ALERT MEMORANDUM

SDNY Rules Transocean's August 2020 Internal Restructuring Does Not Violate Indenture for Existing Notes

December 23, 2020

On December 17, 2020, the United States District Court for the Southern District of New York (the "District Court") granted the summary judgment motion filed by Transocean Ltd. and Transocean Inc. (collectively, "Transocean" or the "Company") and entered a declaratory judgment in favor of Transocean with regard to securities claims brought by Whitebox Relative Value Partners, LP and certain of its affiliates (collectively, "Whitebox") with respect to Transocean's internal reorganization and exchange transactions that the Company undertook in August 2020 (the "Exchange Transaction").[1] Whitebox claimed that Transocean made material misstatements and omissions in violation of the Securities Exchange Act of 1934 in the offering memorandum for the Exchange Transaction pursuant to which 8.0% senior notes due 2027 (the "2027 Existing Notes") were exchanged for new 11.50% senior guaranteed notes due January 2027 (the "New Guaranteed Notes").

This is an important decision for bondholders with respect to the ability of corporate issuers to move assets within a corporate group to structurally subordinate investors who elect not to participate in an exchange transaction without violating the terms of the indenture (or seeking to amend the terms of such indentures through an accompanying consent solicitation). In particular, bondholders should be aware that the potentially protective reach of boiler plate "successor obligation" clauses that require corporate successors to remain liable for the undertakings of their predecessor may not apply where the transferor remains the 100% ultimate beneficial owner of the assets transferred. This decision is also important for companies considering both in-court and out-of-court restructuring options. If companies are contemplating asset transfers within the corporate group as part of such transactions, companies should prepare to have such transactions closely scrutinized by stakeholders and, potentially, courts.

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[1] The Court ruled that the default notice that Whitebox sent to the Company on September 2, 2020 was invalid and concluded that "any associated rights or remedies for Whitebox, including acceleration of the 2027 Existing Notes, are unavailable." Whitebox Relative Value Partners v. Transocean, 20 Civ. 7143, *14 (GBD) (S.D.N.Y. Dec. 16, 2020).

Background on the Transactions and the Complaint

Transocean is the world's largest offshore drilling contractor for oil and gas wells based on revenue and is based in Vernier, Switzerland. The Company, which has approximately $8b of total debt outstanding, contracts its mobile offshore drilling fleet consisting of 38 rigs (including 27 ultra-deepwater floaters and 11 harsh environment floaters), related equipment and work crews primarily on a dayrate basis to drill oil and gas wells in technically demanding regions (with a particular focus on ultra-deepwater and harsh environment drilling services).[2] The oil industry has experienced significant oversupply leading to a decline in prices spurred both by a reduction in demand due to COVID-19 and by production disputes among major oil producing countries.[3] As a result, many drilling rig customers reduced capital expenditures and delayed investment decisions for the remainder of 2020 resulting in several previously sanctioned offshore projects being either delayed or cancelled.[4] Given these conditions, the drilling industry has seen significant chapter 11 bankruptcy activity in 2020.[5]

On August 10, 2020, Transocean announced an exchange offer applicable to three series of its structurally senior notes, including the 2027 Existing Notes along with its 7.50% senior notes due 2026 and its 7.25% senior notes due 2025, (collectively, the "Existing Guaranteed Notes") totaling $2.25b to be exchanged for up to $750m of New Guaranteed Notes. As part of the exchange, Transocean completed an internal restructuring whereby the Company caused three of its wholly-owned subsidiaries, Transocean Holdings 1 Limited, Transocean Holdings 2 Limited and Transocean Holdings 3 Limited (the "Upper Tier Notes Guarantors") to contribute all of their assets (direct equity interests in certain asset holding companies which own the Company's operating assets (collectively, the "Asset Holding Companies")) to each of three recently-created mid-tier notes guarantors, Transocean Mid Holdings 1 Limited, Transocean Mid Holdings 2 Limited and Transocean Mid Holdings 3 Limited (the "Mid-Tier Notes Guarantors") which would only guarantee the New Guaranteed Notes.[6] The effect of this transaction was that the holders of the New Guaranteed Notes would have structural seniority over the Existing Guaranteed Notes – including the 2027 Existing Notes.[7]

On September 2, 2020, two days before the exchange offer was set to expire, funds managed by, or affiliated with, Whitebox, as holders of the 2027 Existing Notes, filed a complaint, described above in the U.S. District Court for the Southern District of New York, alleging violations of the Securities Exchange Act of 1934.[8] Specifically, Whitebox alleged that Transocean included false statements and withheld material facts in the exchange offering memorandum and consent solicitation for the New Guaranteed Notes by allegedly falsely claiming that the New Guaranteed Notes would

2 Transocean Ltd. Form 10-Q, November 2, 2020.

3 Id.

4 Id.

5 On April 26, 2020, Diamond Offshore Drilling Inc., the rig contractor controlled by Loews Corp., filed chapter 11 bankruptcy in the United States Bankruptcy Court Southern District of Texas with $2.6 billion of debt. In re Diamond Offshore Drilling, 20-32307 (DRJ) (S.D.T.X. 2020). On July 31, 2020, Noble Corporation plc, the offshore drilling contractor, filed a petition in the United States Bankruptcy Court for the Southern District of Texas seeking to cut more than $3.4 billion of debt. Noble Corporation plc, 20-33826 (DRJ) (S.D.T.X. 2020). On August 19, 2020, Valaris plc, the offshore drilling contractor with the world's largest fleet filed for chapter 11 in the United States Bankruptcy Court for the Southern District of Texas with $7.85 billion of debt. Valaris plc, 20-34114 (MI) (S.D.T.X. 2020). On November 2, 2020, Pacific Drilling S.A. filed Chapter 11 bankruptcy in the United States Bankruptcy Court for the Southern District of Texas to implement the terms of a consensual financial restructuring transaction to eliminate approximately $1.1 billion of the company's debt. In re Pacific Drilling, 20-35212 (DRJ) (S.D.T.X. 2020). On December 1, 2020 Seadrill Partners, an affiliate of offshore contract driller Seadrill Ltd., filed chapter 11 bankruptcy in the United States Bankruptcy Court Southern District of Texas with $3.12 billion in debt. In re Seadrill Partners, 20-35740 (DRJ) (S.D.T.X. 2020).

6 Whitebox Relative Value Partners v. Transocean, 1:20-cv-07143 (GBD) [ECF No. 60] (S.D.N.Y. Dec. 16, 2020).

7 Transocean is also party to a revolving credit agreement, dated June 22, 2018 (as amended, the "Revolving Credit Facility"), which is structurally senior to the unsecured debt securities issued by Transocean, including the Existing Guaranteed Notes, to the extent of the value of the assets held by the Asset Holding Companies.

8 Complaint, 20 Civ. 7143 1:20-cv-07143 (GBD) [ECF No. 3] (S.D.N.Y. Dec. 16, 2020).

be structurally senior to the 2027 Existing Notes.[9] At the time of the filing of the complaint, there was $612 million in aggregate principal amount of 2027 Existing Notes outstanding.[10] That same day, Whitebox and funds managed by, or affiliated with, Pacific Investment Management Company LLC ("PIMCO"), as holders of about 25% in aggregate principal amount of the 2027 Existing Notes, delivered a notice of default to Transocean. Whitebox requested a temporary restraining order and preliminary injunction with respect to the exchange offer, which the Court denied on September 3, 2020. Transocean filed a motion for summary judgment on September 24, 2020, and Whitebox filed a cross-motion for summary judgement on October 4, 2020.[11] On October 28, 2020, the parties had oral argument on Transocean's and Whitebox's respective motions.

The Parties' Arguments

The parties agreed on the basic facts: the Existing Guaranteed Notes are guaranteed by the Upper Tier Notes Guarantors, which as part of Transocean's internal August 2020 restructuring, transferred all their assets into the newly created Mid-Tier Notes Guarantors subsidiaries but did not cause the Mid-Tier Notes Guarantors to guarantee the Existing Guarantee Notes.[12] Whitebox claimed that this transfer violated the "successor obligation" covenant in the indenture for the 2027 Existing Notes, which provides that if an Upper Tier Notes Guarantor transfers all or substantially all of its assets, the transferee must assume the Upper Tier Notes Guarantor's obligations to guarantee the 2027 Existing Notes.[13] Whitebox argued the covenant requires Transocean to specifically preserve the structural seniority of the guarantee in the event of an internal reorganization whereby the Upper Tier Notes Guarantors transfer or dispose of all or substantially all of their assets to other subsidiaries.[14] Whitebox maintained that the transaction Transocean completed was a transfer of all or substantially all of the assets of the Upper Tier Notes Guarantors to the Mid-Tier Tier Notes Guarantors, thus triggering the "successor obligation" provision.[15]

Transocean, on the other hand, argued that its internal restructuring transaction was explicitly allowed by the indenture governing the 2027 Existing Notes. Transocean first argued that the "successor obligation" provision was not implicated because the transfer of assets from the Upper Tier Notes Guarantors to the Mid-Tier Tier Notes Guarantors was not a transfer of all or substantially all of the assets of the Upper Tier Notes Guarantors because the Upper Tier Notes Guarantors remained indirect equity owners of the Asset Holding Companies.[16] Transocean also argued that the "successor obligation" provision is mere "boilerplate" and does not apply to "internal" transfers where value is not leaving the Company.[17] Transocean focused on the permissibility of the exchange debt under the indenture's debt incurrence provisions,

9 Complaint, [ECF No. 3] ¶ 2.

10 Transocean noted in its 3Q 2020 10-Q that if the Court ultimately determines that an event of default exists under either the indenture governing the 2027 Existing Notes, it is possible all unpaid principal, interest and other obligations under indentures governing such series of notes would be accelerated (unless waived) which could also trigger a default under the Company's revolving credit facility which, if not waived, could result in a termination of the commitments and acceleration of all outstanding borrowings.

11 Transocean Motion for Summary Judgment, 20 Civ. 7143 1:20-cv-07143 (GBD) [ECF No. 24] (S.D.N.Y. Dec. 16, 2020); Whitebox Cross Motion for Summary Judgment, 20 Civ. 7143 1:20-cv-07143 (GBD) [ECF No. 38] (S.D.N.Y. Dec. 16, 2020).

12 Complaint, [ECF No. 3] ¶ 8.

13 The "Successor Obligation" provision in the Indenture for 2027 Existing Notes reads "[a] Subsidiary Guarantor may . . . sell, lease, convey, transfer or otherwise dispose of all or substantially all of its assets to any Person . . . provided however, that in the case of the . . . sale, lease, conveyance, transfer or disposal of all or substantially all of the assets of such Subsidiary Guarantor . . . if such other Person is not the Parent, the Issuer or another Subsidiary Guarantor, such Subsidiary Guarantor's obligations under its Securities Guarantee must be expressly assumed by such other Person, except in connection with a transaction in which the Securities Guarantee of such Subsidiary Guarantor would be released as provided in Section 11.06." [Indenture for 2027 Existing Notes, Section 11.03].

14 Complaint, [ECF No. 3] ¶ 9.

15 Complaint, [ECF No. 3] ¶ 29,31.

16 Memorandum of Law in Support of Transocean Motion for Summary Judgment, [ECF No. 25], *20-21.

17 Id.

specifically section 4.04(a)(12) which allows the Company to incur up to $2.4 billion in debt that is structurally senior to the existing notes held by Whitebox.[18]

Transocean's Second Internal Restructuring Transaction

On November 30, 2020, a day before Whitebox's unremedied notice of default could have ripened into an event of default under the indenture for the 2027 Existing Notes, Transocean completed a second "internal reorganization" transaction designed to cure the default alleged by Whitebox while having the same net effect on the guarantees as the Transocean's first internal restructuring transaction. Specifically, the second internal restructuring ensured that the New Guaranteed Notes would remain structurally senior to the 2027 Existing Guaranteed Notes.

To accomplish this goal, Transocean effectuated the second internal restructuring through a series of transactions and amendments to both its existing Revolving Credit Facility and the indentures for the New Guaranteed Notes so that the Mid-Tier Notes Guarantors, which were the subject of Whitebox's default notices, were eliminated by being merged into the Upper Tier Notes Guarantors.[19] As a result of the merger, the Upper Tier Notes Guarantors continued to directly hold the equity interests of the Asset Holding Companies, as they did prior to the Company's August 2020 restructuring transactions.[20] To provide structurally senior guarantees to the New Guaranteed Notes, and to maintain the structural seniority of the Revolving Credit Facility, which was required by that agreement, Transocean created a new set of wholly-owned subsidiaries below the Asset Holding Companies, Transocean Sub Asset Holdings 1 Limited, Transocean Sub Asset Holdings 2 Limited and Transocean Sub Asset Holdings 3 Limited (collectively, the "Sub Asset Holdings Entities").[21] The Sub Asset Holdings Entities received the assets of the Asset Holdings Companies.[22] The Sub Asset Holdings Entities, now holding the assets formerly held by the Asset Holding Companies, guarantee the obligations under the Revolving Credit Facility.[23] The Asset Holding Companies themselves (now one level up from the assets) guarantee certain other obligations, including the New Guaranteed Notes. Given the second restructuring transaction, Transocean submitted a letter to the Court, arguing that Whitebox's claims based on the transfer of equity in the Asset Holding Companies to the Mid-Tier Notes Guarantors were rendered moot but still asked the Court to issue a ruling.[24]

The District Court's Decision

The Court granted summary judgment in favor of Transocean and found that Transocean's first internal reorganization did not violate the "successor obligation" provision of the indenture governing the 2027 Existing Notes.[25] The Court also noted that the second reorganization in November 2020 "appear[s] to have remedied any alleged harm to Whitebox."[26]

The Court concluded that the first "internal reorganization" did not constitute a transfer of all or substantially all assets of the guarantors of the 2027 Existing Notes for purposes of the "successor

18 Id., *15-16.

19 Transocean Ltd. Form 8-k, December 1, 2020.

20 Transocean Letter to Judge Daniels, [ECF No. 57].

21 Transocean Ltd. Form 8-k, December 1, 2020.

22 Id.

23 To effectuate the second internal restructuring, Transocean entered into an amendment with the lenders to the Company's Revolving Credit Facility, which provided, among other things, that the Sub Asset Holdings Entities would guarantee the obligations under the Revolving Credit Facility and permitted the Asset Holding Companies to, among other things, guarantee the New Guaranteed Notes.

24 Id. Transocean noted in its letter to the Court that the same "successor obligation" provision appears in other debt of the Company and Transocean wanted clarity on the issue in the event it sought to undergo future restructuring transactions with respect to that debt.

25 Memorandum Decision and Order, [ECF No. 60].

26 Id. *5. As noted above, Transocean submitted a letter to the Court, asking the Court to issue a ruling despite its belief that that second internal restructuring mooted Whitebox's claim. Whitebox also submitted a letter to the Court arguing the second restructuring did not moot their potential damage claims if Transocean breached the indenture for the 2027 Existing Notes and asked the Court to render a decision. Whitebox Letter to Judge Daniels, [ECF No. 58].

obligation" provision in the indenture.[27] The Court analyzed both the quantitative and qualitative aspects of the transaction to determine whether a transfer of all or substantially all the assets of the Upper Tier Notes Guarantors occurred. Qualitatively, the Court noted that relevant factors to determine whether a transfer of all or substantially all the assets occurred include the "overall effect of the transaction on the company" and whether the transaction "substantially changed the nature or charter of the entity's business."[28] The Court found that there was no "substantive change to the fundamental purpose" of the Upper Tier Notes Guarantors, as both before and after the transaction, the Upper Tier Notes Guarantors were still holding companies that indirectly owned the same underlying assets.[29] Quantitatively, the Court looked at the economic value of the assets of the Upper Tier Notes Guarantors.[30] Here, the Court found no changes in the economic interests of the Upper Tier Notes Guarantors as their equity interests in the newly created Mid-Tier Notes Guarantors was based on the same operating assets and equivalent to their previous equity interest in the Asset Holding Companies (although now with an extra layer in between). The Court noted that because the same underlying assets remained available to satisfy the Upper Tier Notes Guarantors' debt, "the economic value of the [Upper Tier Notes Guarantors'] assets was unchanged."[31]

Conclusion

This decision is relevant for both bondholders and companies considering restructuring transactions to allow for the incurrence of additional, structurally senior debt. The Court found that a "successor obligation" provision is not implicated where a subsidiary guarantor holding company downstreams all of its equity interests in certain lower tier subsidiaries to newly created intermediate subsidiaries that do not assume the transferor's guarantee obligations. The Court's "all or substantially all" analysis may also be relevant to future skirmishes between corporate issuers and holdout investors because the Court accepts the notion that as long as the transferor holding company remains the ultimate owner of the assets, and the value of the assets has not changed, the test is not triggered. If adopted by other courts, corporate issuers may be able to argue in similar circumstances that all the assets of one member of a group could be moved to another without giving rise to other provisions of an indenture including mandatory prepayment obligations or events of default based on sales of "all or substantially all" assets.

Although Transocean was ultimately successful in its arguments before the Court, the Company scrapped the first internal restructuring transaction in favor of a second internal restructuring which had the same effect as the initial internal restructuring but mooted Whitebox's claims with respect to the "successor obligation" provision.[32] Moving forward, Transocean has indicated that it may pursue similar transactions to the first internal restructuring – and other companies with similar capital structures and debt documents may do so as well. Of course, the Court's decision may not be the last word, as Whitebox has 30 days from the December 16th order to appeal.

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27 Id. *13-14.
28 Id. *8.
29 Id.
30 Id. *9.
31 Id. The Court also rejected Whitebox's argument that because the Upper Tier Notes Guarantors transferred "all" their equity interests in the Asset Holding Companies to the Mid-Tier Notes Guarantors there was no need to conduct a close analysis to determine if the "successor obligation" provision applied. The Court noted that "Whitebox cannot avoid an inquiry into whether all of the assets of the Upper Tier [Notes] Guarantors were transferred by simply claiming that all of the assets were transferred." Id. *10.
32 This was likely because the Court had not issued a decision by the date which a purported default under the Indenture would ripen into an event of default.