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PRACTICAL CONSIDERATIONS FOR CHAPTER 11 RIGHTS OFFERING PROPONENTS

Although a backstopped rights offering can be a critical tool for successful chapter 11 exit financing, neither the Bankruptcy Code nor existing case law provides an express standard for approval of a rights offering or backstop agreement. In the absence of such a standard, it can be difficult to ascertain the likelihood of a challenge to these transactions until the debtor has already incurred significant resources and time. This article discusses certain risks and costs of prosecuting such a transaction that the debtor and other rights offering proponents should endeavor to consider, however difficult they may be to estimate.

By Scott R. Bowling and Shelby V. Saxon *

A backstopped rights offering¹ can be a critical tool for successful chapter 11 exit financing and, ultimately, a successful reorganization. From the debtor's perspective, they often check many restructuring needs: committed fresh capital, enhanced transaction certainty, shorter process duration, positive internal and external messaging, and support from a critical mass of impaired

fulcrum security holders. But a rights offering that proposes allocating economic rights (particularly through a backstop agreement) favorably to holders of some but not all of the claims or interests within the same class under a chapter 11 plan involves heightened risks associated with legal challenges, increased litigation costs, and the risk of case delays that can significantly impact a business reorganization. With no express standard for approval of a rights offering or backstop agreement set forth in the Bankruptcy Code or case law, it can be difficult to ascertain the likelihood of a challenge to such a transaction until the debtor has already incurred significant resources and time-seeking approval of the transaction. Yet — particularly where a chapter 11 debtor requires postpetition financing and must negotiate terms such as the size of the facility, the maturity date, a draw schedule, and case milestones prior to seeking Bankruptcy Court approval of a non-*pro rata*

¹ A rights offering in bankruptcy is a financing transaction in which a debtor offers holders of existing securities or claims the right to purchase new equity or debt securities in the reorganized company upon emergence, typically at an attractive discount to the assumed value of the reorganized company or other inducements to incentivize participation. Rights offerings are often "backstopped," meaning that certain claimants commit capital to purchase both their shares and any unsubscribed shares of rights offering securities, usually in exchange for compensation.

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