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Innovative Solutions......

Pension Resolution

Kodak & Pension Plan Reach Unconventional Settlement

by Randall Reese

When a liquidity shortfall forced Eastman Kodak Company (referred to throughout as "Kodak") into bankruptcy in early 2012, it was a true free fall filing, according to Sullivan & Cromwell partner Andrew Dietderich who represents Kodak. Kodak's advisors were faced with the difficult task of quickly stabilizing a global business. Kodak had over 100 subsidiaries, the majority of which were located outside the United States.

Andrew G. Dietderich
Sullivan & Cromwell

Tyson Lomazow
Milbank, Tweed, Hadley & McCloy

Christopher R. Donoho
Hogan Lovells

"The fundamental problem that Kodak had," says Dietderich, "is that there is no global insolvency law." While there are good examples of cross-border restructurings involving U.S. and Canadian affiliates, it is much more complicated to effect a cross-border restructuring involving many other countries. "There are good examples of liquidation structures, but not reorganizations," notes Dietderich. "We knew that Kodak's going concern value exceeded its liquidation value."

Kodak had key subsidiaries incorporated in the United Kingdom and its largest unsecured creditor was also based in the United Kingdom. Kodak Limited is a wholly-owned U.K. subsidiary of Kodak and owns all of the equity in Kodak International Finance Limited, a U.K. company which serves as an intercompany bank for Kodak. Kodak Limited is also the sole employer under the Kodak Pension Plan of the United Kingdom (referred to throughout as the "Pension Plan"), which is a defined benefit pension scheme governed by English law.

Most Important Creditor

There was no dispute that the Pension Plan was significantly underfunded at the time of the bankruptcy filing. Kodak had entered into a guaranty with Kodak Limited and the trustee of the Pension Plan – KPP Trustees Limited (referred to throughout as "KPP") – in 2007 obligating the parent company to fund contributions sufficient to ensure that the Pension Plan could pay benefits as they become due to members and would achieve fully funded status by 2022. As a result, KPP had claims for the Pension Plan's underfunding against Kodak which constituted over half of the total unsecured claim pool against the U.S. debtors. Those claims were also structurally senior to general unsecured claims due to KPP's primary claims against Kodak Limited.

The result was that, according to Dietderich, "KPP was the most important creditor because it was the largest creditor in the fulcrum class." Therefore, in addition to the issue of how to stabilize a deeply underwater global business in free fall without insolvency proceedings outside the U.S. cases, it became key to resolving the issue of what KPP was going to receive through the reorganization on account of its claims. KPP's claims "had to be resolved to create a viable path to Kodak's successful reorganization," says Tyson Lomazow, a partner with Milbank, Tweed, Hadley & McCloy who, along with colleague Dennis Dunne, represents the Official Committee of Kodak's Unsecured Creditors.

"One of the best things that we did was to think about it from first principles and put all of our efforts into keeping Kodak Limited out of administration proceedings in the United Kingdom," notes Dietderich. To achieve that goal, Kodak suggested that KPP look to the U.S. cases as its largest source of recovery, rather than the assets of Kodak Limited, and asked KPP to be an active participant in the U.S. cases. "This put Kodak and KPP in a position where we were working together, rather than as adversaries," says Dietderich.

Immediate Concerns

According to both Dietderich and Christopher Donoho, a partner with Hogan Lovells who represents

Kodak…

KPP in these transactions, there were two immediate concerns. First, any resolution had to ensure that the Pension Plan would not be forced into the U.K.'s Pension Protection Fund and, second, the resolution had to be fair to both KPP and Kodak's general unsecured creditors.

Dietderich notes that it became clear that, to reach a negotiated settlement with KPP, Kodak "had to come up with a structure that would give KPP enough value in the right currency." Neither Kodak's debt capacity nor the proceeds of asset sales during the bankruptcy were sufficient to allow Kodak to provide KPP with enough cash or notes to keep the Pension Plan out of the Pension Protection Fund. Additionally, providing KPP with equity in the reorganized company was not a workable solution because of differing interests between KPP and most general unsecured creditors, according to Dietderich. Lomazow echoes this sentiment, noting that the Committee's goal "was to resolve KPP's claims without being dilutive to general unsecured creditor recoveries."

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Solution

Fundamentally, KPP needed any settlement to provide a recovery on its claim that would allow it to generate sufficient cash flows to keep the Pension Plan out of the Pension Protection Fund, but also wanted to receive assets with upside potential that could provide a better result in the long term for its pensioners. Kodak's Document Imaging and Personalized Imaging businesses ultimately provided the avenue for a settlement that would allow Kodak, KPP, and Kodak's general unsecured creditors to all achieve their goals.

Kodak had identified the two business lines as non-core and was actively looking to sell them. Both businesses were mature and generated positive cash flows – enough cash, notes Donoho, to keep the Pension Plan out of the Pension Protection Fund. Finally, selling the businesses to KPP, rather than selling them to third parties, offers KPP some upside potential if the businesses flourish in the future. In sum, it allowed a result where each member of the Pension Plan will receive more than he or she would have received if the Pension Plan went into the Pension Protection Fund and has the opportunity to potentially receive much more, says Donoho.

In June, Judge Allan Gropper approved a global settlement between the parties. Among the key transactions contemplated by the settlement, which will be effectuated in connection with Kodak's plan of reorganization, are the sale of the two business lines to KPP, a payment to Kodak by KPP, the withdrawal of KPP's claims against the Kodak debtors, and the release of all of Kodak's debtor and non-debtor entities from any future obligations relating to the Pension Plan, including protection from the assertion of any "moral hazard" claims in the future by the U.K. Pensions Regulator.

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In evaluating the reasons that the parties in these complex cases were able to craft such an unconventional solution, the participants credit their willingness to work together and mutual recognition that traditional structures would not produce satisfactory results. Dietderich emphasizes the parties' ability to structure their relationships early in the cases in a way that aligned their economic incentives. Lomazow describes the settlement as a "testament to the parties' willingness to think outside the box when an obvious solution did not present itself." Donoho also praises the U.K. Pensions Regulator's "willingness to approve something unique and take a commercial approach to a difficult situation."

A hearing on confirmation of Kodak's plan of reorganization is scheduled for later this month. Kodak expects to emerge from bankruptcy in the third quarter of 2013. ¤