

HOW TO INTERPRET A COMPLEX BUSINESS CONTRACT

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Speaker Biography

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He has given many CLE presentations, including on the topics of loan agreements; intercreditor and subordination agreements; loan participations and syndications; securities lending; bank and securities regulations, including bank activities and margin regulations; rights of set-off; Uniform Commercial Code and security interests; bankers' acceptances; lender liability; conflicts of laws and choice of governing law; bankruptcy preferences and fraudulent transfers; arbitration agreements; legal opinions and professional responsibility; assignments; and true sales and bankruptcy estates.

He has been annually recognized in publications such as Texas Super Lawyers, Chambers USA, Best Lawyers in America, and the International Who's Who of Business Lawyers. He is a member of the American Law Institute. He is also a member of the American Bar Association, the Texas Bar Association and the Houston Bar Association, and is a Life Fellow in their respective Foundations.

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HOW TO INTERPRET A COMPLEX BUSINESS CONTRACT

I. GENERAL DESCRIPTION OF THIS TOPIC

The purpose of this paper is to suggest a methodology for interpreting a complex business contract (or any contract, for that matter) by interpreting it as a whole, rather than solely by seizing upon certain language within the contract. This paper assumes that the reader has from law school and legal practice become familiar with basic principles of contract formation, drafting and interpretation. An easy-to-read and excellent resource book on these topics is Charles M. Fox, *WORKING WITH CONTRACTS: WHAT LAW SCHOOL DOESN'T TEACH YOU* (Practising Law Institute (2nd ed. 2008), available inexpensively at Amazon.com and from numerous other sources.

The author illustrates the process by reference to a hypothetical, complex business transaction in which an existing contract places many restrictions on the ability of a party to that contract to do other transactions (directly or through its subsidiaries), including the hypothetical transaction. The task is to identify the salient contractual provisions in the existing, restrictive contract, interpret it as a whole, and reach conclusions regarding the intent of the parties to the restrictive contract. The purpose of the task is to determine whether or not a proposed new transaction would be permitted.

Part II of this paper contains recommended procedures for identifying and resolving contract interpretation issues. Keep these procedures in mind for all that follows.

Part III of this paper is a description of the proposed transaction (including names and definitions of parties and contracts), which is based on an actual transaction that occurred in 2010. *In addition to the textual description, please see the transaction diagram at the end of this paper.* This will make your understanding of the transaction much more clear.

Following a description of the proposed transaction, this paper sets out the problem that, hypothetically, has led you to decide that it is necessary to read and interpret the existing contract. Again, hypothetically, your review of the contract will lead you to discover one or more additional issues of which you were not previously aware—this is a typical situation.

Part IV of this paper will set out the excerpts from the existing contract (*i.e.*, summaries of the potentially relevant provisions). In an actual transaction, the excerpts would have been prepared by you or another attorney in your law firm or law department. From these excerpts, the reader will see a list (that would also have been prepared by you or another attorney in your law firm or law department) of the applicable permissive and restrictive terms that set the parameters within which a new transaction must operate.¹

Part V of this paper contains a hypothetical list, based on the contract excerpts in Part IV, of arguments for and against the ability to do the proposed transaction. From this list, a conclusion is reached in Part VI. The attorney will need to determine his or her level of confidence in this conclusion, both in regard to advice to the client, and as regards whether or not a legal opinion letter can be delivered as to whether the new transaction would breach or constitute a default under the existing contract.

II. SIMPLIFYING THE PROCESS—A PROCEDURE TO FOLLOW

1. Remember, a court should construe a contract in accordance with the parties' intent, and should try to determine that intent from the contract's express terms, taken as a whole. Courts usually interpret contracts according to the plain meaning of the terms used, or, similarly, according to the parties' intent as manifested by the wording of the contract.² Extrinsic evidence—such as oral testimony or emails or other correspondence—to determine the intent of the parties is usually not admissible unless the wording of the contract is found to be ambiguous. Contradictions within a contract should not open the door to extrinsic evidence if, with regard to the issue, the court can make a fair interpretation of the contract as a whole.
2. Read the *entire agreement* and take notes of provisions that may be relevant to the issue presented in Part IV below. Don't just seize on certain words and try to go straight to the answer. Then we can analyze the relevant provisions, determine if they reveal the intent of the parties to the "Big Co Credit

¹ These excerpts begin with a series of definitions, followed by the terms of the agreement that use those defined terms. The reader may choose to read the definitions first, and then the text of the agreement—thus following the page-order of this paper and of the full contract—or the reader may choose to start with the text of the agreement and revert to the definitions as necessary to understand the text. In actual practice, attorneys are probably equally divided on whether to

read the definitions before or after the text of the agreement. This is entirely a matter of personal preference, as long as by the end, the attorneys have read both.

² Under either the plain-meaning rule or the manifest intent rule, a court may modify the contract if there is a mutual mistake (such as inadvertently reversing the words "lessor" and "lessee" in a lease).

- Agreement” (as defined in Part III below) in regard to problematic provisions, make arguments and draw conclusions.
3. For the purpose of this CLE presentation, assume that the Big Co Credit Agreement is 120 pages long, plus exhibits, annexes and schedules, and that you have read the entire agreement and gathered together the relevant provisions by making excerpts of relevant language in that agreement. Those excerpts are in Part IV below.
 4. The transactions and agreements described below should serve as reminders of basic principles of contract interpretation. Here, in our example, we have a problematic definition stated in Part IV below (of permitted “Non-Recourse Debt” that expressly excludes a guaranty or other support for a loan to a third person). Standing in isolation, a restriction on “Debt” that allows such “Non-Recourse Debt” would not operate to allow the borrower to become obligated under an Offshore Platform Use Agreement (defined in Part IV as the “PUA”) or any other contract whose revenues or other rights are relied upon by lenders for repayment. This is because the PUA could be construed as a “guaranty or other support” for the loan, and hence would not constitute “Non-Recourse Debt” and therefore not be exempted from the restriction on “Debt”. But the contract (in this example, the Big Co Credit Agreement) must be read in its entirety, and such a reading shows that the PUA is permitted as part of “Infrastructure Subsidiary” financing if stated criteria are met.
 5. The following procedure list is helpful and efficient for analyzing complex contracts in the context of a particular issue—in our case, whether a new loan arrangement violates an existing one (often-called a “non-contravention issue”). The recommended procedure is:
 - A. Read the entire contract with a clear idea of the issue in mind.³
 - B. Make notations along the way and prepare a summary of provisions that are or may be relevant to the issue.
 - C. Be alert to the discovery of one or more additional issues that may reveal

- D. Identify in the summary those provisions that appear problematic or permissive with regard to the issue(s).
- E. If the issue(s) can be resolved by meeting certain criteria, list the requirements.
- F. List the arguments pro and con, with respect to the issue(s).
- G. Make a conclusion, and determine a level of confidence in that conclusion.
- H. If an attorney legal opinion letter is required with respect to the conclusion, are we confident enough to render the requested opinion, and what assumptions, qualifications or limitations need to be made?
- I. Finally, it should go without saying, save the contract and keep it handy. You will likely need to refer again to it many times throughout the above process. In the course of your review, you are likely to need to refer back to the contract language to confirm various points or state them correctly and to find and add other points relevant to your summary, analysis and conclusion.

III. CAST OF CHARACTERS AND THEIR DEALS—AND THE PROBLEM—FOR PURPOSES OF ILLUSTRATION

(See attached transaction diagram for a visual depiction of the parties and transactions.)

1. “**Big Co**” is a large publicly held corporation with an existing credit agreement with Giant Bank and other lenders (collectively, the “**Lenders**”). In that credit agreement (the “**Big Co Credit Agreement**”), Big Co is called the “**Borrower**”.
2. Big Co has mortgaged its offshore oil and gas leases to the Lenders. Big Co’s understanding with Giant Bank is that Big Co may pledge drilling platforms and other hard assets through “unrestricted subsidiaries” to different lenders, but the Lenders are the sole secured party with respect to the oil and gas and their proceeds.

³ Some parts of the contract may safely be skimmed over if the issue at hand seems clearly unrelated. For example, if the issue is a non-contravention issue such as in this paper, you could safely assume that the parts of the contract dealing with

determination of the interest rate or with expense reimbursement, notices, or other miscellaneous provisions are unrelated. Even here, it is a good practice to scan the supposedly unrelated parts sufficiently to uncover provisions that might actually be related to the issue under consideration.

3. Big Co forms two new bankruptcy-remote special-purpose companies,⁴ structured like a totem pole with Big Co at the top. It directly owns “**MidCo SPE**” that in turn owns “**Bottom SPE**”.
4. Big Co will transfer (by capital contribution) an offshore drilling platform and related assets (the “**Platform**”) (excluding oil and gas) through MidCo SPE to Bottom SPE. Big Co will sign an Offshore Platform Use Agreement (the “**PUA**”), which is like a triple net equipment lease,⁵ with Bottom SPE. Under the PUA, BigCo is obligated to operate the Platform, be responsible for all risks, and is virtually unconditionally obligated to make monthly payments to Bottom SPE for use of the Platform.
5. Bottom SPE will sign a credit agreement (the “**Bottom SPE Credit Agreement**”) with Gulf Credit Bank and its own group of syndicated lenders (collectively “the “**Bottom SPE Lenders**”). They will have a security interest in the Platform and the PUA. The payments under the PUA will be sufficient to allow Bottom SPE to make all its installment payments to the Bottom SPE Lenders, except for a balloon final installment payment. At that point, Big Co has an option to repurchase the Platform (which is worth much more than the final balloon payment). If it does not exercise the purchase option, it continues to make PUA payments that would ultimately satisfy the loan, or the Bottom SPE Lenders can foreclose on the Platform.
6. MidCo SPE will guarantee the loan to Bottom SPE and will pledge its equity ownership of Bottom SPE to the Bottom SPE Lenders. MidCo SPE has no other assets. Bottom SPE will pledge all its assets to the Bottom SPE Lenders, including a \$10 million cash reserve which it obtains from proceeds of the initial loan from the Bottom SPE Lenders.
7. For so long as there is no default under the loan documentation with the Bottom SPE Lenders, Bottom SPE will distribute all loan proceeds (net of the cash reserve and closing expenses) up to MidCo SPE, who in turn will distribute all such proceeds to Big Co.

⁴ Bankruptcy-remote special-purpose companies are ordinarily formed specifically for the particular financing transaction and are not permitted to do any activities or incur any obligations other than such financing. These types of companies are passive in nature and are not considered likely to become subject to bankruptcy proceedings if they follow the requisite organizational formalities so as to make their substantive consolidation with other companies unlikely.

THE PROBLEM:

1. As the lawyer for BigCo, MidCo SPE and Bottom SPE, you are asked to issue a legal opinion to the Bottom SPE Lenders that the loan to Bottom SPE will not violate the Big Co Credit Agreement.
2. You are initially undecided whether you can give this legal opinion, because you have been told that the Big Co Credit Agreement prevents Big Co from guaranteeing or supporting any other loan. Bottom SPE has no other assets and clearly can repay its loan only with virtually unconditional payments from Big Co under the PUA. So the PUA looks like the equivalent of a guaranty or, at least, “other support” of Bottom SPE’s payments to the Bottom SPE Lenders.
3. In reading the Big Co Credit Agreement, you also see that Big Co is not permitted to grant Liens on property included in the Borrowing Base (an asset value set by the Lenders which affects how much they will lend). Floating infrastructure assets (such as the Platform) are included in the Borrowing Base, and those assets are supposed to be pledged to the Bottom SPE Lenders.

IV. EXCERPTS FROM EXISTING BIG CO CREDIT AGREEMENT⁶

ARTICLE I

Definitions and Accounting Matters

Section 1.02 Certain Defined Terms.

“Affiliate” means, with respect to a specified Person, another Person that directly, or indirectly through one or more intermediaries, Controls or is Controlled by or is under common Control with the Person specified.

“Borrowing Base” means ... an amount equal to the amount determined in accordance with Section 2.07 [an amount determined by the Lenders based on the value of proven oil and gas reserves plus the Borrower’s direct or indirect interests in reusable floating

⁵ A “triple net lease” is one where the lessor’s only responsibility is to provide the asset free of interference from third parties. Thus, the lessee has the obligations for maintenance, insurance and taxes.

⁶ These are excerpts from an existing Credit Agreement among Big Co, as Borrower, Giant Bank, N.A., as Administrative Agent and Collateral Agent, and the Lenders party thereto from time to time.

infrastructure assets to the extent a Lien can be granted on either the asset or the Borrower's Capital Stock in the Person owning the asset], as the same may be adjusted pursuant to Sections ... or 9.12.

“Capital Stock” of any Person means any and all shares, units, interests, rights to purchase, warrants, options, participation or other equivalents of or interests in (however designated) equity of such Person”

“Control” means the possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of a Person, whether through the ability to exercise voting power, by contract or otherwise....

“Credit Party” means the Borrower and each Guarantor.

“Debt” means, with respect to any Person, on any date of determination (without duplication):

- (a) the principal of ... Debt⁷ of such Person for borrowed money;
- (b) the principal of ... obligations of such Person evidenced by bonds, debentures, notes or other similar instruments;

- (g) Debt of other Persons secured by a Lien on any asset of such Person, whether or not such Debt is assumed by such Person ...

Notwithstanding the preceding, “Debt” shall not include: ...

- (m) any obligation of the Borrower or a Restricted Subsidiary providing for indemnification, guaranties ... contingency payment obligations or similar obligations (other than guaranties of Debt), in each case incurred in connection with the acquisition or disposition of any business.

“Indebtedness” means any amounts owing or to be owing by the Borrower, any Subsidiary or any Guarantor ... to [Big Co's Lenders or their administrative agent].

“Infrastructure Subsidiaries” means any Person (a) in which the Borrower or any of its Subsidiaries owns Capital Stock and to which the Borrower or any of its Restricted Subsidiaries transfers the following infrastructure assets: ...the Platform ..., or (b) that owns or holds, directly or indirectly through one or more subsidiaries, Capital Stock of a Person described in the preceding clause (a).

“Investment” means, with respect to any Person, all investments by such Person (including Affiliates) in the form of any direct or indirect advance, loan or other extensions of credit (including by way of guarantee or similar arrangement ...) or capital contribution to (by means of any transfer of cash or other property to others or any payment for property or other services for the account or use of others), or any purchase or acquisition of Capital Stock, Debt or similar instruments ... issued by, such other Person and all other items that are or would be classified as investments on a balance sheet prepared in accordance with GAAP

“Lien” means ... [customary definition] ... and any filing of or agreement to give any financing statement under the UCC

“Net Cash Proceeds” means ...

- (a) with respect to the issuance of any Capital Stock, means⁸ the net proceeds of such issuance or sale, net of attorneys' fees, accountants' fees, underwriters' or placement agents' fees and other fees and charges actually incurred in connection with such issuance and sale and satisfactorily documented in connection therewith and net of taxes paid or payable as a result of such issuance or sale (after taking into account any available tax credit or deductions and any tax sharing arrangements).

- (c) with respect to an Investment in an Infrastructure Subsidiary under Section 9.05(e) made with floating infrastructure assets and other assets not comprised of Oil and Gas Properties or interests in Hydrocarbons, if

⁷ Note the poor drafting of this part of the definition. It is circular: “Debt” means “Debt” ... for borrowed money.

⁸ Note the editorial oversight of using the word “means” twice—here and in the lead-in of the definition.

- (i) such Infrastructure Subsidiary (or any Infrastructure Subsidiary that is a direct or indirect subsidiary of such Infrastructure Subsidiary) shall concurrently or thereafter incur any Debt in respect of borrowed money, 100% of the aggregate principal amount of such Debt net of original issue discount, attorneys' fees, accountants' fees, underwriters' or placement agents' fees and other fees and charges actually incurred in connection with such issuance and sale and satisfactorily documented in connection therewith and net of any reserve determined in good faith by the Borrower to be required by such Infrastructure Subsidiary to maintain adequate working capital for the starting up and continued conduct of such Infrastructure Subsidiary's operations; and
- (ii) such Infrastructure Subsidiary shall concurrently or thereafter issue or sell any Capital Stock, 100% of the Net Cash Proceeds of such sale or offering (as determined by reference to clause (a) of this definition.

“Non-Recourse Debt” means Debt of any Unrestricted Subsidiary, in respect of which (a) the holder or holders thereof (i) shall have recourse only to, and shall have the right to require the obligations of such Unrestricted Subsidiary to be performed, satisfied, and paid only out of, the Property of such Unrestricted Subsidiary and/or one or more of its Subsidiaries (but only to the extent that such Subsidiaries are Unrestricted Subsidiaries) ... and (ii) shall have no direct or indirect recourse (including by way of guaranty, support or indemnity) to the Borrower or any Restricted Subsidiary or to the Property of the Borrower or any Restricted Subsidiary ..., (b) such Debt contains customary provisions providing that the holder(s) of such Debt shall have no recourse to the Borrower or Credit Parties or any of their respective Property and (c) the assets financed by such Debt are floating infrastructure assets

“Restricted Subsidiary” means any Subsidiary of the Borrower that is not an Unrestricted Subsidiary.

“Unrestricted Subsidiary” means (y) ... any ... Infrastructure Subsidiary ... designated an Unrestricted Subsidiary by the Borrower in

accordance with the requirements of Section 9.18; ... and (aa) any subsidiary of an Unrestricted Subsidiary.

ARTICLE IX Negative Covenants

Section 9.02 Debt. The Borrower will not, and will not permit any Restricted Subsidiary to, incur, create, assume or suffer to exist any Debt except:

- (h) Non-Recourse Debt.

Section 9.03 Liens. The Borrower will not, and will not permit any Restricted Subsidiary to, create, incur, assume or permit to exist any Lien on any of its Properites ... except:

- (d) Liens on Property not included in the Borrowing Base and pledged to secure Non-Recourse Debt under Section 9.02(h).

Section 9.05. Investments, Loans and Advances. The Borrower will not, and will not permit any Restricted Subsidiary to, make or permit to remain outstanding any Investments in or to any Person, except that the foregoing restriction shall not apply to:

- (e) ... Investments (including, without limitation, capital contributions) in one or more Infrastructure Subsidiaries, provided that (i) such Infrastructure Subsidiary is engaged exclusively in the business of oil and gas gathering, processing, transportation and related activities or owning or holding, directly or indirectly through one or more subsidiaries, Capital Stock of one or more Infrastructure Subsidiaries, (ii) all of the Net Cash Proceeds resulting from such Investment are distributed by each Infrastructure Subsidiary receiving such proceeds (including proceeds received from one or more other Infrastructure Subsidiaries) to the Borrower or another Credit Party, ... (iv) the Borrower or such Restricted Subsidiary shall pledge all of the Capital Stock in any Infrastructure Subsidiary owned directly by such

Person⁹ to the Administrative Agent to secure the Indebtedness and (v) at the time of and immediately after giving effect to such Investment ... any Debt incurred by such Infrastructure Subsidiary is Non-Recourse Debt.

Section 9.07 Limitation on Leases. The Borrower will not, and will not permit any Restricted Subsidiary to, create, incur, assume or suffer to exist any obligation for the payment of rent or hire of Property of any kind whatsoever (real or personal but excluding in all instances ... leases, facility use agreements and other agreements between the Borrower and¹⁰ one or more Restricted Subsidiaries and an Infrastructure Subsidiary permitted in accordance with Section 9.14)....

Section 9.12 Sale of Properties. The Borrower will not, and will not permit any Restricted Subsidiary to, sell, assign, farmout, convey or otherwise transfer any Property ... except for

- (e) the sale or other disposition of floating infrastructure assets [including the Platform] and other assets not comprised of Oil and Gas Properties or interests in Hydrocarbons... to an Infrastructure Subsidiary [MidCo SPE, and indirectly to Bottom SPE] provided that, at the time of such sale or other disposition, (i) the conditions of Section 9.05(e) have been met and (ii)...(A) the Borrowing Base shall be adjusted to reflect the disposition of such assets and the Borrower's or such Restricted Subsidiary's retained Capital Stock in the Infrastructure Subsidiary, and (B) the Borrower or such Restricted Subsidiary shall pledge all of the Capital Stock owned directly by such Person in any first-tier Infrastructure Subsidiary [MidCo SPE] to the Administrative Agent to secure the Indebtedness.

Section 9.14 Transactions with Affiliates.

- (a) The Borrower will not, and will not permit any Restricted Subsidiary to, directly or indirectly, enter into, make, amend or conduct any transaction (including making a payment to, the purchase, sale, lease or exchange of any property or the rendering of any service), contract, agreement or understanding with or for the benefit of any Affiliate of the Borrower (an "Affiliate Transaction") unless:
- (i) the terms of such Affiliate Transaction are no less favorable to the Borrower or such Restricted Subsidiary, as the case may be, than those that might reasonably have been obtained in a comparable transaction at the time of such transaction in arm's length dealings with a Person who is not an Affiliate of the Borrower or such Restricted Subsidiary;
- (ii) if such Affiliate Transaction involves an aggregate consideration in excess of \$15,000,000, the terms of such transaction have been approved by a majority of the disinterested members of the Board of Directors of the Borrower (and such majority determines that such Affiliate Transaction satisfies the criteria in clause (i) above); and
- (iii) if such Affiliate Transaction involves an aggregate consideration in excess of \$50,000,000, the Borrower has received a written opinion from an independent investment banking, accounting or appraisal firm of nationally recognized standing that such Affiliate Transaction is fair, from a financial standpoint, to the Borrower or such Restricted Subsidiary, or is not materially less favorable than those that could reasonably be expected to be obtained in a comparable transaction at such time on an arm's-length basis from a Person that is not an Affiliate; provided, that with respect to

⁹ This is poor drafting in that "such Person" could refer grammatically to either "the Borrower or such Restricted Subsidiary" or to "Infrastructure Subsidiary" (*i.e.*, this is in grammar the problem of an indefinite antecedent). However, the only interpretation that makes sense in the context of the Big Co Credit Agreement is the former—the Borrower or any Restricted Subsidiary is required to pledge the Common Stock of its first-tier Infrastructure Subsidiary. This is consistent with Sections 9.12(e)(ii)(B) and 9.14(b)(xiii), which, respectively, require a pledge of the Common Stock of the first-tier Infrastructure Subsidiary to Big Co's Lenders

and permit an Unrestricted Subsidiary to pledge Capital Stock of Unrestricted Subsidiaries for the benefit of lenders to Unrestricted Subsidiaries. Moreover, any requirement in this Section 9.05(e)(iv) that only an Infrastructure Subsidiary need pledge any Common Stock owned by it would not protect Big Co's Lenders from the possibility that the first-tier Common Stock could be pledged to someone else. **The interpretation in this footnote is an example of the necessity to construe ambiguous terms in the context of other terms in a contract, rather than to be viewed in isolation.**

¹⁰ The word "and" would better have been "or" in this context.

any operating, management or other agreement entered into between the Borrower or any Restricted Subsidiary and an Infrastructure Subsidiary at the time such Infrastructure Subsidiary is an Unrestricted Subsidiary, the terms of such agreement need only comply with clauses (i) and (ii) of this Section 9.14(a).

- (b) Section 9.14(a) will not apply to:
 - (i) any Investment ... permitted by this Agreement;

- (xii) transactions with a Person (other than an Unrestricted Subsidiary) that is an Affiliate of the Borrower solely because the Borrower owns, directly or through a Restricted Subsidiary, Capital Stock of such Person; and
- (xiii) pledges of Capital Stock of Unrestricted Subsidiaries of the Borrower for the benefit of lenders to Unrestricted Subsidiaries of the Borrower.

Section 9.18 Designation and Conversion of Restricted and Unrestricted Subsidiaries; Debt of Unrestricted Subsidiaries.

- (a) Schedule 7.14 sets forth all the Restricted Subsidiaries and Unrestricted Subsidiaries. [NB: MidCo SPE and Bottom SPE did not exist at the time of signing the Big Co Credit Agreement and are not listed in Schedule 7.14.] Unless designated as an Unrestricted Subsidiary on Schedule 7.14 as of the date hereof or thereafter, assuming compliance with Section 9.18(b), any Person that becomes a Subsidiary of the Borrower or any of its Restricted Subsidiaries shall be classified as a Restricted Subsidiary. [NB: MidCo SPE and Bottom SPE will become Unrestricted Subsidiaries if they are designated as such by the Borrower and if they comply with Section 9.18(b).]
- (b) The Borrower may designate any Subsidiary ... to be an Unrestricted Subsidiary only if (1) such Subsidiary is an Infrastructure Subsidiary and substantially concurrently with such designation such Infrastructure Subsidiary (or any Infrastructure Subsidiary owned by it, directly or indirectly through one or more subsidiaries) receives debt and/or equity financing from a third party that is not

the Borrower, a Restricted Subsidiary of the Borrower or an Affiliate of the Borrower or any Restricted Subsidiary, or (2) such Subsidiary satisfies the following requirements:

- (ii) all the Debt of any such Subsidiary and its subsidiaries shall, at the date of designation, and at all times thereafter, consist of Non-Recourse Debt ...

- (iv) such Subsidiary is a Person with respect to which neither the Borrower nor any of its Restricted Subsidiaries has any direct or indirect obligation:
 - (A) to subscribe for additional Capital Stock of such Person; or
 - (B) to maintain or preserve such Person's financial condition or to cause such Person to achieve any specified levels of operating results;
- (v) on the date such Subsidiary is designated an Unrestricted Subsidiary, such Subsidiary is not a party to any agreement, contract, arrangement or understanding with the Borrower or any Restricted Subsidiary with terms substantially less favorable to the Borrower than those that might have been obtained from Persons who are not Affiliates of the Borrower; and
- (vi) prior, and after giving effect to such designation, neither a Default nor a Borrowing Base deficiency would exist.

V. CONTRACT REVIEW NOTES—TESTS AND RESTRICTIONS FROM BIG CO CREDIT AGREEMENT

9.02 *Debt* of Bottom SPE and MidCo SPE **must be “Non-Recourse Debt”** That definition requires that (1) **there can be no recourse to Big Co, including by way of guaranty, support or indemnity** and (2) the *Bottom SPE and MidCo SPE credit documents must contain customary provisions that there be no recourse to Big Co* or any guarantors under the Big Co Credit Agreement.

9.03 *Liens on property not included in the Borrowing Base* are permitted if they secure permitted Non-Recourse Debt. Floating

infrastructure assets (such as the Platform) are included in the Borrowing Base.

9.05(e) Investments in Infrastructure Subsidiaries must meet the following tests: (1) *all Net Cash Proceeds of Bottom SPE and MidCo SPE must be distributed to Big Co*, (2) *Big Co must pledge all the Capital Stock of MidCo SPE to the Administrative Agent for its bank lenders and* (3) *all Net Cash Proceeds of the Bottom SPE transactions, including loan proceeds and future income of Bottom SPE and all distributions of Bottom SPE to MidCo SPE, must be distributed to Big Co*. The definition of “Net Cash Proceeds” requires upstreaming of the Bottom SPE loan proceeds and future income (from the PUA) through MidCo SPE to Big Co, but allows Big Co to leave working capital needs with Bottom SPE—this would allow Bottom SPE to maintain the minimum cash reserves required by Gulf Credit Bank.

9.07 Leases, *facility use agreements and other agreements* between Big Co and an Infrastructure Subsidiary are *permitted if they comply with Section 9.14* (Affiliate Transactions—terms not less favorable to Big Co than might reasonably have been obtained from a non-Affiliate).

9.12(e) Sale of Properties *permits the disposition of floating infrastructure assets* (the Bottom SPE platform) and related assets to an Infrastructure Subsidiary (MidCo SPE, and indirectly to Bottom SPE), *provided that Big Co shall pledge all its Capital Stock in any first-tier Infrastructure Subsidiary* (MidCo SPE) to the Administrative Agent for Big Co’s bank lenders. *The Borrowing Base will be adjusted to reflect the disposition and pledge.*

9.14 *Transactions with Affiliates (including with Infrastructure Subsidiaries) must be on terms no less favorable to Big Co than it might reasonably have obtained in a comparable transaction with a non-Affiliate. A majority of the disinterested directors of Big Co must determine that a transaction meets this test.*

9.18 The Borrower will designate Bottom SPE and MidCo SPE as Unrestricted Subsidiaries. The Debt and other covenants in the Big Co Credit Agreement are by Big Co and its Restricted Subsidiaries. Because Bottom SPE and MidCo SPE will be newly created, special purpose Subsidiaries with no

other business than the proposed transaction, and the PUA and other agreements among the parties must pass the affiliate-transaction requirements of Section 9.14, Bottom SPE and MidCo SPE should meet the tests set out in Section 9.18(b) for being Unrestricted Subsidiaries.

VI. ARGUMENTS FOR AND AGAINST OUR DEAL; CONCLUSION

A. Arguments in Favor of Our Deal:

1. The definition of “Infrastructure Subsidiaries” and the provisions of Section 9.05(e)(iv) (Investments) and Section 9.12(e) (Sale of Properties) contemplate the transfer of the Platform to an Infrastructure Subsidiary (and both MidCo SPE and Bottom SPE will be designated as Infrastructure Subsidiaries) and Big Co’s ownership of the Capital Stock of a first-tier subsidiary such as MidCo SPE. That section also requires that the first-tier Capital Stock will be pledged by Big Co to its Lenders. Section 9.12(e) also contemplates a borrowing by Bottom SPE as Non-Recourse Debt.
2. Section 9.02(h) permits Liens on property not included in the Borrowing Base if they secure Non-Recourse Debt. Although the Platform would be a floating infrastructure asset included in the Borrowing Base, Section 9.12(e) contemplates that the Borrowing Base will be adjusted to reflect Big Co’s disposition of the Platform and retention of the equity interest in MidCo SPE. Therefore, the initial inclusion of the Platform in the Borrowing Base should not operate to prevent the disposition of the Platform as contemplated in several provisions of the Big Co Credit Agreement.
3. As a condition precedent to lending under the Bottom SPE Credit Agreement, documentary evidence should be provided that Bottom SPE and MidCo SPE are “Unrestricted Subsidiaries.” The restrictions of the Big Co Credit Agreement are on Big Co and its Restricted Subsidiaries—not its Unrestricted Subsidiaries. Thus, we can do our deal if it doesn’t contravene restrictions on Big Co and meets tests applicable to Big Co in the Big Co Credit Agreement.
4. The limitation on Leases in Section 9.07 expressly permits a lease or facility use agreement between Big Co and an Infrastructure Subsidiary (Bottom SPE) if the PUA meets the arm’s length tests of Section 9.14. Such leases or facility use agreements

are commonly triple net arrangements in which the user of the assets (here, Big Co) takes all risks of use and operation of the assets, including payments for maintenance, insurance and taxes.

5. The limitations on sales and other dispositions of assets in Section 9.12 expressly permit the transfer of floating infrastructure assets (such as the Platform) to Infrastructure Subsidiaries (such as MidCo SPE and Bottom SPE) if Big Co pledges the MidCo SPE equity interest to the Administrative Agent for Big Co's Lenders and if Bottom SPE's net loan proceeds are distributed (as "Net Cash Proceeds") through MidCo SPE to Big Co.
6. The definition of "Net Cash Proceeds" contemplates, in clause (c)(1) thereof, that floating infrastructure assets (such as the Platform) may be transferred to an Infrastructure Subsidiary (such as MidCo SPE and Bottom SPE), and that 100% of the net proceeds of the related borrowing (less a cash reserve for working capital) is to be distributed to Big Co.

B. Arguments Against Our Deal:

1. Section 9.02 prohibits Debt. Debt would include the PUA because it is a contract guaranteeing or supporting repayment of the borrowing by Bottom SPE. Although "Non-Recourse Debt" is permitted, that defined term excludes guaranties or other support by Big Co.
2. Section 9.03 prohibits Liens. The Platform is a floating infrastructure asset included in the Borrowing Base. The permission to have Liens securing Non-Recourse Debt excludes Liens on assets included in the Borrowing Base.
3. Section 9.14 prohibits Big Co from entering into contracts, such as the PUA, on terms less favorable than it might reasonably have obtained from a non-Affiliate. The PUA is virtually a hell-or-high-water contract obligating Big Co to pay no matter what happens to the Platform. The clear purpose of the PUA is to guaranty or support the borrowing by Bottom SPE.

C. Conclusion:

1. The Big Co Credit Agreement clearly contemplates that Big Co will contribute the Platform through a two-tier Infrastructure Subsidiary arrangement, with Big Co's pledging the top-tier equity interest to its own

Lenders. The use of the Platform can be contracted back to Big Co, provided that the contract is on terms no less favorable to Big Co than in a comparable transaction with a non-Affiliate. MidCo SPE and Bottom SPE (as Infrastructure Subsidiaries) are permitted to pledge equity interests and grant security interests in the Platform and in MidCo's equity ownership of Bottom SPE to the Bottom SPE Lenders, if the net loan proceeds are distributed upstream to Big Co.

2. The Bottom SPE Credit Agreement should require, among its conditions precedent to lending, that evidence be provided as to Big Co's satisfaction of the applicable requirements in the Big Co Credit Agreement, including the pledge of the MidCo SPE equity interest by Big Co to its Lenders, and the designation of MidCo SPE and Bottom SPE as Infrastructure Subsidiaries. As regards the PUA's compliance with Section 9.14, (i) the PUA should not contain any provisions which manifestly on their face would be less favorable to Big Co than it could obtain in a comparable agreement with a non-Affiliate, and (ii) Big Co should deliver an officer's certificate or other evidence regarding the requisite finding, pursuant to Section 9.14(a)(ii), by a majority of the disinterested directors of Big Co. In addition, the Bottom SPE Credit Agreement and the MidCo Pledge Agreement should each require the upstream distribution of net loan proceeds, as required by Section 9.05(e), and contain non-recourse language, as required in the definition of "Non-Recourse Debt" in Section 1.02.
3. Although Big Co is not permitted, under Section 9.01 (Debt), to guaranty or support the Debt of a third person, and, standing alone, the PUA could be regarded as a guaranty or support agreement, this interpretation would not be reasonable in light of the other provisions of the Big Co Credit Agreement that contemplate our transaction if specific requirements are met, as outlined above. The Bottom SPE Credit Agreement and related loan and security documents must be drafted with non-recourse provisions so as to qualify to be categorized as "Non-Recourse Debt" under the Big Co Credit Agreement.
4. Although Liens are not permitted on assets included in the Borrowing Base under the Big Co Credit Agreement, that agreement contemplates the existence and structure of the proposed transaction and provides, in Section 9.12, that the Borrowing Base will be adjusted in connection with the disposition of

floating infrastructure assets (such as the Platform) to an Infrastructure Subsidiary (such as MidCo SPE and Bottom SPE) if Big Co pledges its equity ownership of its first-tier Infrastructure Subsidiary (MidCo SPE) to Big Co's Lenders. This adjustment is also contemplated in the definition of the "Borrowing Base" which expressly refers to Section 9.12.

See following page which is a transaction diagram.



