UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE:	§	**Chapter 11**
	§	
COBALT INTERNATIONAL ENERGY, INC., *et al.*[1]	§	**CASE NO. 17-36709 (MI)**
	§	
	§	
Debtors.	§	**(Jointly Administered)**

WHITTON PETROLEUM SERVICES LIMITED'S OBJECTION TO THE DEBTORS' AMENDED DISCLOSURE STATEMENT [RELATES TO DOC. NO. 430]

TO THE HONORABLE MARVIN ISGUR,
UNITED STATES BANKRUPTCY JUDGE:

Whitton Petroleum Services Limited ("Whitton"), a creditor and party in interest in the above-captioned bankruptcy case, hereby submits this Objection to the Disclosure Statement for the Amended Joint Chapter 11 Plan of Cobalt International Energy, Inc. and its Debtor Affiliates [Doc. No. 430] (the "Disclosure Statement") and respectfully states as follows:

SUMMARY OF OBJECTION

The Debtors' Disclosure Statement contains deficiencies that preclude creditors from making informed decisions about whether to vote in favor of the Debtor's Amended Chapter 11 Plan of Reorganization (the "Plan") [Doc. No. 429].[2] Specifically, the Debtors' Disclosure Statement lacks adequate information concerning the estimated recovery for holders of Cobalt General Unsecured Claims and Subsidiary General Unsecured Claims (together, the "General Unsecured Claims") under the Debtors' Plan. The Disclosure Statement also fails to adequately

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: Cobalt International Energy, Inc. (1169); Cobalt International Energy GP, LLC (7374); Cobalt International Energy, L.P. (2411); Cobalt GOM LLC (7188); Cobalt GOM # 1 LLC (7262); and Cobalt GOM # 2 LLC (7316) (the "Debtors"). The Debtors' service address is: 920 Memorial City Way, Suite 100, Houston, Texas 77024. References herein to the "Debtors" refer, as applicable, to the Debtors and their non-debtor subsidiaries and affiliates.

[2] Capitalized terms used but not otherwise defined herein shall have the meaning provided in the Plan.

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disclose the amount and intended treatment of potentially substantial Intercompany Claims, which, based on the Debtors' schedules, may include an alleged claim of ***over $6 billion*** owed from Cobalt International Energy, L.P. ("Cobalt L.P.") to Cobalt International Energy, Inc. ("Cobalt Inc.").[3] Relatedly, neither the Disclosure Statement nor the Plan contains information regarding the nature and origin of the Intercompany Claims, which is imperative for creditors who may seek to equitably subordinate or reclassify the Intercompany Claims as equity. Without a clear description of the Intercompany Claims, including their intended priority *vis a vis* general unsecured claims, creditors lack information that is crucial to assessing whether the Plan is fair and complies with applicable requirements of the Bankruptcy Code.

BACKGROUND

a. The Bankruptcy Case

1. On December 14, 2017, (the "Petition Date"), the Debtors filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Southern District of Texas (the "Bankruptcy Court"). The Debtors are operating their businesses and managing their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

2. On January 23, 2018, the Debtors filed their original Joint Chapter 11 Plan and Disclosure Statement [Doc. Nos. 273 and 274]. On February 19, 2018, the Debtors filed the Amended Plan and Disclosure Statement (previously defined as the "Plan" and "Disclosure Statement," respectively)a. The Debtors' Plan provides for the liquidation of substantially all of the Debtors' businesses through a Sale Transaction under chapter 11 of the Bankruptcy Code. As set forth in the Disclosure Statement, distributions under the Plan will be funded by the Sale

[3] Whitton reserves all rights to contest the amount and allowance of the Intercompany Claims.

Transaction Proceeds, Cash on hand, and any other Cash received or generated by the Debtors. *See* Disclosure Statement at 11.

b. Whitton and the Overriding Royalty Agreement

3. Whitton is party to that certain Overriding Royalty Agreement Relating to Blocks Located Offshore Angola (the "Whitton ORA") by and between Whitton and Cobalt L.P. dated February 13, 2009. The Whitton ORA entitles Whitton to a cash consideration ("Cash Value") in the event that the Debtors and/or the Angolan Subsidiaries assign all or any part of their interests in the Angola assets (the "Angola Assets") to a third party free of Whitton's overriding royalty interest, and sets out the mechanics by which the Cash Value should be calculated under such circumstances.

4. On December 21, 2017 the Debtors filed a Motion for Entry of an Order (I) Authorizing Performance Under Settlement Agreement, (II) Approving Settlement Agreement, and (III) Granting Related Relief (the "Settlement Motion") [Doc. No. 127]. Among other things, the Settlement Motion sought approval of a settlement agreement (the "Settlement Agreement") that would: (i) resolve certain ongoing arbitration between the Debtors and Sonangol, (ii) transition the Debtors' Angolan Assets to Sonangol, and (iii) require two cash payments from Sonangol to the Debtors—an initial installment of $150 million upon Court approval of the Settlement Motion and Agreement, and second installment of $350 million between February 23, 2018 and July 1, 2018.

5. On January 25, 2018, the Court entered an Order Approving the Settlement Motion (the "Settlement Order"), which authorized the Debtors and their non-debtor subsidiaries to transfer the Angola Assets to Sonangol and to take other actions necessary to "perform under and consummate the Settlement Agreement" [Doc. No. 300]. The Settlement Order also

provided that, upon payment in full by Sonangol of $500 million pursuant to the Settlement Agreement: (i) the transition of interests in the Angola Assets to Sonangol would constitute an "assignment" of the Debtors percentage interest in Blocks 20 and 21 under Section 8.1 of the Whitton ORA (the "Assignment"); (ii) immediately upon the Assignment, the Debtors will be deemed to have made an irrevocable election to Whitton that it has elected to pay Whitton the Cash Value in accordance with Clause 8.1(c) of the Whitton ORA; and (iii) the Cash Value shall be expressly agreed or determined in accordance with Clause 8.8 of the Whitton ORA. *See* Settlement Order at ¶ 6.

LEGAL STANDARD

6. A disclosure statement must contain "adequate information" pursuant to Bankruptcy Code Section 1125(b), which provides, in part:

> An acceptance or rejection of a plan may not be solicited … unless, at the time of or before such solicitation, there is transmitted [] the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing by the court as containing adequate information.

Adequate information is defined as:

> information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of claims or interests in the relevant class to make an informed judgment about the plan . . . .

11 U.S.C. § 1125(a)(1); *see also In re Cajun Elec. Power Co-op, Inc.*, 150 F.3d 503, 518 (5th Cir. 1998) (citing to the legislative history, which favors a case-by-case determination as to what constitutes adequate information for the particular debtor involved).

7. Factors relevant for evaluating the adequacy of a disclosure statement include the estimated return to creditors under a Chapter 7 liquidation and projections relevant to the creditor's decision to accept or reject the Chapter 11 plan. *See In re U.S. Brass Corp.*, 194 B.R.

420, 424–45 (Bankr. E.D. Tex. 1996) (listing relevant factors for evaluating the adequacy of a disclosure statement, including "the estimated return to creditors under a Chapter 7 liquidation" and "projections relevant to the creditors' decision to accept or reject the Chapter 11 plan").

8. In evaluating whether a disclosure statement contains adequate information, the Court has substantial discretion. *See In re Texas Extrusion Corp.*, 844 F.2d 1142, 1157 (5th Cir. 1988) (stating that "[t]he determination of what is adequate information is subjective and made on a case-by-case basis. This determination is largely within the discretion of the bankruptcy court."). Importantly, "[t]he code requires that the debtors adequately, not selectively, disclose fully and precisely all information a creditor would reasonably want before voting on the plan." *Westland Oil Dev. Corp.* v. *MCorp Mgmt. Solutions, Inc.*, 157 B.R. 100, 104 (S.D. Tex. 1993).

OBJECTION

a. Approval of the Debtors' Disclosure Statement should be denied because it fails to provide adequate information regarding the expected recoveries for holders of General Unsecured Claims.

9. The Disclosure Statement does not provide "adequate information" as required by Section 1125(b) because it fails to provide projected recoveries for holders of Cobalt General Unsecured Claims and Subsidiary General Unsecured Claims. Instead, the projected recovery table on pages 8-10 of the Disclosure Statement contains bracketed placeholders in the cells that should disclose expected recoveries for general unsecured creditors. *See* Disclosure Statement at 8-10. The Disclosure Statement also contains bracketed placeholders in the cells that should disclose the projected amount of Cobalt General Unsecured Claims and Subsidiary General Unsecured Claims. *See id.*

10. Likewise, the Disclosure Statement's discussion of the Debtors' capital structure contains ***no*** description of the Debtors' unsecured debt, such as trade debt, litigation liabilities, and anticipated contract rejection damages. According to the Debtors' schedules, these

categories include millions of dollars of unsecured claims. Liabilities of this magnitude could have a material impact on distributions under the Plan, and should be addressed in the Disclosure Statement. *See, e.g.,* Schedules of Assets and Liabilities for Cobalt International Energy, L.P. and Cobalt International Energy, Inc. [Doc. Nos. 335 and 337].

11. Because the Disclosure Statement lacks even a basic description of the Debtors' unsecured debt—as well as of projected recoveries for holders of General Unsecured Claims under the Plan—creditors are unable to make informed decisions regarding whether to vote in favor of the Plan. *See In re U.S. Brass Corp.*, 194 B.R. at 423-24 (noting that "the purpose of the disclosure statement is . . . to provide enough information to interested persons so they can make an informed choice" and relevant factors include "projections relevant to the creditors' decision to accept or reject the Chapter 11 plan"). Accordingly, approval of the Disclosure Statement should be denied unless the Debtors "fully and precisely" disclose all information regarding General Unsecured Claims that creditors need to know before voting on the Plan. *See Westland Oil Dev. Corp.*, 157 B.R. at 104.

b. Approval of the Debtor's Disclosure Statement should be denied because it fails to provide adequate information regarding the amount and intended treatment of substantial Intercompany Claims.

12. The Disclosure Statement is deficient because it fails to disclose the amount and intended treatment of substantial Intercompany Claims. According to the Debtors' schedules, the Intercompany Claims may include an alleged claim of ***over $6 billion*** owed from Cobalt L.P. to Cobalt Inc. If valid, this Intercompany Claim is by far the largest liability of Cobalt L.P., and has the potential to swamp the recovery pool for General Unsecured Claims and substantially dilute recoveries for holders of Subsidiary General Unsecured Claims.

13. Despite the potentially significant impact of the Intercompany Claims on recoveries for holders of General Unsecured Claims, the Disclosure Statement provides no clarity regarding how the Intercompany Claims will be treated under the Plan.[4] Instead, the Plan and Disclosure Statement provide that:

> Intercompany Claims may be, at the option of the Debtors, either (i) Reinstated as of the Effective Date or (ii) cancelled; *provided* that no distribution shall be made on account of such Claims, and any Reinstatement will be solely to determine the right or entitlement of other holders of Claims to recoveries.

See Plan at 20.

14. This language appears to invite the possibility of two diametrically opposed outcomes, the determination of which is in the sole discretion of the Debtors. Moreover, it is unclear what circumstances, if any, may result in distributions to holders of Intercompany Claims.[5] Generally, cancellation of the Intercompany Claims should not result in a distribution, while reinstatement should have the opposite effect. Although the language states that any reinstatement would be "solely to determine the right or entitlement of other holders of Claims to recoveries," the Debtors offer no explanation regarding what this means, or why such a reinstatement would be necessary.

15. The Debtors' failure to clearly describe their intended treatment of Intercompany Claims in the Disclosure Statement exposes holders of General Unsecured Claims to substantial uncertainty and makes it impossible for them to cast an informed vote on the Plan. Accordingly,

[4] Intercompany Claims are carved out of the definitions of Cobalt General Unsecured Claims and Subsidiary General Unsecured Claims under the Plan, and will receive treatment as a separate class.

[5] Further, if holders of Intercompany Claims are to receive a distribution, neither the Plan nor the Disclosure Statement discloses whether the Debtors propose to pay Intercompany Claims before or after General Unsecured Claims. While the Plan clearly provides that Allowed Cobalt General Unsecured Claims will be paid after Allowed Subsidiary General Unsecured Claims, there is no such language indicating the priority of Intercompany Claims *vis a vis* General Unsecured Claims.

approval the Disclosure Statement should be denied unless the Debtors clarify the amount and intended treatment of Intercompany Claims under the Plan.

c. Approval of the Debtors' Disclosure Statement should be denied because it fails to provide adequate information regarding the origin and nature of the Intercompany Claims.

16. In addition to failing to disclose the amount and intended treatment of the Intercompany Claims, the Disclosure Statement fails to explain the nature and origin of the Intercompany Claims. While the Disclosure Statement contains a robust discussion of the Debtors' secured and unsecured notes and common stock—including their inception dates and noteworthy historical events related to the debt—the Disclosure Statement contains absolutely ***no*** explanation of the Intercompany Claims. For example, the Disclosure Statement offers no description of whether the Intercompany Claims originated from documented intercompany loans, guaranty obligations, or other intercompany obligations.

17. Adequate disclosure regarding the Intercompany Claims is imperative for creditors who may seek to equitably subordinate or re-characterize the substantial Intercompany Claims as equity interests.[6] Thus, in order to satisfy the requirements of 1125(b), the Disclosure Statement should provide information sufficient to enable creditors to assess whether the Intercompany Claims could be re-characterized as equity under applicable law. In the Fifth Circuit, courts look to applicable state law when evaluating re-characterization. *See In re Lothian Oil Inc.*, 650 F.3d 539, 544 (5th Cir. 2011). Some commonly considered factors in a re-characterization analysis include: (1) the intent of the parties; (2) the names given to the instruments, if any, evidencing the indebtedness; (3) the extent of participation in management

[6] Notably, if the Intercompany Claims are re-characterized as equity, paying them before or *pari passu* with General Unsecured Claims would violate the absolute priority rule, which prohibits junior constituents from receiving property on account of their claims or interests before senior creditors are paid in full. *See* 11 U.S.C. § 1129(b)(2)(B); *see also Matter of Greystone III Joint Venture*, 995 F.2d 1274, 1282 (5th Cir. 1991) (discussing the codification of the absolute priority rule).

by the holder of the instrument; (4) the ability of the corporation to obtain funds from outside sources; (5) the thinness of the capital structure in relation to debt; (6) the risk involved; (7) the formal indicia of the arrangement; (8) the relative position of the obliges as to other creditors regarding the payment of interest and principle; (9) the voting power of the holder of the instrument; (10) the provision of a fixed rate of interest; (11) a contingency on the obligation to repay; (12) the source of the interest payments; (13) the presence of absence of a fixed maturity date; (14) a provision for redemption by the corporation; (15) a provision for redemption at the option of the holder; (16) the timing of the advance with reference to the organization of the corporation; and expanded upon in *Lothian Oil* with (17) the name or title of the instrument and (18) the right to enforce payment of principle and interest. *Fin Hay Realty Co. v. United States*, 398 F.2d 694 (3d Cir. 1968)); *see also In re Autobacs Strauss, Inc.*, 473 B.R. 525, 572,73 (Bankr. D. Del. 2010); *In re Am. Housing Found.*, No. 09-20232-RLJ, 2015 WL 1543585 at *13-14 (Bankr. N.D. Tex. Mar. 31, 2015) (applying and expanding upon, eleven-factor test promulgated in *Fin Hay*).

18. Accordingly, approval the Disclosure Statement should be denied unless the Debtors disclose information sufficient to enable creditors to assess whether the Intercompany Claims may be re-characterized as equity according to the above-described factors.

CONCLUSION

Unless the Debtors remedy the Disclosure Statement inadequacies outlined herein, Whitton respectfully requests that the Court enter an Order denying approval of the Disclosure Statement and granting such other relief as the Court may deem appropriate.

Dated: February 20, 2018

PORTER HEDGES LLP

By: */s/ John F. Higgins*

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CERTIFICATE OF SERVICE

I hereby certify that on February 20, 2018, a true and correct copy of the foregoing document was duly served by electronic transmission to all registered ECF users appearing in the case.

/s/ *John F. Higgins*
John F. Higgins