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Hot Spots in a Cold Bankruptcy World: Energy and Healthcare Restructurings

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- **Overview**

- Causal factors of distress in energy and healthcare sectors
- Typical capital structures for energy and healthcare companies
- Elements of typical energy and healthcare cases
- Legal issues common to energy and healthcare cases
- Legal issues unique to energy and healthcare cases



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I. CAUSAL FACTORS OF DISTRESS IN ENERGY AND HEALTHCARE SECTORS



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- **Energy Sector – Causal Factors of Distress:**
 - Price of the commodity
 - Liquidity issues
 - Exploration/development risks
 - Management issues
 - Borrowing base redeterminations
 - Current liabilities coming due
 - Vendor issues/liens
 - Overall leverage/stranded debt



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- **Healthcare Sector– Causal Factors of Distress:**
 - Payer mix/reimbursement
 - Competition
 - Management issues
 - Doctor issues
 - Overall leverage/stranded debt
 - Technology
 - Capital expenditure needs
 - Complex regulatory environments
 - Real estate and general economic conditions (CCRC)



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II. TYPICAL CAPITAL STRUCTURES FOR ENERGY AND HEALTHCARE COMPANIES



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- **Energy Sector – Typical Capital Structure:**
 - Reserve based lending (revolver/term)
 - Hedges/swaps
 - 2nd lien debt
 - Unsecured note/bonds
 - Key contracts
 - JOAs
 - Development agreements
 - AMIs
 - Gathering agreements
 - Seismic



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- **Healthcare Sector – Typical Capital Structure:**
 - Primary secured lender(s)
 - Unsecured notes
 - Tax exempt bonds and letters of credit
 - Challenges:
 - Unique lending criteria (e.g., management, occupancy rates, payer mixes) often lead to non-payment covenant defaults
 - Perfecting security interests in government receivables



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III. ELEMENTS OF TYPICAL ENERGY AND HEALTHCARE BANKRUPTCY CASES



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- **Elements of a Typical Energy Case:**

- A successful case depends on a number of factors
- Need to identify fulcrum security
- Valuation
- Adequate protection
- Vendor issues
- Emerging from bankruptcy



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- **Elements of a Typical Healthcare Case:**
 - Expedited timeline
 - Consideration of federal and state regulations
 - Involvement of a broad range of constituents
 - Challenges related to sale of healthcare assets
 - Recoupment and successor liability



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IV. LEGAL ISSUES COMMON TO ENERGY AND HEALTHCARE BANKRUPTCY CASES



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- **Common Legal Issues:**
 - First day hearings
 - Cash collateral and DIP financing
 - Adequate protection
 - Executory contracts and unexpired leases
 - State and federal regulatory impact



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V. LEGAL ISSUES UNIQUE TO ENERGY AND HEALTHCARE CASES



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- **Unique Issues in Energy Cases:**
 - Oil and gas leases: real property or unexpired lease
 - Executory contracts
 - Joint Operating Agreements – pref rights, consent rights
 - Gathering Agreements – covenants running with the land
 - Plugging and abandonment issues
 - Onshore/state regulatory
 - Offshore/BOEM/BSEE
 - Reserves depletion and impact on adequate protection issues and plan feasibility
 - Numerous parties, including royalty owners, working interest owners, and M&M claimants, can add complexity and potential disputes



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- **Unique Issues in Healthcare Cases:**

- The Absolute Priority Rule and NFPs

- Many healthcare cases involve not-for-profit entities (“NFPs”).
- Congress recognized the unique nature of NFPs.
- Courts give deference to the status and purpose of NFPs.
- Because of the structure and purpose of NFPs, the absolute priority rule should not apply.



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- **The Absolute Priority Rule and NFPs**

- When cramming down a plan over the objection of an impaired class, the Bankruptcy Code requires that a debtor establish that a plan is “fair and equitable.”
- Absolute priority rule prohibits the holder of any claim or interest junior to that of an impaired dissenter from receiving or retaining any property under the plan on account of such junior claim or interest.
- In determining whether an equity interest exists, courts have examined 3 factors: control, profit sharing and ownership of corporate assets.



- **The Absolute Priority Rule and NFPs**

- **Control**

- Seventh Circuit held that members of electrical cooperative that maintained control over the cooperative through a plan of reorganization do not hold equity interests because such control was divorced from the ability to generate profits or increase their own share of profits. *In re Matter of Wabash Valley Power Ass'n, Inc.*, 72 F.3d 1305, 1319-20 (7th Cir. 1995).

- **Profit Sharing**

- Seventh Circuit found that mere control over a debtor does not amount to an equity interest. Rather, such control must be coupled with a share of profits. *Id.*

- **Ownership of Corporate Assets**

- Ninth Circuit held that local union's international parent union did not have an equity interest in the local even though the international's constitution provided that, upon the local's liquidation, its assets would escheat to the international for two years or until the local was reorganized. *In re Gen. Teamsters, Warehousemen & Helpers Union, Local 890*, 265 F.3d 869, 876 (9th Cir. 2001).



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- **The Absolute Priority Rule and NFPs**

- Courts around the country have found that the absolute priority rule does not apply to various types of NFPs, including:
 - Hospital
 - CCRC
 - Electrical cooperative
 - Labor union
 - Native American rodeo organization



- **Healthcare Cases under Chapter 9 of the Bankruptcy Code**
 - **Eligibility requirements:**
 - A "municipality"
 - Specifically authorized, in its capacity as a municipality or by name, to be a debtor under Chapter 9 by state law, or by a governmental officer or organization empowered by state law to authorize such entity to be a debtor
 - Must be "insolvent" (current or prospective)
 - Desire to effect a plan to adjust its debts
 - Satisfy one of four creditor negotiation requirements
 - **Confirmation of Plan of Adjustment**
 - Share many of the same confirmation requirements as Chapter 11 with notable differences.



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QUESTIONS