

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

)	
In re:)	Chapter 11
)	
COBALT INTERNATIONAL ENERGY, INC., <i>et al.</i> , ¹)	Case No. 17-36709 (MI)
)	
Debtors.)	(Jointly Administered)
)	

**DEBTORS’ OMNIBUS REPLY IN SUPPORT OF
DEBTORS’ MOTION FOR ENTRY OF AN ORDER (I) APPROVING
BIDDING PROCEDURES FOR THE SALE OF THE DEBTORS’ ASSETS,
(II) SCHEDULING AN AUCTION, (III) APPROVING THE FORM AND MANNER OF
NOTICE THEREOF, (IV) SCHEDULING HEARINGS AND OBJECTION DEADLINES
WITH RESPECT TO THE DEBTORS’ DISCLOSURE STATEMENT AND
PLAN CONFIRMATION, AND (V) GRANTING RELATED RELIEF**

The above-captioned debtors and debtors in possession (collectively, the “Debtors”) respectfully submit this omnibus reply in support of the *Debtors’ Motion for Entry of an Order (I) Approving Bidding Procedures for the Sale of the Debtors’ Assets, (II) Scheduling an Auction, (III) Approving the Form and Manner of Notice Thereof, (IV) Scheduling Hearings and Objection Deadlines with Respect to the Debtors’ Disclosure Statement and Plan Confirmation, and (V) Granting Related Relief* [Docket No. 15] (the “Motion”)² and in response to the limited objections thereto filed by Chevron U.S.A. Inc. (“Chevron”) [Docket No. 157] and the creditors’ committee [Docket No. 247] and respectfully state 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, LP (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 but not otherwise defined herein shall have the meanings ascribed to them in the Motion.

Introduction

1. On the first day of these cases, the Debtors moved for approval of bidding procedures and a case schedule to drive their restructuring to an efficient and value-maximizing sale of their businesses and confirmation of a chapter 11 plan that will distribute value (monetized through a sale) to the Debtors' stakeholders. Approval of the bidding procedures and schedule is in the best interests of the Debtors' estates and, the Debtors believe, is supported by the vast majority of the Debtors' key stakeholders, including ad hoc groups of the first lien, second lien, and unsecured noteholders as well as the creditors' committee.

2. This support is testament to the Debtors' work before and after filing for chapter 11 to build consensus. Toward this end, the Debtors and their advisors engaged in numerous discussions with stakeholders (or their advisors) including the committee, ad hoc groups of their secured and unsecured noteholders, the U.S. Trustee, and the Department of Justice on behalf of certain regulatory agencies. These discussions resulted in modifications to the bidding procedures and schedule regarding, among other things, the bid requirements, the stakeholder consultation process and auction procedures, contract counterparties' access to adequate assurance information, and maintaining flexibility to implement a sale through or outside of a chapter 11 plan.

3. The Debtors have also negotiated a revised timeline as set forth below, which the Debtors believe is acceptable to all key parties in interest.

Event	Original Proposed Date	Revised Proposed Date
Disclosure Statement Objection Deadline	February 12, 2018	February 20, 2018
Disclosure Statement Hearing	February 14, 2018	February 23, 2018
Solicitation Deadline	February 16, 2018	February 26, 2018
Bid Deadline	February 19, 2018	February 22, 2018

Event	Original Proposed Date	Revised Proposed Date
Auction	February 27, 2018	March 6, 2018
Plan Objection Deadline	March 16, 2018	March 26, 2018
Voting Deadline	March 16, 2018	March 26, 2018
Confirmation Hearing	March 20, 2018	March 30, 2018

4. In the face of the broad consensus among the Debtors' creditor stakeholders stands Chevron, the only party that has raised a substantive objection to any feature of the Debtors' proposed bidding procedures. Chevron—a joint owner in and counterparty to the Debtors' unit operating agreement for the Anchor asset—is one of the world's largest integrated energy companies and has a significant presence in the deepwater Gulf of Mexico. In its objection, Chevron seeks to modify the bidding procedures to, among other things, preserve an alleged contractual right of first refusal to purchase the Debtors' assets.³

5. Chevron's objection is without merit and should be overruled because the proposed sale process—for all of the Debtors' businesses, including in the deepwater Gulf of Mexico—is not subject to Chevron's right of first refusal under the express terms of the underlying contract. More specifically, Chevron's right of first refusal does not apply to a proposed sale of all, or substantially all of the Debtors' assets in the deepwater Gulf of Mexico. Moreover, even if Chevron's right of first refusal were to apply to the proposed sale of the Debtors' assets out of bankruptcy, the bidding procedures and the open and public auction contemplated here should be deemed to satisfy that right.

³ In addition, Chevron requests that the Debtors include a process for obtaining information related to adequate assurance of future performance under executory contracts (which the Debtors have included in a revised proposed form of order); a right for any party to cause the Debtors to withhold information from potential bidders (unnecessary in light of the Debtors' compliance with governing confidentiality arrangements); and a right for any contract counterparty to attend the auction (unnecessary in light of parties' notice and objection rights and potentially creating an unwieldy auction).

6. Finally, assuming for the sake of argument that Chevron's right of first refusal **both** applies to the proposed sale of the Debtors' assets (it does not) **and** remains unsatisfied after the in-court bidding process (it should not), it would nevertheless be unenforceable as a restriction on the Debtors' rights to assign estate property in a value-maximizing transaction. *See In re Adelpia Comm. Corp.*, 359 B.R. 65, 87 (Bankr. S.D.N.Y. 2009) ("Section 365(f) renders unenforceable not only provisions which prohibit assignment **outright**, but also lease [or contract] provision[s] that are so restrictive that they constitute de facto anti-assignment provisions." (emphasis in original)); *In re Mr. Grocer*, 77 B.R. 349, 352 (Bankr. D.N.H. 1987) (rights of first refusal are *per se* unenforceable under section 365(f)).

7. For the reasons set forth herein and in the Motion, the Bankruptcy Court can and should approve the bidding procedures. The Debtors have agreed to revise the bidding procedures and the Bidding Procedures Order, in each case reflecting modifications agreed to by the Debtors and their stakeholders. Accordingly, the Debtors respectfully request that the Court overrule the objections and enter the Bidding Procedures Order and the bidding procedures, which the Debtors will file in revised proposed form.

Reply

I. The Bidding Procedures and Schedule Should Be Approved.

A. The Debtors and Their Advisors Have Worked Cooperatively with Their Stakeholders to Develop and Revise the Bidding Procedures.

8. The revised bidding procedures and case calendar are the product of arm's-length discussions between the Debtors and their stakeholders. Through the course of these discussions, the Debtors agreed on a number of modifications to the bidding procedures and schedule based on input received from various parties in interest, including secured creditors, the committee, and the Department of Justice (on behalf of certain regulatory agencies).

9. The Debtors carefully considered alternatives and modifications to the bidding procedures and determined in their judgment that the contemplated sale process (on the revised timeline) will maximize value to the Debtors' estates. In short, the revised bidding procedures are the cooperative framework by which the Debtors seek to pursue a sale of their assets for the benefit of all stakeholders.

II. The Objections Should Be Overruled.

A. The Committee's Objection Has Been Resolved by the Debtors' Revisions.

10. The Debtors have worked diligently with the committee and its advisors to negotiate mutually acceptable proposed bidding procedures. As a result of these discussions, the Debtors have made modifications to the proposed revised Bidding Procedures Order that have resolved any concerns the committee may have had. Accordingly, the committee's limited objection should be overruled as moot.

B. Chevron's Right of First Refusal Does Not Apply to the Proposed Sale of the Debtors' Assets Pursuant to the Express Terms of the Parties' Contractual Agreements.

11. In its objection, Chevron claims a right of first refusal for the Debtors' Anchor assets pursuant to provisions contained in the Anchor Prospect Offshore Operating Agreement dated effective November 26, 2013 (as amended) and the Anchor Prospect Unit Operating Agreement dated effective February 1, 2014 (as amended) (collectively the "Anchor Unit Agreements"). Chevron argues that the bidding procedures should be modified to include language preserving its alleged contractual right of first refusal, in lieu of the existing language deeming any such preferential right of purchase to have been satisfied. This request should be denied. Chevron's right of first refusal does not apply to the proposed sale of the Debtors' assets by its own terms.

12. Specifically, both Anchor Unit Agreements contain an identical section 24.2.3 entitled “Transfer of Interest Not Affected by the Preferential Right to Purchase,” which provides in pertinent part as follows:

Article 24.2 (Preferential Right to Purchase) shall not apply when a Party proposes to . . . dispose of its Working Interest by . . . a Transfer of Interest of all or substantially all of a Party’s exploration and production properties in the Gulf of Mexico in water depths greater than 1200 feet;

Anchor Unit Agreements, art. 24.2.3.

13. Here, because the Debtors *are* proposing to sell all or substantially all of their exploration and production properties in the deepwater Gulf of Mexico, Chevron’s right of first refusal is inapplicable by its own terms. Because Chevron could not exercise its right of first refusal in the context of the proposed sale, its objection should be overruled.

C. The Bidding Procedures Should Be Deemed to Satisfy Chevron’s Right of First Refusal.

14. Even if Chevron’s right of first refusal were applicable to the proposed sale of the Debtors’ assets, the bidding procedures and the open and public auction they propose should be deemed to satisfy any such right. The reason for this is simple: Chevron can attend the auction and exercise its alleged right of first refusal simply by placing the winning bid. In other words, there is no need for the bidding procedures to “preserve” Chevron’s right of first refusal given that the bidding procedures already satisfy any such right by its own terms.

15. Ordinarily, in an out-of-court sale, a right of first refusal would be necessary because the sale would first be negotiated in private, and only then, as a last step, would Chevron be entitled to notice of the sale and an opportunity to exercise its right.⁴ Here, Chevron has prior

⁴ Rights of first refusal are common in the oil and gas industry. See Harlan Abright, *Preferential Right Provisions and Their Applicability to Oil and Gas Instruments*, 32 SW. L.J. 803, 803 (1979) (“An important, yet often overlooked, provision commonly included in oil and gas instruments, particularly, joint operating agreements . . . and unit operating agreements, is one providing for a preferential right to purchase.”).

notice of the potential sale proposed by the Debtors, and an opportunity to bid at auction. Effectively, Chevron enjoys exactly the same benefits as it would have enjoyed in a private sale where its right of first refusal would be applicable and therefore suffers no prejudice.

D. Chevron’s Right of First Refusal Should Be Found Unenforceable.

16. Furthermore, even if Chevron’s right of first refusal were applicable to the proposed sale and remained unsatisfied, it would nevertheless be unenforceable as a restriction on the Debtors’ rights to assign estate property in a value-maximizing transaction. Specifically, courts have refused to enforce, or have modified, a right of first refusal in a chapter 11 sale context, in certain circumstances. Section 365(f)(1) provides that a debtor in possession may assign an executory contract notwithstanding a provision in the contract “that prohibits, restricts, or conditions the assignment of such contract.” 11 U.S.C. § 365(f)(1); *see also In re Adelpia*, 359 B.R. at 87. Courts evaluating the enforceability of a right of first refusal must therefore determine whether the provision imposes so heavy a burden on the ability to assign the contract that it should be rendered unenforceable. *ConocoPhillips Co. v. Dahlberg*, No. 10-285, 2011 WL 710604, at *1 n.2 (S.D. Tex. Feb. 22, 2011) (citing *Hicks v. Castille*, 313 S.W.3d 874, 883 (Tex. App. 2010); *Tenneco Inc. v. Enterprise Products Co.*, 925 S.W.2d 640, 646 (Tex. 1996) (“[C]ourts narrowly construe rights of first refusal.”)).

17. At least one court has gone so far as to hold that rights of first refusal are *per se* unenforceable under section 365(f). *See In re Mr. Grocer*, 77 B.R. at 352. Other courts have rejected the *per se* rule in favor of a “facts and circumstances test” under which the court examines the specific facts of the case and fashions relief based on whether the right of first refusal acts as a sufficient burden on assignability that it should be ruled unenforceable. *See, e.g., In re Farmland Indus., Inc.*, 284 B.R. 111 (Bankr. W.D. Mo. 2002) (reopening bidding on closed auction where party holding right of first refusal was not given notice of the auction); *In re Todd*, 118 B.R. 432,

435–36 (Bankr. D.S.C. 1989) (granting highest bidder opportunity to raise bid after third party sought to exercise its right of first refusal).

18. It is commonly acknowledged that a right of first refusal can act to discourage potential bidders from submitting a bid. *In re Adelpia*, 359 B.R. at 86 (refusing to enforce a right of first refusal due to its chilling effect upon bids); *In re ATP Oil & Gas Corp.*, No. 12-36187 (MI) (Bankr. S.D. Tex.) Feb. 14, 2013 Hr’g Tr. 33:6–8 (noting in dicta on a reservation of a right of first refusal: “Is that going to, for example, chill bidding, so we need to do an early resolution on that, or can a resolution of that reservation be made after the bidding occurs?”). Here, enforcing Chevron’s right of first refusal (in spite of the plain language in the Anchor Unit Agreements) would create a chilling effect on potential bids.

19. Although courts diverge on whether a chilling effect is sufficient to invalidate a right of first refusal, the surrounding circumstances are often considered in such an analysis. *See, e.g., In re Adelpia*, 359 B.R. at 86 (invalidating a right of first refusal where a group of assets were being sold, only some of which were subject to the preferential right of purchase). A primary consideration in evaluating whether a right of first refusal should not be enforced is whether such chilling effects may result in the bankruptcy estate failing to realize the highest possible value for its assets.

20. Here, the Debtors’ ability to maximize the value of their assets for the benefit of their stakeholders could be jeopardized if Chevron were able to stand idly by, sitting on its right of first refusal. Any prospective winning bidder would be faced with the possibility of losing the assets to Chevron even after the auction is conducted. This outcome would benefit neither the Debtors’ estates nor any other party in interest (save Chevron). In light of the foregoing, Chevron’s objection should be overruled in regards to its right of first refusal.

E. The Revised Bidding Procedures Provide Contract Counterparties with Adequate Assurance Information, Mooting Chevron's Objection on this Issue.

21. In its objection, Chevron requests that a successful bidder provide adequate assurance of future performance information to each contract counter-party included in their respective bids. The Debtors have added language to resolve this issue into their revised bidding procedures, and therefore Chevron's objection is moot and should be overruled on this point.

F. Confidential Information Is Adequately Protected, Mooting Chevron's Objection on this Issue.

22. Chevron's objection also requests that the bidding procedures and proposed sale process be consistent with certain confidentiality provisions in the Anchor Unit Agreements. The Debtors will comply with all such obligations, and will protect all confidential, proprietary, and commercially-sensitive information required by their contractual agreements. Accordingly, Chevron's objection on this point is moot, and should be overruled.

G. Chevron May Attend the Auction and Place a Bid and Is Therefore Not Prejudiced.

23. Finally, Chevron argues that the bidding procedures prevent it from participating in the auction without placing a bid. This argument is without merit. In fact, Chevron may follow the bidding procedures, attend the auction, and place a bid, just the same as any other bidder.

24. Chevron cites no specific statutory or precedential authority to support its argument that it should be permitted to attend the auction without complying with the terms of the bidding procedures. Although Chevron does broadly cite to sections 363, 365, and 1109 of the Bankruptcy Code in its argument, nothing in those sections mandates that auctions be open to parties who have not complied with the terms of the bidding procedures.

25. In addition, nothing in the bidding procedures prejudices the rights of Chevron or any other party in interest to object at the appropriate time to the sale, the assignment of any

contract, or to the adequate assurance offered by any potential assignee/purchaser. As such, Chevron's argument that it must attend the auction should be overruled.

Conclusion

26. For the foregoing reasons, the Debtors respectfully submit that the bidding procedures should be approved. As such, the Debtors respectfully request that the Court overrule the objections of Chevron and the creditors' committee, and enter the Bidding Procedures Order.

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Houston, Texas
Dated: January 24, 2018

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Certificate of Service

I certify that on January 24, 2018, I caused a copy of the foregoing document to be served by the Electronic Case Filing System for the United States Bankruptcy Court for the Southern District of Texas.

/s/ Zack A. Clement

Zack A. Clement