

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

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In re: : Chapter 11
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COBALT INTERNATIONAL ENERGY, INC., *et al.*,¹ : Case No. 17-36709 (MI)
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Debtors. : (Jointly Administered)
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**LIMITED OBJECTION OF AD HOC COMMITTEE OF UNSECURED
NOTEHOLDERS TO DEBTORS’ EMERGENCY MOTION FOR ENTRY OF INTERIM
AND FINAL ORDERS (I) AUTHORIZING POSTPETITION USE OF CASH
COLLATERAL, (II) GRANTING ADEQUATE PROTECTION TO THE PREPETITION
SECURED PARTIES, (III) MODIFYING THE AUTOMATIC STAY, (IV)
SCHEDULING A FINAL HEARING, AND (V) GRANTING RELATED RELIEF**

The Ad Hoc Committee of Unsecured Noteholders (the “Ad Hoc Committee”) hereby submits this limited objection (the “Limited Objection”) to the *Debtors’ Emergency Motion for Entry of Interim and Final Orders (I) Authorizing Postpetition Use of Cash Collateral, (II) Granting Adequate Protection To The Prepetition Secured Parties, (III) Modifying The Automatic Stay, (IV) Scheduling a Final Hearing, And (V) Granting Related Relief* [Docket No. 14] (the “Motion”).² This Court entered an order approving the Motion on an interim basis on December 14, 2017 [Docket No. 57] (the “Interim Order”). In support of its Limited Objection, the Ad Hoc Committee respectfully states as follows:

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’ service address is: 920 Memorial City Way, Suite 100, Houston, Texas 77024.

² Capitalized terms used and not defined herein shall have the meanings ascribed to them in the Motion.



PRELIMINARY STATEMENT

1. The Proposed Final Order, if entered, would provide the Prepetition Secured Parties with an adequate protection package that exceeds what is permitted by the Bankruptcy Code and what is necessary under these circumstances.³ The Proposed Final Order purports to grant adequate protection for diminution in value of the Prepetition Secured Parties' interest in the Prepetition Collateral "in any way," as opposed to the traditional and more limited formulation that would grant adequate protection only for diminution in value of the Prepetition Secured Parties' interest in the Prepetition Collateral caused by the Debtors' sale, use or lease of the Prepetition Collateral or the imposition of the automatic stay. There is no basis in law or fact to provide the Prepetition Secured Parties—to the detriment of unsecured creditors—with the more expansive formulation of diminution in value in the Proposed Final Order.

2. Moreover, the Proposed Final Order includes a number of stipulations by the Debtors that purport to bind all parties in interest, including with respect to the Applicable Premium (as defined in each of the First Lien Indenture and the Second Lien Indenture, as applicable). The Ad Hoc Committee does not object in concept to the inclusion of binding stipulations in the Proposed Final Order, but there must be limits on the scope and effect of those stipulations. Here, in the interest of caution, the Ad Hoc Committee requested that the First Lien Ad Hoc Group revise the Proposed Final Order to make clear that the binding stipulations would

³ As of the date of this Limited Objection, the Debtors have not filed a proposed form of final order (the "Proposed Final Order") although the Ad Hoc Committee was recently provided with a draft from the First Lien Ad Hoc Group. The objection deadline for the Ad Hoc Committee has been extended by the Debtors pending discussions over the Proposed Final Order. The Ad Hoc Committee therefore assumes for the purposes of this Limited Objection that the Proposed Final Order, when filed, will include the same terms and conditions as the draft Proposed Final Order made available to the Ad Hoc Committee, and any references or citations in this Limited Objection to provisions of the Proposed Final Order are generally to such provisions as they are set forth in the Interim Order, with some modifications as noted herein based on the latest version of such draft Proposed Final Order. The Ad Hoc Committee has filed this Limited Objection to apprise the Court of its concerns and preserve its rights; however, discussions continue and the Ad Hoc Committee is hopeful that some or all of the objections raised herein will be resolved prior to the hearing on the Motion.

not preclude reinstatement of the First Lien Notes or Second Lien Notes pursuant to a chapter 11 plan if reinstatement becomes warranted.⁴ This clarification has not been forthcoming. Any attempt today to prevent the reinstatement of the First Lien Notes or Second Lien Notes is not appropriate and the Proposed Final Order should be clarified.

3. The Proposed Final Order also adds language that had been removed by the Court in the Interim Order relating to the termination of the stay under section 362 of the Bankruptcy Code that would allow the Prepetition Secured Parties to exercise any and all remedies in the event there is an Event of Default under the Proposed Final Order. The First Lien Notes Secured Parties have not contributed new money and are grossly oversecured. Any rights beyond the mere termination of *consensual* use of Cash Collateral is inappropriate.

4. Finally, the official committee of unsecured creditors (the “Creditors’ Committee”) has interposed an objection that raises certain additional issues. The Ad Hoc Committee intends to rely on the Creditors’ Committee with respect to any argument relating to these additional issues; however, the Ad Hoc Committee supports generally the Creditors’ Committee objection.

LIMITED OBJECTION

5. The Bankruptcy Code permits a secured party to request or receive “adequate protection” of its interest in a debtor’s property when the debtor intends to use, or borrow against, that property following the petition date, or when such party is stayed from enforcing its rights as to its interest. *See* 11 U.S.C. §§ 362(d), 363(c)(2), 363(e), 364(d).

6. Section 361 of the Bankruptcy Code provides that a debtor may provide adequate protection to a secured party by doing, among other things, the following:

⁴ This request for a clarification was made with proposed language to the Debtors on January 2, 2018.

(1) requiring the trustee to make a cash payment or periodic cash payments to such entity, *to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 . . . , or any grant of a lien under section 364 . . . results in a decrease in the value of such [party's] interest in such property;*

(2) providing to such [party] an additional replacement lien *to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such [party's] interest in such property;*
or

(3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) . . . as an administrative expense, as will result in the realization by such [party] of *the indubitable equivalent of such [party's] interest in such property.*

11 U.S.C. § 361 (emphasis added).

7. The concept of adequate protection is derived from the protection of interests in property required by the Fifth Amendment. *See Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935). The protection that is required is only for the value of a secured party's interest in its prepetition collateral and only to the extent that there is a decrease in the value of that interest as a result of the stay under section 362 of the Bankruptcy Code, the use, sale, or lease under section 363 of the Bankruptcy Code, or any grant of a lien under section 364 of the Bankruptcy Code. *See, e.g., In re Timbers of Inwood Forest Assocs., Ltd.*, 793 F.2d 1380, 1389 (5th Cir. 1986), *on reh'g*, 808 F.2d 363 (5th Cir. 1987), *aff'd, sub nom., United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988) (“[T]he language of the adequate protection provisions suggests that they were intended to protect a secured creditor against a decrease in the value of its collateral *due to the debtor's use, sale or lease of that collateral during the stay.*”) (emphasis added). It is well settled that adequate protection should not be used to improve the position of secured creditors in

relation to other creditors. *See In re Weinstein*, 227 B.R. 284, 297 (B.A.P. 9th Cir. 1998) (noting that “[p]ermitting such a bonus would be akin to providing the undersecured creditor with interest or lost opportunity costs which is expressly prohibited by *Timbers*”). Likewise, adequate protection should not be used to unduly tilt the bankruptcy process to the detriment of unsecured creditors or to otherwise predetermine treatment under a chapter 11 plan.

8. The following provisions included in the Proposed Final Order appear to contravene these basic principles and should be modified accordingly:

- Cause of Diminution in Value: The Proposed Final Order would entitle the Prepetition Secured Parties to adequate protection for diminution in the value of their interests in Prepetition Collateral from and after the Petition Date “*in any way*” during these chapter 11 cases. (Proposed Final Order ¶ 4.) As discussed above, the Bankruptcy Code contemplates that secured parties receive adequate protection *only* to the extent that such diminution is the result of the stay under section 362 of the Bankruptcy Code or the Debtors’ use, sale, or lease of the Prepetition Collateral (including Cash Collateral) under section 363 of the Bankruptcy Code. *See* 11 U.S.C. § 361.
- Aggregate Diminution in Value: The Proposed Final Order does not expressly provide that it is the aggregate value of the Prepetition Secured Parties’ interests in the Prepetition Collateral that is entitled to protection. (Proposed Final Order ¶ 4.) To preclude the potential for argument later in these cases, the Proposed Final Order should be revised to make clear that “Diminution in Value” is not measured by reference only to the Prepetition Secured Parties’ interests in specific items of Prepetition Collateral. For instance, courts have held that the use of a secured creditor’s cash collateral to maintain or increase the value of such creditor’s non-cash collateral constitutes adequate protection. *See, e.g., In re Residential Capital, LLC*, 501 B.R. 549, 597 (Bankr. S.D.N.Y. 2013) (holding that, unless aggregate value of cash and non-cash collateral falls below value of collateral on petition date, creditor is not entitled to compensation for amount of cash collateral spent); *In re Las Vegas Monorail Co.*, 429 B.R. 317 (Bankr. D. Nev. 2010).
- Applicable Premium under Reinstatement Plan: The Proposed Final Order provides that the Debtors stipulate that, as of the Petition Date, they are justly indebted to the Prepetition Secured Parties in aggregate amounts that include the respective “Applicable Premium” under each of the First Lien Indenture and Second Lien Indenture, as applicable. (Proposed Final Order ¶¶ D.1.(a), (b).) The Debtors also stipulate that no portion of the

Applicable Premium is subject to set-off, avoidance, impairment, disallowance, recharacterization, reduction, subordination, counterclaims, recoupment, cross-claims, defenses, or any other challenges under or pursuant to the Bankruptcy Code or applicable law. (*Id.* ¶ D.2.) Although nothing in the order purports to determine the treatment of the Prepetition Secured Parties' claims under a chapter 11 plan, to avoid the potential for argument later in these cases, the Final Proposed Order should be revised to make clear that nothing in it (including the stipulations) (a) precludes any party in interest from proposing, pursuing, soliciting or obtaining confirmation of a chapter 11 plan that reinstates the First Lien Notes or the Second Lien Notes (a "Reinstatement Plan") or (b) determines whether and to what extent (i) the First Lien Notes Secured Parties and Second Lien Notes Secured Parties are entitled to a claim for the Applicable Premium under a Reinstatement Plan or (ii) the First Lien Notes Secured Parties are entitled to keep Interest Payments at the default contract rate under a Reinstatement Plan.

- Procedures Relating to "Claims and Defenses": The Proposed Final Order binds non-Debtor third parties to the Debtors' stipulations subject to certain exceptions. (Proposed Final Order ¶ 7.) Among other stipulations, the Proposed Final Order appears require a party in interest to (i) obtain standing by order of the Court to bring a Claim or Defense and (ii) bring any Claim or Defense by commencing an adversary proceeding. (*Id.*) However, under the Bankruptcy Code and Bankruptcy Rules, parties in interest already have standing to bring certain Claims and Defenses and need only do so by way of a contested matter—*e.g.*, an objection to the Prepetition Secured Parties' claims. *See* 11 U.S.C. §§ 502 (a), (b), 1109(b). The Proposed Final Order should be revised to not impose procedural hurdles that contravene the Bankruptcy Code and Bankruptcy Rules.
- Right to Exercise Remedies Without Further Notice: The Proposed Final Order permits the Prepetition Secured Parties to exercise rights and remedies available under the Prepetition Loan Documents following an Event of Default and the expiration of a five business day notice period absent further order of the Court. (Proposed Final Order ¶ 6.)⁵ The Proposed Final Order should be revised to permit the Prepetition Secured Parties to exercise remedies only after obtaining an order from the Court after an Event of Default lifting or otherwise modify the stay under section 362.

⁵ This provision was included in ¶ 6 of the latest version of the Proposed Final Order made available to the Ad Hoc Committee.

RESERVATION OF RIGHTS

9. This Limited Objection is without prejudice to, and the Ad Hoc Committee hereby fully reserves, its rights to raise additional arguments in respect of the Motion and the Proposed Final, and to seek other appropriate relief if the circumstances warrant.

CONCLUSION

WHEREFORE, based on the foregoing, the Court should (a) deny entry of the Proposed Final Order absent the Debtors remedying the infirmities identified in this Limited Objection and (b) grant the Ad Hoc Committee any other and further relief that is just and proper.

Dated: January 23, 2018

Respectfully submitted,

COLE SCHOTZ P.C.

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CERTIFICATE OF SERVICE

I hereby certify that on January 23, 2018, a true and correct copy of the foregoing document was served via email on the parties entitled to receive service through the Court's CM/ECF system.

/s/ Michael D. Warner

Michael D. Warner