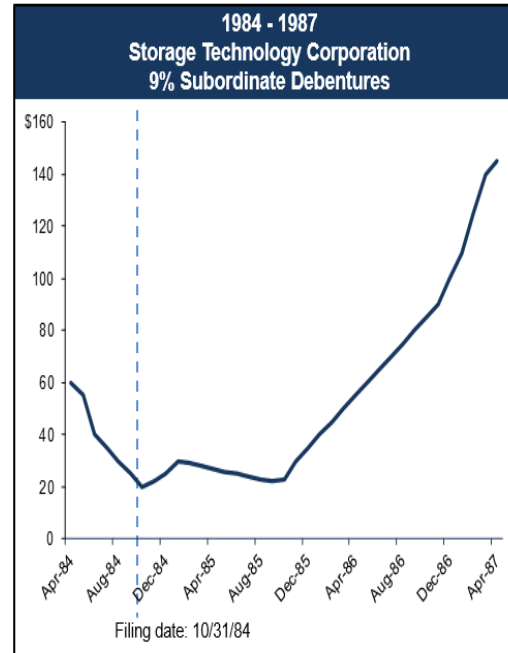
Source: Bloomberg and High-Yield Market.

(a) TEV = Total Debt - Cash + Market Cap + Minority Interest + Preferred Equity. Based on the assumption that divestment of assets since 2006 is for the purpose of repurchasing stock, Cash is adjusted for sale of assets and proceeds from investing activities of discontinued operations.

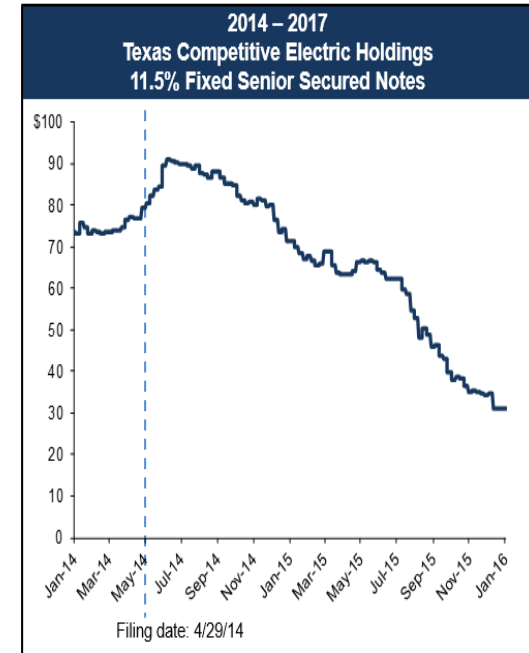
# VALUATION DISPUTES IN BANKRUPTCY

PANELISTS  
INTRODUCTION  
POLLS  
MARKET  
**EXPERT**  
MIDDLE GROUND  
RESULTS  
FURTHER READING

- For Expert evidence
  - Another Case in Point: The changing market for Distressed Securities



Source: Bloomberg



Source: Merrill Lynch

Note: Pricing is between six months prior to filing to two-plus years post-filing.



# VALUATION DISPUTES IN BANKRUPTCY

PANELISTS

INTRODUCTION

POLLS

MARKET

EXPERT

**MIDDLE GROUND**

RESULTS

FURTHER READING

- Middle Ground
  - Can scope be narrowed?
  - Is DCF more problematic than most?
  - Peer reviewed financial theory?

# VALUATION DISPUTES IN BANKRUPTCY

PANELISTS

INTRODUCTION

POLLS

MARKET

EXPERT

MIDDLE GROUND

**RESULTS**

FURTHER READING

- Results of Poll Question #4
  - Markets or Experts?
- Results of Poll Question #5
  - Favored Valuation Method

# VALUATION DISPUTES IN BANKRUPTCY

PANELISTS  
INTRODUCTION  
POLLS  
MARKET  
EXPERT  
MIDDLE GROUND  
RESULTS  
FURTHER READING

## BIBLIOGRAPHY

### Texts

Damodaran, A. (2002). Investment Valuation: Tools and Techniques for Determining the Value of Any Asset (2nd ed.). New York, NY: John Wiley & Sons, Inc.

This text covers the valuation of various assets, including stocks, bonds, options, futures, real assets, etc.

Damodaran, A. (2006). Damodaran on Valuation (2nd ed.). Hoboken, New Jersey: John Wiley & Sons, Inc.

This text explores many aspects of valuation, such as the fundamentals of estimating cash flows and discount rates to the principles underlying the use of multiples.

Damodaran, A. (2010). The Dark Side of Valuation (2nd ed.). Upper Saddle River, New Jersey: FT Press. (Original work published 2009)

The text covers the core tools of valuation, examines modern estimation questions and issues, and addresses valuation issues in a firm's lifecycle. Damodaran also addresses valuation of commodity firms, cyclical companies, financial services firms, organizations dependent on intangible assets, and global firms operating diverse businesses.

McKinsey & Company, Koller, T., Goedhart, M., & Wessels, D. (2005). Valuation: Measuring and Managing the Value of Companies (4th ed.). Hoboken, New Jersey: John Wiley & Sons, Inc. (Original work published 1990)

This text covers how to create, manage, and measure the value of an organization.

Stark, R.J., Siegel, H.L. and Weisfelner E.S. (2011). Contested Valuation in Corporate Bankruptcy. LexisNexis.

The source for practical insights into every facet of valuation!

# VALUATION DISPUTES IN BANKRUPTCY

PANELISTS  
INTRODUCTION  
POLLS  
MARKET  
EXPERT  
MIDDLE GROUND  
RESULTS  
FURTHER READING

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### Journals

- Ayotte, Kenneth, Morrison, Edward (2018, May). "Valuation Disputes in Corporate Bankruptcy". SSRN-id 3176182.pdf  
Current restatement of the record and shortcomings of expert testimony. Recently circulated on Harvard Law School Bankruptcy Roundtable.
- Fischel, D. R. (2002, Summer). "Market Evidence in Corporate Law". *The University of Chicago Law Review*, 69(3), 941-961. Retrieved from <http://www.jstor.org/stable/1600637>  
In this paper, Fischel argues that courts should rely more heavily on market prices when resolving valuation disputes than has occurred to date.
- Gilson, S. C., Hotchkiss, E. S., & Ruback, R. S. (2000, Spring). "Valuation of Bankrupt Firms". *The Review of Financial Studies*, 13(1), 43-74. Retrieved from <http://links.jstor.org/sici?sici=0893-9454%28200021%2913%3A1%3C43%3AVOBF%3E2.0.CO%3B2-A>  
This study compares the market value of firms that reorganize in bankruptcy with estimates of value based on their published cash flow projections. The authors find that the methods generally yield unbiased estimates of value, but the dispersion of valuation errors is generally very wide.
- Malkiel, B. G. (2003, April). "The Efficient Market Hypothesis and its Critics" (CEPS Working Paper No. 91). Princeton, NJ: Princeton University.  
In this paper, Malkiel addresses the efficient market hypothesis and its criticisms.
- Sontchi, Christopher. "Valuation Methodologies: A Judge's View", *ABI Law Review*, Vol. 20: 1-2012, View on the issue from the Bench.
- Stark, Robert, Williams, Jack, Maxwell, Anders (2013, August). "Market Evidence, Expert Opinion, and the Adjudicated Value of Distressed Businesses". *The Business Lawyer*, Vol. 68, Issue 4.  
Rebutting article by Schwartz and Bryan, "Campbell, Iridium, and the Future of Valuation Litigation".
- Widen, R. S. (n.d.). "Delaware Law, Financial Theory and Investment Banking Valuation Practice". *NYU Journal of Law and Business*, 579-604. Retrieved from <http://www.omm.com/files/upload/Widen-NYU-Delaware-Law.pdf>  
This article provides an overview of current Delaware law on business valuations using a discounted cash flow analysis. It discusses Delaware courts' views on the proper methods for calculating a weighted average cost of capital and a cost of equity, and the use of the Capital Asset Pricing Model and the Fama-French Model. The article also discusses Delaware courts' views toward methods of calculating terminal multiples in the context of discounted cash flow

### Court Findings

- Mirant Corporation, No. 03-46590-DML-11. (United States Bankruptcy Court for the Northern District of Texas Fort Worth Division Dec. 9, 2005).  
In this memorandum opinion, the court addresses the issue of how to determine the total enterprise value of the entities that make up Mirant Group.

VALUATION  
DISPUTES IN  
BANKRUPTCY

THANK YOU

Questions?