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Bankruptcy Conference

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CONCURRENT SESSION

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Bankruptcy Litigation Panel
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FRAUDULENT TRANSFERS: DEVELOPMENTS CONCERNING SUBSEQUENT TRANSFEREES AND FRAUDULENT INTENT*

1. **Recent Case Law Concerning Subsequent Transferees**

(a) ***Subsequent Transferees – Section 550(a)(2)***

(i) A trustee may not recover a fraudulent transfer from a subsequent transferee if the subsequent transferee can establish that it:

(1) gave value, including by way of satisfaction or securing of a present or antecedent debt, in exchange for the transferred asset;

(2) in good faith; and

(3) without knowledge of the voidability of the initial transfer.

11 U.S.C. § 550(b)(1); and

(ii) A trustee is also prohibited from recovering property from any immediate or mediate good faith transferee of such a good faith subsequent transferee under Section 550(b)(1). 11 U.S.C. § 550(b)(2).

(b) ***Initial Transferees – Section 548(c)***

(i) In contrast to the protections afforded a subsequent transferee, an initial transferee that takes for value and in good faith will be protected only to the extent of the value actually transferred to the debtor in the exchange.

(ii) Thus, the main difference between the initial transferee's and the subsequent transferee's liability is that section 550(b) provides a complete defense to recovery of the property transferred from a subsequent transferee, whereas section 548(c)protects an initial transferee only to the extent that the initial transferee extended actual value in exchange for the property transferred, or obligation incurred, by a debtor.

(c) ***Who is an initial transferee and who is a subsequent transferee?***

(i) The Bankruptcy Code does not define "initial transferee," "immediate transferee," or "mediate transferee." Generally, the party who receives a transfer of property directly from the debtor is the initial transferee. However, many courts have found that a party acting merely as a conduit who facilitates the transfer from the debtor to a third party is not a "transferee" and, therefore, not the initial transferee. Rather, these courts have held that the minimum requirement of status as a "transferee" is dominion or control over the property transferred. 5 Collier on Bankruptcy ¶ 550.02. *See, e.g.*, *Bonded Fin. Servs., Inc. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988) ("the minimum requirement of status as a

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'transferee' is dominion over the money or other asset, the right to put the money to one's own purposes. When A gives a check to B as agent for C, then C is the 'initial transferee;' the agent may be disregarded").

(ii) Factors that courts have considered in this context include: (A) the level of control the recipient had over the property; (B) whether the recipient received consideration or compensation for the transfer; (C) whether the recipient had any liability in the transaction; and (D) whether the recipient held any security interest in the property transferred. *See id.*

(iii) Because an initial recipient of property may establish that it was a "mere conduit" rather than a transferee, a situation may arise where "the party who receives the property from the conduit is likely to be considered the 'initial transferee,' albeit several steps removed." *See, e.g.*, *In re International Administrative Services, Inc.*, 408 F.3d 689, 705 (11th Cir. 2005); *see also In re Granada, Inc.*, 156 B.R. 303 (D. Utah 1990) ("a creditor who received a preference payment from a conduit is liable as an initial transferee. This prevents the creditor from raising the defense provided in § 550(b) for subsequent transferees."). It is possible that a trustee may seek to employ the conduit theory offensively to "bypass an intermediary" in an attempt to prevent a party from accessing a complete defense to an avoidance action under § 550(b). *Id.* at 307 (note, however, that the court ultimately denied the trustee's attempt to use the mere conduit theory offensively in *In re Granada*).

(iv) **<u>Generation Resources</u>**

(1) In the 2020 decision in *Rajala v. Spencer Fane LLP (In re Generation Resources Holding Co.)*, 964 F.3d 958 (10th Cir. 2020), the Tenth Circuit held that, to qualify as a subsequent transferee under section 550(b), a party must have received the actual "property transferred" by the debtor.

(2) Generation Resources Holding Company, LLC ("Generation Resources") developed three wind power projects in Pennsylvania, known as Stonycreek, Forward, and Lookout. *Id.* at 962. In February 2004, Generation Resources entered discussions with Edison Capital ("Edison") about selling the projects. *Id.* In November 2005, Generation Resources created Lookout Windpower Holding Company, LLC ("LWHC") and Forward Windpower Holding Company, LLC ("FWHC"). *Id.* Later that month, Generation Resources became unable to pay its debts, and in December 2005 Generation Resource's insiders circulated among themselves revised development agreements, which had the effect of transferring Generation Resource's rights to payment under the contract with Edison to LWHC and FWHC. *Id.* In April 2008, Generation Resources filed for bankruptcy and a trustee (the "Generation Resources Trustee") was appointed. *Id.* at 963.

(3) In November 2008, LWHC asserted that the Lookout project was operational and demanded payment from Edison. *Id.* Edison unilaterally reduced the payment to LWHC from approximately $10 million to $5.5 million "due to delays in construction and increased costs attributable to LWHC." *Id.* LWHC disputed these reductions and, in December 2008, LWHC hired Husch Blackwell on a contingency fee arrangement to sue Edison for the remaining balance. *Id.* Husch Blackwell commenced

a lawsuit against Edison in Pennsylvania federal district court in April 2009. *Id.* Shortly before commencing the suit, the Generation Resources Trustee notified LWHC that the funds LWHC sought belonged to the bankruptcy estate. *Id.* In May 2011, the Generation Resources Trustee tried to enjoin LWHC from pursuing its lawsuit in Pennsylvania but was unsuccessful. *Id.* at 963–64. LWHC ultimately obtained a $9 million judgment against Edison in Pennsylvania federal district court. *Id.* at 963–64. The district court transferred enforcement of that judgment to the court overseeing Generation Resource's bankruptcy to determine "whether the judgment, partially or completely, is part of the bankruptcy estate." *Id.* Edison deposited funds in satisfaction of the judgment into the bankruptcy court's registry. *Id.*

(4) LWHC then hired another law firm, Spencer Fane, to seek release of the funds on the ground that the award was not part of the bankruptcy estate. *Id.* The bankruptcy court ultimately held that the $9 million payment was not an estate asset and granted the request for the release of the funds, ruling that, if the Generation Resources Trustee "prevails on his fraudulent transfer claims, he then has the remedy of avoiding the fraudulent transfer." *Id.* The funds were released by the bankruptcy court, with most of the funds going to a bank account controlled by LWHC, whereafter LWHC paid certain obligations, including those owing to Spencer Fane and Husch Blackwell. *Id.*

(5) The Generation Resources Trustee brought fraudulent transfer claims against the insiders of Generation Resources, LWHC, and FWHC. *Id.* The Generation Resources Trustee and Generation Resources insiders eventually negotiated a settlement reflected in a consent judgment avoiding the original transfer of rights to certain payments under the development contracts from Generation Resources to LWHC and FWHC. *Id.* However, the Generation Resources Trustee was unable to recover against LWHC, and, at the time of the decision, the Generation Resources Trustee claimed he had not recovered any of the LWHC funds "from any source." *Id.*at 965. The Generation Resources Trustee then sued the law firms, seeking to hold them liable under section 550 as subsequent transferees. *Id.* The law firms moved to dismiss, and the bankruptcy court denied the motion, reasoning that the law firms had received proceeds of Generation Resources fraudulent transfer of the Edison receivable to LWHC and were therefore subsequent transferees. *Id.*

(6) On appeal, the Tenth Circuit reversed. According to the Tenth Circuit, in order to succeed on a claim under Section 550, (a) the claim must relate to a transfer avoided under the Bankruptcy Code; and (b) the plaintiff must plausibly allege that it is seeking to recover "the property transferred" or "the value of such property" as required by the plain language of Section 550(a), and (c) the defendant is the "the initial transferee," "the entity for whose benefit such transfer was made," or "any immediate or mediate transferee of such initial transferee" as required by Section 550(a). *Id.* at 965–66.

(7) Because section 550 entitles a trustee to recover "the property transferred" from the transferees, the court first sought to identify "the property transferred." *Id.* The court interpreted this to mean the property fraudulently transferred in the first instance. *Id.* Here, that property was the receivable payable to Generation

Resources by Edison, which Generation Resources had transferred to LWHC. *Id.* The "initial transferee" of the receivable was therefore LWHC. *Id.* However, the law firms, the court held, were not transferees of the receivable. *Id.* at 967. Instead, the firms received funds that LWHC was able to obtain in satisfaction of the receivable, and those funds, the court held, were "distinct 'from the property transferred,' which in § 550 refers only to that property that changed hands as part of the avoided transfer." *Id.* Put another way, if LWHC had assigned the receivable to the law firms, who then converted the receivable into funds, presumably the trustee could have sought to recover the receivable or its value from the law firms. However, because the law firms never received the property in question, the right to payment from Edison, the firms were not subsequent transferees for the purposes of § 550.

(8) *Generation Resources* represents one extreme, focusing on the identity of the fraudulently transferred property (or its value) and requiring the plaintiff to trace the property transferred from the initial transferee through to the subsequent transferees of the initial transferee. In stark contrast to the *Generation Resources* case, Judge Rodriguez of the United States Bankruptcy Court for the Southern District of Texas issued a decision in *In re Giant Gray, Inc.* that essentially provides that *any party* that transacts with an initial transferee of a fraudulent transfer could theoretically be liable as a subsequent transferee of the initial transferee.

(v) **<u>In re Giant Gray</u>**

(1) Less than six months after the *Generation Resources* decision was issued, the Bankruptcy Court for the Southern District of Texas issued a decision in *In re Giant Gray, Inc.*, 629 B.R. 814 (Bankr. S.D. Tex. 2020), which held that while an initial transfer must necessarily involve the transferred property itself, the same restriction is not placed on subsequent transferees. *Id.* at 846. Instead, to be a subsequent transferee, "one need only be a transferee of the initial transferee." *Id.*

(2) In *Giant Gray*, the founder of a software company, a privately held company largely owned by third-party investor shareholders, sought an exit in 2015 through a sale of the company. *Id.* at 824. The founder approached an old ally, Assed "Ozzie" Kalil ("Kalil"), who, along with Michael J. O'Donnell ("O'Donnell"), agreed to help the founder find a buyer. *Id.* However, the founder determined that shareholder approval of a sale would be difficult to obtain and would not produce the return desired for him personally. *Id.* at 825. In an effort to facilitate a sale transaction and to extract greater value for himself, the founder caused the company to issue 1,000 shares of convertible preferred stock to himself. *Id.* In consideration for the issuance of stock, the founder agreed to the terms of an employment agreement with *Giant Gray*. *Id.*

(3) In July 2015, after the convertible stock was issued, the founder entered an agreement to sell the stock for $15 million to Pepperwood Fund II, LP ("Pepperwood II"), a vehicle created by Kalil and O'Donnell and funded by third-party investors. *Id.* at 825–26. Of the $15 million purchase price, the founder directed that $5 million be payable as a referral fee to a separate entity established by Kalil and O'Donnell

(the "Referral Agent"). *Id.* at 826. In addition, on the same day that the founder received the balance of the purchase price, he made several transfers of funds to his children. *Id.*

(4) At the time of the issuance of the convertible stock, the company owed millions of dollars to noteholders that it could not pay. *Id.* at 828. An involuntary Chapter 7 bankruptcy petition was ultimately filed three years later against *Giant Gray* on April 13, 2018. *Id.* at 824. An Order for Relief was entered, and a trustee (the "Giant Gray Trustee") was appointed. *Id.* On May 12, 2020, the Giant Gray Trustee filed separate complaints pursuant to the Texas Uniform Fraudulent Transfer Act and Sections 544 and 550(a) of the Bankruptcy Code against the founder's children, the Referral Agent, Kalil, and O'Donnell (collectively, the "Defendants"). *Id.* at 820. In total, the Giant Gray Trustee sought to avoid and recover more than $6 million from the Defendants as subsequent transferees of the alleged fraudulent transfer of the convertible stock. *Id*. The Defendants moved to dismiss. *Id.*

(5) The Defendants asserted, among other things, that they were not subsequent transferees because they possessed proceeds from the stock sale to Pepperwood II, not the property itself (i.e., the convertible stock) or the value of the property. *Id.* at 841. In response, the Giant Gray Trustee argued that, if the convertible stock was property of the estate, so too were the proceeds from the sale of that stock. *Id.* at 843. The bankruptcy court rejected the Defendants' argument, reasoning that parties "are subject to recovery actions [as subsequent transferees] based solely on their relationship with the initial transferee," rather than their relationship to the property transferred. *Id.* at 846. Accordingly, the court held that as long as the Defendants received a transfer from the initial transferee, the Giant Gray Trustee could recover from the Defendants unless they are able to establish a subsequent transferee defense under § 550(b). *Id.*

(6) The bankruptcy court further reasoned that, to hold otherwise, "[t]ransferees could take with knowledge of the voidability of the transfer, in bad faith, or without providing value, and escape unscathed with property properly belonging to a debtor." *Id.* at 847.

(7) Additionally, in response to the Defendants' argument that the Giant Gray Trustee failed to bring an action to avoid the transfer of convertible stock to the founder, as the initial transferee, the court held that § 550 does not require a trustee to bring an action against the initial transferee in order to recover from subsequent transferees. *Id.* at 832.

(d) ***For Value***

(i) The "value" required to be paid by a subsequent transferee is "merely consideration sufficient to support a simple contract.... There is no requirement that the value given by the transferee be a reasonable or fair equivalent." *In re Enron Corp.*, 333 B.R. 205, 236 (Bankr. S.D.N.Y. 2005). Further, there is "no requirement that the value given by the transferee be a reasonable or fair equivalent." *Id.*

(e) ***In Good Faith***

(i) The Code does not define "good faith." As one court, quoting a classic treatise, defined it: "The question is solely whether the grantee knew or should have known that he was not trading normally but that on the contrary, the purpose of the trade, so far as the debtor was concerned, was the defrauding of his creditors." *See* 5 Collier on Bankruptcy ¶ 550.03.

(ii) The requirement to take in good faith is sometimes seen as redundant with the requirement to take without knowledge of the avoidability of the initial transfer (discussed below). However, literal knowledge of the avoidability of a transfer or willful blindness to such avoidability may not be required to bar a good faith finding—failure to investigate in the face of sufficient facts to cause a reasonable party to investigate may be sufficient. *See, e.g.*, *Bonded Financial Services, Inc. v. European American Bank*, 838 F.2d 890, 897–98 (7th Cir. 1988) ("the recipient of a voidable transfer may lack good faith if he possessed enough knowledge of the events to induce a reasonable person to investigate").

(iii) **In re Bernard L. Madoff Investment Securities, LLC**

(1) The Second Circuit weighed in on the good faith question in 2021 in a decision from the long running saga of avoidance actions in the wake of the Madoff ponzi scheme. The court of appeals vacated a 2019 bankruptcy court ruling dismissing the trustee's claims against certain defendants on a determination by the bankruptcy court that the Trustee had failed to allege that the subsequent transferees had not received the transferred funds in good faith.

(2) In 2014, Judge Jed Rakoff of the U.S. District Court for the Southern District of New York held in *Securities Investor Protection Corp. v. Bernard L. Madoff Inv. Securities LLC*, 516 B.R. 18, 24 (S.D.N.Y. 2014) that, under the Securities Investor Protection Act ("SIPA"), a SIPA trustee seeking to avoid a fraudulent transfer bears the burden of pleading that the defendant lacked good faith. The court determined that placing the burden on the defendant would "totally undercut" SIPA's twin goals of maintaining marketplace stability and encouraging investor confidence "if a trustee could seek to recover the investors' investments while alleging no more than that they withdraw proceeds from their facially innocent securities accounts."

(3) Judge Rakoff also held that "willful blindness," rather than "inquiry notice" is the proper standard for pleading a lack of good faith in fraudulent transfer actions commenced under SIPA. Following a dismissal of the trustee's actions by the bankruptcy court on remand, the Second Circuit accepted a direct appeal of the dismissals.

(4) The Second Circuit first rejected the argument that federal securities law requires a willful blindness standard for good faith in SIPA liquidations. *In re Bernard L. Madoff Investment Securities LLC*, 12 F.4th 171 (2d Cir. 2021). Under the Second Circuit's decision, a transferee may be found to lack good faith when the information the transferee learned would have caused a reasonable person in the transferee's position to investigate the matter further. Notably, however, the panel held that inquiry notice "does not universally impose an affirmative duty to investigate." *Id.* at 195.

(5) The court held that a determination as to whether a transferee has acted in good faith requires a three-step analysis. **First**, a court must examine what facts the defendant knew. **Second**, a court must determine whether those facts put the transferee on inquiry notice of the fraudulent purpose behind the transaction–whether a reasonable person would conduct further inquiry into a possible fraud. **Third**, if the court determines that a transferee had been put on inquiry notice, the court must then determine whether diligent inquiry by the transferee would have discovered the fraudulent purpose of the transfer.

(6) Finally, the Second Circuit reasoned that good faith is an affirmative defense under both Sections 548 and 550. Accordingly, the defendant bears the burden of pleading the affirmative defense of "good faith". The trustee does not bear the burden of pleading or proving a lack of good faith.

(f) ***Without Knowledge***

(i) To be protected under section 550(b)(1), a subsequent transferee also must take "without knowledge of the voidability of the transfer avoided."

(ii) Implicit in the "value" requirement of section 550(b) is that the value paid is determined without knowledge of the potential voidability of the underlying transfer of the property to the initial transferee. *In re Enron Corp.*, 333 B.R. 205, 236 (Bankr. S.D.N.Y. 2005). Moreover, as discussed above, the "without knowledge" element somewhat overlaps "good faith" prong of section 550(b)(1). *See, e.g.*, *In re Commercial Loan Corp.*, 396 B.R. 730, 745 (Bankr. N.D. Ill. 2008) (both "good faith" and "knowledge of avoidability" "hinge on knowledge").

(g) ***Burden of Proof***

(i) Section 550(b) does not contain a provision placing the burden of proof on either the trustee or the transferee. The *Madoff* decision settles the question in the Second Circuit by placing the burden of proving the affirmative defense of good faith squarely on the transferee. Not every Circuit has ruled on this issue; however, those that have seem to have come to the same conclusion as the Second Circuit. *See, e.g.*, *In re Smith*, 811 F.3d 228, 246 (7th Cir. 2016); *In re Mortgage Store, Inc.*, 773 F.3d 990 (9th Cir. 2014); *In re Nieves*, 648 F.3d 232 (4th Cir. 2011); *In re Nordic Vill., Inc.*, 9015 F.2d 1049 (6th Cir. 1990), *rev'd on other grounds sub nom. United States v. Nordic Vill., Inc.*, 503 U.S. 30 (1992).

2. <u>**Recent Developments Concerning Intent**</u>

(a) ***Fraudulent Transfers – Section 548(a)(1)(A)***

(i) Section 548(a)(1)(A) permits a trustee to avoid any transfer of the debtor's property made in the two years preceding a bankruptcy filing when such transfer is made "with an actual intent to hinder, delay or defraud" creditors.

(ii) Because of the difficulty in proving a debtor's actual intent to defraud, intent may be inferred from the existence of certain "badges of fraud," including whether: (a) the transfer or obligation was to an insider; (b) the debtor retained possession or control of the property transferred after the transfer; (c) the transfer or obligation was disclosed or concealed; (d) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit; (e) the transfer was of substantially all of the debtor's assets; (f) the debtor absconded; (g) the debtor removed or concealed assets; (h) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred; (i) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred; (j) the transfer occurred shortly before or shortly after a substantial debt was incurred; and (k) the debtor transferred the essential assets of the business to a lienor that transferred the assets to an insider of the debtor.

(iii) **<u>In re Tribune</u>**

(1) The Tribune Company ("Tribune") filed a chapter 11 petition in the Delaware bankruptcy court in December 2008. 10 F.4th 147, 158 (2nd Cir. 2021). Tribune's plan of reorganization was confirmed in 2012. *Id.* Pursuant to Tribune's confirmed plan, certain causes of action retained by the estate were assigned to a litigation trust. *Id.* A litigation trustee was appointed and empowered to pursue the litigation trust's causes of action, which included, among other things, potential causes of action against shareholders owning approximately 33% of Tribune's outstanding shares (the "Large Shareholders") and Citigroup, Merrill Lynch, Morgan Stanley, and VRC (each defined below and collectively, the "Financial Advisors") resulting from alleged intentional fraudulent transfers by Tribune to those entities. *Id.*[1]

(2) In late 2005, Tribune's board of directors (the "Board") hired two financial advisors, Merrill, Lynch, Pierce, Fenner and Smith, Inc. ("Merrill Lynch"), and Citigroup Global Markets, Inc. ("Citigroup") to conduct a "strategic review and to recommend possible responses to the ongoing changes in the media industry." *Id.* at 155. Both Merrill Lynch and Citigroup stood to receive a $12.5 million "Success Fee" if a "Strategic Transaction" was completed. *Id.* In 2006, the Board appointed a special committee (the "Special Committee"), comprised of all seven of the Board's independent directors, to consider ways to return value to Tribune's shareholders. *Id.* The Special Committee hired Morgan Stanley & Co. ("Morgan Stanley") to serve as its independent financial advisor. *Id.* at 156. In early 2007, an investor proposed to take Tribune private through a two-step LBO, and, on April 1, 2007, the Special Committee unanimously voted to recommend the two-step LBO, which the Board approved. *Id.* Tribune also retained Valuation Research Company ("VRC") to provide two solvency opinions, one for each step of the LBO, agreeing to pay VRC a $1.5 million fee for the engagement. *Id.* at 157. As part of the LBO, Tribune borrowed $7 billion to pay off its existing bank debt and to complete a tender offer, buying back just over half of its publicly held shares, including those held by the Large Shareholders. *Id.* at 164. Less than a year after closing the LBO, Tribune filed for bankruptcy. *Id.* at 158.

(3) In 2017, the district court dismissed the trustee's intentional fraudulent conveyance claims, finding that the complaint failed to allege with specificity, as required

[1] The trustee also asserted constructive fraudulent transfer claims against Tribune, claims against the Large Shareholders for breach of fiduciary duty, and claims against the Financial Advisors for aiding and abetting breach of fiduciary duty and professional malpractice. Those claims are beyond the scope of this outline, and, as such, are not discussed here.

by Rule 9(b) of the Federal Rules of Civil Procedure for intentional fraudulent conveyance actions,[2] that Tribune had the actual intent to defraud its creditors when it bought back shares from shareholders pursuant to the LBO (*Id.* at 158) and paid certain advisory fees to the Financial Advisors. *Id.* at 159.

(4) On appeal, the trustee advanced two arguments in support of his assertion that he had pled his intentional fraud claims with sufficient particularity. First, the trustee argued that Tribune's senior management possessed actual intent to defraud, and that intent could be imputed to the Special Committee. *Id.* at 161. Second, even if the senior management's intent to defraud could not be imputed to the special Committee, the Special Committee had the requisite intent as demonstrated by badges of fraud. *Id.* The Second Circuit affirmed the district court's rejection of both of these arguments. *Id.* In its decision, the Second Circuit adopted the "control test" to determine whether the entity authorized to approve a transfer, the Special Committee in this instance, had the actual intent to harm creditors. *Id.* Under the control test, "a court may impute any fraudulent intent of an actor to the transferor if the actor was in a position to control the disposition of the transferor's property." *Id.* (citation omitted). Here, however, the Board had created a Special Committee to evaluate the LBO, the Special Committee had, in turn, retained a financial advisor, and there was no evidence that the senior management improperly pressured the Independent Directors or dominated the Special Committee. *Id.* Moreover, the trustee did not allege any financial or personal ties between senior management and the Independent Directors that could have affected the impartiality of the Special Committee. *Id.*

(5) After finding that the trustee failed to sufficiently allege facts from which intent could be imputed to the Special Committee as a result of the actions of Tribune's senior management, the court then scrutinized the trustee's allegations that actual fraudulent intent on the part of the Special Committee could be inferred from the fact that the members of the special Committee stood to earn $6 million for selling their shares if they approved the LBO. *Id.* at 162. In affirming the determination of the district court that the trustee failed to plead "badges of fraud sufficient to raise a strong inference of actual fraudulent intent on the part of the Special Committee", the Second Circuit concluded that it "would be unreasonable to assume actual fraudulent intent whenever the members of a board of director (or a committee created by that board) stood to profit from a transaction they recommended or approved." *Id.* Further, the court was not persuaded by the trustee's allegations that the Independent Director's knew of the riskiness of the transaction and likelihood that Tribune would be unable to generate enough cash to service its debt following the LBO. *Id.*

(6) The court similarly rejected the trustee's intentional fraudulent conveyance claims as they related to fee payments to Citigroup, Merrill Lynch, and Morgan Stanley. *Id.* at 170–71. In the case of Morgan Stanley, the court noted that the Trustee had failed to make any allegation that the fees paid for its fairness opinion were motivated

[2] Federal Rule of Civil Procedure 9(b) provides that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally."

by any fraudulent intent. *Id.* at 170. While the Second Circuit noted that the Trustee had alleged that Citigroup and Merrill Lynch were incentivized to promote the LBO over other proposals and that they had not reported the concealment of certain facts by Tribune's management, the court ultimately determined that without a showing of "reserving rights in the property, hiding funds, and paying an unconscionable price . . . the Trustee has not satisfied the heightened pleading standard [of Federal Rule of Civil Procedure 9(b)] for demonstrating an actual fraudulent conveyance as to Citigroup and Merrill Lynch. *Id.* at 171.

(7) In contrast, the court found that the badges of fraud were sufficient to survive a motion to dismiss with respect to the intentional fraudulent conveyance claims against VRC. *Id.* Specifically, in finding that the trustee sufficiently alleged the existence of badges of fraud to infer actual fraudulent intent on VRC's part, the court cited the fact that Tribune had "hastily hired VRC after Duff & Phelps, the company initially hired to perform a solvency analysis, informed Tribune that it could not provide a favorable solvency opinion, and after another "prominent" valuation firm rebuffed Tribune," that VRC had charged its highest fee ever for this engagement, and that VRC was willing to use a special definition of "fair value" that was not in line with industry standards. *Id.*

ABI NYC Bankruptcy Conference Bankruptcy Litigation Panel

Distressed Liability Management Transactions **June 10, 2022**

DLA Piper LLC and Quinn Emanuel Urquhart & Sullivan, LLP

Distressed Liability Management Transactions

HISTORY AND CURRENT ISSUES

DLA Piper LLC and Quinn Emanuel Urquhart & Sullivan, LLP

Distressed Liability Management Transactions

OVERVIEW

- There are two types of liability management transactions:
  - ***"Drop-down" financings***, in which lenders provide structurally senior financing secured by assets outside of an existing collateral package often, though not always, using unrestricted subsidiaries.
    - The quintessential drop-down financing was the *J.Crew* transaction from 2016.
    - More recent examples include:
      - *Neiman Marcus (2017)*
      - *Pet Smart (2018)*
      - *Travelport* (2020)
      - *Cirque du Soleil* (2020)
      - *Revlon* (2020)
  - ***"Uptiering" transactions***, in which lenders enhance the priority of their claims to an existing collateral and guarantee package, typically in connection with and consideration for providing priming new-money debt.
    - One of the earliest uptiering transactions was the *NYDJ* transaction from 2017
    - More recent examples include:
      - *Murray Energy* (2018; litigated in 2020)
      - *Serta Simmons* (2020)
      - *Boardriders (2020)*
      - *TriMark (2020)*
      - *Incora (2022)*

Drop-Down Financings

Typical Transaction Structure

- Company forms/designates an unrestricted subsidiary or another non-guarantor subsidiary (such as a foreign subsidiary, joint venture or other excluded subsidiary) ("NewCo") which is not required to guarantee existing loan obligations.
- Either NewCo is completely excluded from the restrictive covenants in the existing debt documents (in the case of an unrestricted subsidiary) or there is sufficient capacity (including after giving effect to concurrent amendments) in the existing loan documents for NewCo to incur structurally senior debt.
- Company contributes, sells or otherwise transfers assets (often intellectual property) to NewCo.
  - Contribution/sale/transfer is permitted under the existing loan documents and results in an automatic release of liens on such assets in favor of existing lenders.
  - NewCo incurs (or guarantees) new debt financing that is secured by the contributed assets (and sometimes by the existing collateral package of Company and its other guarantor subsidiaries).
- As consideration for providing such new debt financing, participating lenders may also be entitled to exchange or "roll up" all or a portion of their existing loans into a *pari passu* or junior claim against NewCo (and, if applicable, the Company and its other guarantor subsidiaries).
- As to the NewCo assets, the new debt financing (as well as any exchanged or rolled-up loans) is structurally senior to the loans of the existing lenders.

Drop-Down Financings

STRUCTURAL SUBORDINATION

Typical Structure Applicable/Credit Agreement Provision

Formation or identification of NewCo

- Definition of "unrestricted subsidiary" and "designation" provisions
- Collateral and guarantee / excluded subsidiary provisions

Transfer of assets to NewCo (often accompanied by a license back to borrower)

- Investment covenant
- Asset sale covenant
- Collateral release provisions
- Sale leaseback covenant
- Limitations on release of all or substantially all collateral

Incurrence of new debt at NewCo (the "New Structurally Senior Debt"), which is either:

- Unlimited (if NewCo is an unrestricted subsidiary);
- Subject to the existing credit facility covenants (if NewCo is an excluded restricted subsidiary)

- If applicable, restrictions on unrestricted subsidiaries guaranteeing, or being guaranteed by, credit parties
- If incurred at or guaranteed by an excluded restricted subsidiary, debt and lien capacity (typically subject to "non-guarantor" sub-limits)

Where applicable, exchange or "roll-up" all or a portion of—

- Pro rata sharing provisions existing loans of the new creditors into New Structurally Senior
- Borrower buybacks or Dutch auction provisions Loans
- Limits on prepayments junior debt (if applicable)

Uptiering Transactions

Typical Transaction Structure

- Company incurs new money "super-priority" loans provided by a group of existing lenders.
- In exchange, existing debt (whether senior, junior or subordinated) of participating lenders is exchanged for or "rolled up" into (typically, a lesser amount of) *pari passu* "super-priority" or "second" priority loans.
- Existing loans of non-participating lenders are, effectively, subordinated to "third" priority.
- Priorities may be affected by:
  - Incurring the new and rolled up loans under a separate credit facility and secured by separate classes of liens with priority as between the new (senior) and existing (junior) credit facilities dictated by an intercreditor agreement.
  - Incurring the new and rolled up loans as new classes within the existing credit facility with priority dictated by the credit agreement waterfall .
  - A combination of the foregoing
- Equity (or equity-like) instruments may be included to provide participating lenders with potential equity upside.

Uptiering Transactions

CONTRACTUAL SUBORDINATION

Typical Structure/Applicable Credit Agreement Provision

Incurrence of new debt by the borrower that is senior to existing

- Debt and lien covenants loans
- Limits on subordination of existing debt

Exchange/rollup of all or a portion of existing loans into senior

- Pro rata sharing provisions debt that is *pari w*ith or junior to the New Superpriority Loans
- Buybacks or Dutch auction provisions senior to the existing loans ("Rolled Up Superpriority Debt").
- Limits on prepayment of junior debt (if applicable)

The New Superpriority Debt and the Rolled Up Superpriority Debt may take the form of:

- New tranche of loans within the loan document, with priority governed by a waterfall; or
- Debt under a separate credit facility, with priority governed by an intercreditor agreement

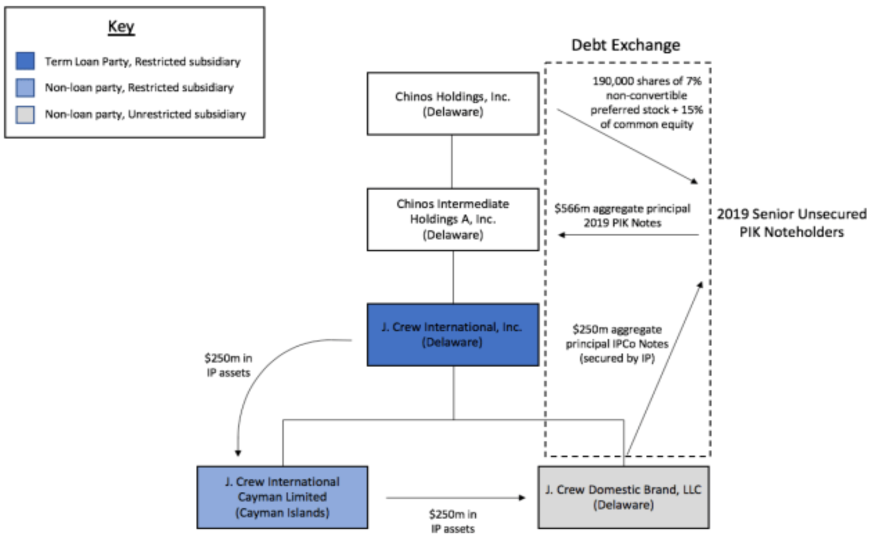
- Pro rata sharing/waterfall provisions (including related amendment requirements)
- Subordination/release of all or substantially all collateral
- Intercreditor restrictions

Covenant stripping" and Exit Consent

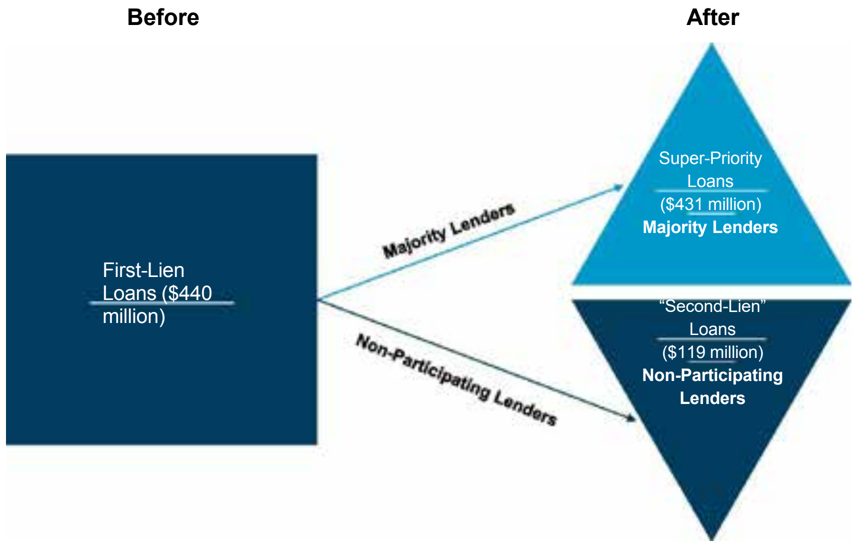
- Gives "pro forma" effect to new indebtedness in determining Required Lenders.
- Limits on exit consents

J. CREW

J. Crew Maneuver



Boardriders



Summary of Relevant Transactions

DROP DOWN TRANSACTIONS

Transaction	Summary and Status
J. Crew	➢ The J. Crew transaction involved J. Crew Group, Inc. moving a majority of its U.S. trademarks into an unrestricted subsidiary and, then, using the value thus created to obtain, in effect and through the issuance of new debt, a two-year maturity extension from its Holdco bondholders. ➢ In the first step of a two-step transaction, J. Crew contributed an undivided 72.04% interest in the IP Assets to IPCo, an unrestricted subsidiary formed when J. Crew still had ability under its Term Loan Facility credit agreement covenants to designate subsidiaries as unrestricted. ➢ In the second step, J. Crew entered into a Term Loan Facility Amendment and Exchange Offer providing for (A) the repurchase and cancellation of $150 million of Term Loans, a new Term Loan of $30 million and the issuance of $97 million of new notes; and (B) the exchange of $543 million in PIK Notes into: (i) $250 million of new IPCo Notes, which bore a 13% interest rate, were due 2021, and were secured by the transferred IP Assets; (ii) $190 million of new 5% cash / 2% PIK non-convertible perpetual preferred stock; and (iii) 15% of the common equity. ➢ Litigation ensued, with J. Crew filing an action (the "Company Action") in New York State court against WSFS, as successor Term Loan Agent (the "Term Loan Agent"), seeking a declaratory judgment that the IP transaction did not violate the Term Loan Facility credit agreement, which was ultimately dismissed as a condition to consummation of the Exchange Offer. ➢ In June 2017, certain of the Company's Term Loan Facility lenders (the "Term Loan Lenders") commenced an action (the "Term Lender Action") to enjoin or unwind the Term Loan Facility Amendment, the transfer of the IP Assets, and PIK Notes exchange. In May 2018, the New York court issued a decision (i) dismissing most of Term Loan Lenders' claims on "no action clause" grounds; and (ii) declining to dismiss the claim that J. Crew

Transaction	Summary and Status
J. Crew (cont'd)	breached the Term Loan Agreement by transferring "all or substantially all of its assets" without unanimous lender consent, as to which litigation continued for additional year. The refinancing and litigation bought J. Crew a longer runway, which finally ran out due to the impact of COVID-19 in May 2020, when the company filed for Chapter 11.
Neiman Marcus	➢ In September 2017, Neiman spun off its MyTheresa unrestricted subsidiaries to the Company's ultimate parent. By spinning off the MyTheresa unrestricted subsidiaries to its parent, the Company removed this value from the relevant collateral packages, and the Company's creditors could no longer look to the value of the equity of the MyTheresa unrestricted subsidiaries for credit support under the terms of the Term Loan, the ABL, and the Senior Notes. Neiman was thereafter able to undertake a two-step transaction to obtain additional financing. ➢ In December 2018, Marble Ridge Capital ("Marble Ridge"), a significant holder of the Senior Notes and Term Loan debt, commenced a suit in Texas state court, asserting that Neiman had orchestrated an "integrated two-step scheme" to loot the Company and transfer the MyTheresa business, which represented approximately $1 billion of value, to the Neiman parent "***for no consideration***." ➢ Marble Ridge's lawsuit sought to avoid the transfers made to the parent and/or to subsequent transferees as an intentional or constructive fraudulent transfer and also sought to recover the recovered assets. Neiman argued in response that it had "specifically bargained for - and its financial creditors agreed to provide - the significant flexibility afforded by the ability to designate entities as unrestricted subsidiaries as well as the very broad baskets under the Debt Documents." ➢ In March 2019, the Texas court dismissed Marble Ridge's claims with prejudice for lack of standing. The challenge to the transaction continued in the chapter 11 cases, where the Creditors' Committee, led by Marble Ridge, negotiated a settlement that would have resulted in the transfer of 140 million shares of MyTheresa stock to the bankruptcy estate for the benefit of the unsecured creditors.

Transaction	Summary and Status
iHeart Media	➢ On December 3, 2015, a wholly-owned restricted subsidiary of iHeart, contributed 100 million Class B shares of Clear Channel Outdoor Holdings Inc. ("CCOH") to Broader Media, LLC ("Broader Media"), a newly formed wholly-owned subsidiary of iHeart. Unlike CCOH, Broader Media was an unrestricted subsidiary of iHeart, and thus generally not bound by the indentures (the "PGN Indentures") governing the Company's Preferred Guarantee Notes (the "PGNs"). ➢ CCOH subsequently declared a dividend as to the CCO stock, and Broader Media, the unrestricted subsidiary, used the proceeds of its share of the dividend to repurchase iHeart debt at a discount, something which the Restricted Payment covenant in the PGN Indentures prohibited iHeart and its restricted subsidiaries from doing directly. ➢ The PGN Noteholders threatened to declare a default and in anticipation of this possibility, iHeart filed an action in Texas state court, seeking (i) a temporary restraining order prohibiting the PGN Noteholders from issuing false notices of default; and (ii) a declaratory judgment that the Company was not in default under the PGN Indenture by reason of the capital contribution of the CCOH Equity. ➢ In May 24, 2016, the Texas court entered judgment, granting iHeart's request for declaratory relief that the capital contribution of the CCOH Equity complied with the PGN Indentures, as well its request for a permanent injunction rescinding the notices of default and permanently enjoining the PGN Noteholders from issuing new notices of default based on the CCOH Equity capital contribution. ➢ In its opinion, the Texas court held that the capital contribution of the CCOH Equity constituted an "Investment" under the PGN Indentures because it was both a "capital contribution" and also "property transferred to . . . an Unrestricted Subsidiary," in compliance with the definition of "Investment" in the PGN Indentures. ➢ In October 2016, the Texas Court of Appeals upheld the lower court's decision, and no additional litigation as to the iHeart/Broader Media transaction has ensued in Texas state court or elsewhere.

Transaction	Summary and Status
PetSmart	➢ In June 2018, PetSmart transferred 36.5% of its equity interests in Chewy, it's online pet product division, through the use of available restricted payment and investments baskets under its secured credit facilities. PetSmart transferred 20% by way of a distribution to a holding company owned by its equity investors (none of whom provided credit support for PetSmart's credit facilities) and contributed 16.5% as an investment to a new wholly-owned subsidiary of PetSmart that was designated as an unrestricted subsidiary. ➢ Importantly, PetSmart relied on an "available amount" basket to make the distribution, meaning that PetSmart was able to make distributions in an amount up to the approximately $1 billion of cash contributions that it had received from PetSmart's equity holders from the period following the initial closing of the PetSmart credit facilities. ➢ A third-party advisor hired by PetSmart determined the value of the distribution of the equity interests in Chewy to be $908.5 million. Thus PetSmart considered that the distribution was permitted by the terms of its debt agreements because the value of the Chewy equity interests so distributed fell within the available basket amount. ➢ To the chagrin of the lender group, PetSmart's credit agreement and indentures included an automatic release provision, which effectively provided that if a subsidiary ceased to be wholly-owned by PetSmart, such subsidiary would be automatically released from its guarantee obligations, and any liens granted on the assets of such subsidiary would be terminated. ➢ PetSmart approached the administrative and collateral agent for its credit facilities and asked for a confirmation of a release of the guarantee and liens, but the administrative agent and lenders, allegedly at the direction of an ad hoc group of lenders, refused to cooperate. Litigation ensued, with PetSmart's credit agreement lenders challenging, among other things, the calculations used to value the baskets utilized by PetSmart to effect the transfers and asserting that the transfers and distributions left PetSmart insolvent.

Transaction	Summary and Status
PetSmart (cont'd)	➢ Chewy, in the meantime, continued to rapidly grow, and PetSmart and its equity investors eyed an IPO of Chewy to monetize that growth. In order to clear an IPO, the litigation between PetSmart and its creditors needed to be resolved. After a failed attempt at an amendment to approve the equity transfers, PetSmart was successful in convincing the lenders to agree to such approval, but only after enhancing the terms of a second amendment, including with higher interest rates, a consent fee and improved paydown terms. After a large key investor consented, lenders rushed to consent to make sure they were not left out of the deal. ➢ With the lenders now presumably consenting to the transfers and the litigation hurdle cleared, the IPO was ready to be proceed, resulting in an IPO of Chewy on the NYSE in June 2019. At the end of the day, the PetSmart creditors received a paydown from IPO proceeds received by PetSmart (approximately 15% of the term loans were repaid) and PetSmart's corporate credit rating was upgraded (from CCC to B- by S&P and from Caa1 to B3 by Moody's). ➢ PetSmart continues to own approximately 67% of Chewy, which, with an implied valuation of $14 billion post-IPO, continues to give PetSmart lenders some collateral coverage due to the value of the portion of Chewy still owned by PetSmart. While some lenders have continued to litigate the Chewy transactions and lender consent process, the situation has mostly stabilized.

Transaction	Summary and Status
Travelport	➢ In May 2020, Travelport engaged in a similar action, transferring intellectual property to an unrestricted subsidiary and subsequently obtaining a $1 billion loan secured by such intellectual property. According to Travelport, the loan was necessary to provide the company with much-needed cash as it navigated a market with substantial drops in flight bookings and an uncertain near-term recovery. ➢ In the face of expected opposition from Company's existing first lien lenders, Travelport filed a lawsuit in New York state court in June 2020 seeking a declaratory judgment that Travelport's transfer of assets was permitted under the terms of its credit facility. Litigation continued in this action, but, at the same time, Travelport entered into negotiations with the first lien lenders. ➢ In July 2020, an ad hoc group of lenders asserted counterclaims seeking a finding that the asset transfer was a breach of the credit agreements and constituted an event of default thereunder and that, due to the breach, the secured lenders continued to have liens on the "siphoned IP" securing the obligations under the credit agreements, which liens were senior in priority to "any purported lien securing the insider financing." The group argued that the "siphoning transfer is avoidable as an intentional fraudulent transfer," and the "siphoning transfer is a breach of the duty of good faith and fair dealing." ➢ In September 2020, Travelport reached an agreement with the ad hoc group of lenders, pursuant to which consenting lenders received a 50-bps fee, a higher interest rate and a $250 million par paydown within 12 months and Travelport effectuated certain financing open market purchase and exchange transactions, pursuant to which, among other things, the company's existing lenders provided $500 million in new funding to the Company and the parties released all related litigation and claims against one another. ➢ The Travelport settlement differed from the J. Crew and PetSmart settlements in a number of respects, including, most significantly, that it was the only one that resulted in an unwinding of the IP transfer.

Transaction	Summary and Status
Cirque du Soleil	➢ In response to disruptions caused by COVID-19 pandemic, Cirque du Soleil skipped an interest payment on its senior secured lending facility, cancelled performances, and laid off approximately 95% of its workforce. ➢ At the same time, the Company transferred certain trademarks and other intellectual property rights into an unrestricted subsidiarycontrolled by three of the company's largest equity holders. ➢ Rejecting a separate financing offer from its existing lenders, Cirque du Soleil then accepted a $50 million "emergency" loan from these same equity holders, who offered better terms, given the intellectual property collateral they were receiving. ➢ According to TPG, the lead equity holder, "[t]he purpose of the dropdown, which was recommended by the independent transaction committee of the Cirque Council, was to establish a structure that would ensure Cirque could seek and receive emergency financing, which would otherwise be unavailable given the continued disruption brought on by the COVID-19 pandemic. By using bargained for provisions in the credit agreement that the lenders consented to at the time of the credit agreement, Cirque was able to create unrestricted subsidiaries and drop down the IP assets, which allowed it to receive several financing proposals to address near term liquidity needs and sustain limited operations during this period." ➢ There was market speculation that Cirque du Soleil's creditors would seek to have the transaction unwound if Cirque du Soleil subsequently filed for bankruptcy. ➢ Cirque did file for bankruptcy both under Companies' Creditors Arrangement Act in Canada and Chapter 15 in the United States. ➢ A sale process ensued, pursuant to which Cirque's secured creditors took control, in a transaction that closed in November 2020, of the business. TPG, which had benefitted from the drop down transaction as an interim measure, received no recovery on its equity investment.

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Transaction	Summary and Status
Revlon	➢ In 2019, Revlon (i) transferred a significant amount of intellectual property, comprising the American Crew brand, out of the reach of existing creditors to foreign unrestricted subsidiaries; (ii) entered into a Term Credit Agreement for a $200 million term loan secured by the transferred assets that was structurally senior to existing secured debt on the transferred assets, and *pari passu* as to all other assets, and licensed back the transferred IP to the Company's operating business. ➢ In 2020, the Company went a few steps further and transferred the vast majority of remaining IP collateralizing the 2016 Term Loan, including IP comprising the Elizabeth Arden brand, to BrandCo and used the transferred IP (together with the IP previously transferred in 2019) secure, on a first priority basis, a new term loan facility (the "2020 Term Loan Agreement") that, among other things, refinanced in full the 2019 Term Loans. ➢ The lenders under the 2016 Term Loan Agreement ("2016 Term Loan Lenders") thereafter challenged the transfers relating to both the 2019 Term Loan Agreement and the 2020 Term Loan Agreement, and the overall enforceability of the 2020 Term Loan Agreement. ➢ In the interim—in a well-publicized decision about bank payment error—the 2016 Term Loan Lenders received payment in full ($900 million) on their loans, only to see Citibank, the agent under the 2016 Term Loan Agreement, bring suit claiming the repayment was made in error. ➢ The District Court ruled that the 2016 Term Loan Lenders could retain the funds; Citibank appealed to the Second Circuit, the case was argued in Second Circuit on September 29, 2021, and remains *sub judice*. ➢ In the interim, there have been no publicly disclosed developments in the still pending drop down litigation.

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Summary of Relevant Transactions

UPTIERING TRANSACTIONS

Transaction	Summary and Status
Serta Simmons	➢ In June 2020, Serta entered into a transaction with a majority of its existing first lien and second lien lenders that created two new tranches of debt, both ranking ahead of Serta's existing first lien loans: (i) a $200 million new-money tranche; and (ii) an exchange tranche comprising $875 million of loans created through an exchange of the participating lenders' first and second lien loans. Serta and the participating lenders negotiated and executed a series of amendments to the loan documents including the First Lien Term Loan Agreement (Agreement), which allowed the transaction to be consummated. ➢ Lenders that were not included in the negotiations resulting in the uptiering transactions—holders of approximately $7.4 million of existing first lien loans—brought an action alleging, among other things, that Serta (i) breached the Agreement by structuring a debt exchange that did not qualify as an "open market purchase" and, accordingly, violated the lenders' rights to receive *pro rata* payments under the Agreement; and (ii) breached the implied duty of good faith and fair dealing by depriving the plaintiffs of their senior secured position in Serta's debt stack. ➢ The Serta litigation commenced in New York state court, but, after denial of a preliminary injunction in that venue, the action shifted to federal court in the Southern District of New York. In a win for non-participating lenders, in March 2022 U.S. District Judge Katherine Failla of the Southern District of New York issued an opinion denying Serta's motion to dismiss the action challenging its uptiering exchange and allowing the minority lenders to continue to pursue claims against Serta for breaches of the credit agreement and the implied covenant of good faith and fair dealing. ➢ The court concluded, among other things, that Serta may have breached the credit agreement's "open market purchase" provisions in consummating the uptiering exchange and violated standards of good faith and fair dealing in depriving the non-participating lenders of their seniority status in the debt structure. ➢ The court also found that the minority lenders had standing to bring such claims despite a no-action clause in favor of the administrative agent under the credit agreement.

Transaction	Summary and Status
Murray Energy	➢ In June 2018, with the majority of lenders' consent, Murray amended its $2 billion credit facility to remove all negative covenants (including limitations on incurring debt and granting liens) and to permit the majority of lenders to sell their existing loans (the "2015 Loans") to Murray in exchange for new loans issued under a new credit agreement (the "2018 Loans"). As part of the amendment, the 2018 Loans were granted a first-out position in front of the 2015 Loans, which were now held by the minority lenders who did not consent to the amendments. ➢ Murray subsequently filed for bankruptcy, and the agent, on behalf of certain of the minority lenders, filed an adversary proceeding to rescind the transaction, proffering two arguments: (i) the lenders who purchased the 2018 Loans and consented to the amendment should not have been counted for purposes of determining majority-of-lenders consent because they had already committed before the amendment to selling the 2015 Loans back to Murray; and (ii) the subordination of liens required the consent of all affected lenders because it implicated a "sacred right," *i.e.*, essentially a release of all or substantially all of the collateral. ➢ The court dismissed these claims (*In Re Murray Energy Holdings Co.*, No. 19-56885 (Bankr. S.D. Ohio, May 4, 2020), finding that (i) while the lenders holding the 2015 Loans had committed before entering the 2018 amendment to selling the 2015 Loans to Murray, they remained "lenders" under the agreement at the time of their consent, and thus the amendment was effective; and (ii) consent to subordination was not required by all lenders "merely because the actual impact of a subordination on a particular creditor is the same as a release of collateral" because if the parties had intended the amendment provision to cover subordination, they would have used that term in addition to "release." ➢ In an effort to spare their estates escalating costs associated with the litigation, the court, with the consent of Debtors and the Ad Hoc Group, an Order was entered staying the litigation so long as the chapter 11 plan was amended to provide the Term Loan Claims with *pari passu* treatment with the Superpriority Claims. Such a plan was proposed, but disputes relating to its implementation emerged and litigation continued.

Transaction	Summary and Status
Murray Energy	➢ On November 8, 2021, the court denied cross-motions for summary judgment due to conflicting expert testimony on whether the transaction was in fact a modified Dutch auction "as that term is commonly understood in the finance industry." The Court separately scheduled a status conference to address pretrial matters and the scheduling of a trial. ➢ In February 2022, settlement was reached on terms that have not been publicly disclosed and the action dismissed.
Boardriders	➢ In April 2018, Boardriders, a surfing and skateboarding apparel maker, announced a recapitalization transaction that was negotiated among certain of the Company's first lien term lenders comprising the majority lenders (the "Majority Lenders") and the equity sponsor. ➢ Boardriders and the Majority Lenders amended the existing credit agreement to (i) waive the negative covenants limiting debt and liens to provide new senior lien debt capacity; and (ii) eliminate substantially all of the affirmative and negative covenants. ➢ More than $110 million in new senior lien debt was incurred pursuant to a superpriority credit agreement using the open market repurchase provisions to exchange existing loans of the Majority Lenders into new senior lien debt. ➢ In September 2020, an ad hoc group of non-participating first lien lenders (the "Non-Participating Lenders") sent a demand letter to the company characterizing the transaction as "Serta on steroids" and demanding that the company repay all of its existing term loans in full in cash or exchange the existing term loans held by the lender group for superpriority term loans. ➢ In October 2020, the Non-Participating Lenders filed a complaint in New York Supreme Court seeking to challenge the transaction alleging that it "unfairly favors" the equity sponsor and the Majority Lenders to the detriment of the Non-Participating Lenders ➢ The complaint alleged that as a result of the unlawful "Private Roll-up Transaction," the Non-Participating Lenders had been subordinated in lien priority by up to $431 million of super-priority secured debt, of which $321 million was *pari passu* to the existing term loans held by the Non-Participating Lenders prior to the exchange

Transaction	Summary and Status
Boardriders (cont'd)	➢ Similar to the arguments set forth by certain of the *Serta* plaintiffs, the Non-Participating Lenders argued that "nothing about [the transaction] resembles an open market purchase" ➢ The complaint further alleged that the debt exchange required the consent of *all* lenders because the roll-up of Majority Lenders' existing term loans resulted in a reduction in their principal amount and such reduction directly and negatively affected the obligations of the Non-Participating Lenders. ➢ In December 2020, Defendants Boardriders and the Participating Lenders moved to dismiss the complaint in its entirety, alleging that the refinancing transaction at issue was permitted under the credit agreement. ➢ More specifically, Boardriders contended that the complaint should be dismissed in its entirety with prejudice, arguing that on its face, the credit agreement governing the term loans permits the "liquidity transaction." ➢ Additionally, Boardriders argued that the plaintiffs lacked standing to bring the claims because they failed to meet their own basic obligations under the applicable no-action provision in the credit agreement, by failing to post a cash indemnity and failing to provide the requisite direction to the administrative agent to pursue litigation. ➢ Finally, Boardriders argues that the relevant amendments could be properly effected with the consent of less than all the lenders because the "sacred rights" enumerated under section 12.12(a) of the credit agreement "*do not* cover or apply to amendments which (i) subordinate the liens securing the Term Loans, (ii) change or remove the affirmative and negative covenants under Sections 8 and 9 of the Credit Agreement, or (iii) modify the requirements for Lenders to pursue claims against Boardriders. ➢ In September 2021, after hearing oral argument at several hearings, the New York court took the dismissal motion under advisement, telling the parties that, given the complexity of the issues, "this decision is going to take some time."

Transaction	Summary and Status
Trimark	➢ In September 2020, TriMark—a foodservice equipment and supplies distributor to restaurants—announced a recapitalization transaction executed with majority first lien term lenders (the "<u>Majority Lenders</u>") whereby TriMark and the Majority Lenders entered into (i) a superpriority credit agreement issuing $120 million in new money superpriority "first out" loans and superpriority "second out" roll-up loans that rank ahead of the existing lenders; and (ii) a superpriority ICA that subordinated the existing non-participating first lien debt to the Majority Lenders' super senior debt. ➢ At the same time, TriMark and the Majority Lenders entered into an amendment to the existing credit agreement to, among other things, remove all affirmative and negative covenants, including reporting requirements and any restrictions on TriMark's issuance of incremental senior debt. ➢ TriMark also issued $307.5 million of new super senior debt to these same lenders through a dollar-for-dollar exchange for the lender defendants' existing $307.5 million face amount of first-lien debt. ➢ The effect of this transaction was to push down non-participating lenders in the capital structure, effectively transforming their first-lien debt into third-lien debt, and causing the market value of the debt stack to plummet. ➢ In November 2020, an ad hoc group of non-participating minority first lien term lenders (the "<u>Minority Lenders</u>") filed a complaint in New York Supreme Court calling the recapitalization a "cannibalistic assault by one group of lenders in the syndicate against another."

Transaction	Summary and Status
Trimark (cont'd)	The Minority Lenders raised several concerns, many consistent with those raised in *Serta Simmons* and *Boardriders*: (i) the uptiering transaction was not an "open market purchase" but a prepayment of debt through a private debt exchange which should have been executed *pro rata* under the existing credit agreement; (ii) by virtue of reducing the value of and principal amount of first lien debt, 100% lender approval was required; and (iii) by effectively releasing all or substantially all of the collateral, 100% lender approval was required. ➢ In response, the Majority Lenders argued that Minority Lenders lacked standing because they did not comply with the amended no-action clause or provide a cash indemnity and request that the administrative agent initiate the litigation. ➢ The Court rejected this argument, reasoning that no-action clauses are generally enforceable because they reflect an "*ex ante agreement* to sacrifice certain individual rights for the 'salutary purpose' of benefitting the venture as a whole," and here, there was no *ex ante* agreement or salutary benefit. ➢ On January 7, 2022, TriMark announced that it reached a consensual resolution of the dispute with the nonparticipating lenders. ➢ According to published reports, TriMark will exchange "all outstanding First Lien Term Debt on a dollar-for-dollar basis for Tranche B Loans pursuant to the company's Super Senior Credit Agreement. Tranche A Loans outstanding under the Company's Super Senior Credit Agreement will retain their position senior to the Tranche B Loans." ➢ The exchange was consummated on or about January 31, 2022, and the New York state action was thereafter dismissed.

Transaction	Summary and Status
Incora	➢ In March 2022, Incora, a distributor of airplane parts owned by Platinum Equity LLC, reached an agreement with its creditors to undertake a non-pro-rata uptiering exchange that included (i) the issuance of $250 million of new super senior 2026 notes; (ii) an exchange of unsecured notes due 2027 into new $473 million 1.25 lien notes due 2027 and (iii) the extension of $450 million of the existing $643.5 million 8.5% notes due 2024 to new bonds due in November 2026 and November 2027. ➢ Under the terms of the transaction, the company will issue the new super senior notes to the members of a group of supporting secured noteholders, which hold at least two-thirds of the 8.5%secured notes due 2024, and with the issuance of the additional 2026 notes, it will hold more than two-thirds of the 2026 bonds as well. ➢ However, an ad hoc group of secured noteholders that may hold as much as a third of the existing 9% 2026 senior secured notes is likely to challenge the transaction, as its members would have their covenants stripped and become unsecured bondholders, which is permitted if the deal has the support of holders of two-thirds of the secured bonds. ➢ The challenge will likely center on Incora's solvency and on the fact that the ad hoc group had been willing to provide cheaper, secured debt financing of about $200 million within the permitted debt baskets. ➢ All the arguments made, for and against the uptiering transaction in *Serta*, *Boardriders*, *Murray Energy*, and *Trimark* may come into play, but the fact that the *Incora* notes were issued under indentures that did not have the same pro rata, open market sale, and related language as found in these other credit agreement transactions suggests that the content and outcome of the litigation may differ.

Faculty

Eric C. Daucher is Norton Rose Fulbright US LLP's New York head of Financial Restructuring and Insolvency. His full-spectrum practice includes litigating avoidance actions and contested chapter 11 plans, prosecuting and defending bankruptcy appeals, advising on value-maximizing distressed M&A transactions, analyzing complex capital structures and related covenant issues, and negotiating and implementing out-of-court workouts. Mr. Daucher frequently investigates complex transactions or unusual business failures for potential wrongdoing, and identifies and pursues avenues for unlocking creditor value. His practice spans a broad range of industries, including metals and commodities, financial services, energy, agribusiness, aviation, automotive, telecommunications, traditional and digital publishing, insurance and government entities. Mr. Daucher has been repeatedly recognized as a rising star in the insolvency and restructuring field, and has been identified in the *Legal 500 U.S. Guide* from 2019-21 as both a "Next Generation Partner" for his work in municipal restructurings and a "Recommended Practitioner" for general restructuring work. He received his B.A. in 2006 from Trinity College and his J.D. in 2009 from Emory University School of Law, where he participated in its moot court.

Evan C. Hollander is a senior partner in Orrick Herrington & Sutcliffe LLP's New York office and a member of the firm's Restructuring group. He has more than 25 years of experience representing debtors, creditors and directors in a wide range of complex restructuring matters — both in and out of court — with a particular emphasis on complex U.S. and cross-border restructurings. In addition, he assists clients seeking to acquire the assets of, or claims against, troubled companies, and in structuring commercial transactions to reduce or eliminate risk. In addition to his experience in U.S.-based restructuring matters, involving both U.S. domestic corporations and as well as foreign corporations seeking relief in the U.S., Mr. Hollander has advised clients on numerous foreign and multinational restructuring matters. An active member of ABI, he routinely speaks and writes on key topics in financial restructuring and insolvency law. Mr. Hollander received his B.A. from Columbia College and his J.D. from Emory University School of Law, where he was the executive articles editor for the *Bankruptcy Developments Journal*.

Hon. Sean H. Lane is a U.S. Bankruptcy Judge for the Southern District of New York in New York, sworn in on Sept. 7, 2010. He previously clerked for Hon. Edmund V. Ludwig, U.S. District Judge for the Eastern District of Pennsylvania, from 1991-92, as well as for Hon. Charles R. Richey, U.S. District Judge for the District of Columbia, from 1992-93. From 1993-97, he practiced with the law firm of BakerHostetler in Washington, D.C., and thereafter served as a trial attorney in the Department of Justice, Civil Division, National Courts Section, until 2000. From 2000 until he was appointed to the bench, Judge Lane served as an assistant U.S. attorney for the Southern District of New York and was also chief of the Tax & Bankruptcy Unit of that office. During his time in the U.S. Attorney's Office, he was awarded the Attorney General's Distinguished Service Award in 2005 and the Henry L. Stimson Medal by the New York City Bar Association in 2008. Judge Lane is a member of the Federal Bar Council and has served as an adjunct professor at both New York University School of Law and Fordham Law School. He received his B.A. from New York University College of Art & Science in 1987 and his J.D. from New York University School of Law in 1991.

Michael Luskin is a partner with Luskin, Stern & Eisler LLP in New York and represents financial institutions in litigation in state and federal courts, including bankruptcy courts, across the country. Much of his work involves enforcing a creditor's rights under the Bankruptcy Code or defending a creditor against lender liability, fraudulent conveyance or preference claims brought by a creditors' committee or bankruptcy trustee. He also has experience representing creditors in loan restructurings and out-of-court workouts, and in representing trustees and examiners in cases presenting complex litigation issues. Mr. Luskin served as special counsel to the Financial Oversight and Management Board for Puerto Rico in lift-stay and related litigation in the U.S. District Court for the District of Puerto Rico and in the U.S. Court of Appeals for the First Circuit, and in connection with various contract and conflict issues. He also was conflicts counsel to the chapter 11 examiner in the Caesar's Entertainment chapter 11 cases in connection with the examiner's investigation of certain prepetition transactions, and the preparation of his final report. Mr. Luskin has served as a panelist on numerous CLE programs. He is a Fellow of the American College of Bankruptcy and a member of ABI, the New York State Bar Association, for which he is a past co-chair of the Creditors' Rights and Bankruptcy Litigation Committee of its Commercial and Federal Litigation Section, and the Federal Bar Council. He has been recognized as a leading bankruptcy lawyer by *Chambers USA: America's Leading Lawyers for Business* every year since 2001, and is also recognized in *Super Lawyers* and *The Best Lawyers in America*. Mr. Luskin received his undergraduate degree from Harvard College *magna cum laude* in 1973 and his J.D. from Harvard Law School in 1977.

Kevin Montague is a managing director with AlixPartners, LLP in Chicago and works with clients to frame complex, bet-the-company issues; develop compelling solutions; and deliver results in a succinct and persuasive manner. During his more-than-15-year career, he has led many litigation engagements across a variety of situations, including bankruptcy-related litigation, damages, solvency and investigations. Mr. Montague received his M.B.A. with concentrations in accounting, finance and strategic management from the University of Chicago's Booth School of Business.

Dennis C. O'Donnell is a partner with DLA Piper in New York and has experience in corporate reorganization and bankruptcy-related litigation matters. He represents debtors, lenders, official and unofficial committees, significant creditors, equityholders, examiners and acquirors in chapter 11 cases, chapter 15 cases, loan restructurings and out-of-court workouts. Mr. O'Donnell has played significant roles in some of the largest and most complex chapter 11 cases of the past 30 years, including Maxwell Communications, Olympia & York, Enron, Refco, Lehman Brothers, TOUSA, Arcapita, Momentive, ResCap, Relativity, LightSquared/Ligado, Avianca, Aeromexico, Alpha Latam and PWM Property Management. He also has written and spoken extensively on current chapter 11, chapter 15, real estate foreclosure and enforcement, and broker/dealer liquidation issues and developments. Mr. O'Donnell has appeared in federal courts throughout the U.S., including before the U.S. Supreme Court, the Second and Third Circuit Courts of Appeals, and numerous district and bankruptcy courts. He received his B.A. in classics and philosophy from Haverford College in 1979 his J.D. from Benjamin R. Cardozo School of Law in 1991, where he was articles editor for the *Cardozo Law Review*.

James C. Tecce is a partner in the New York office of Quinn Emanuel Urquhart & Sullivan, LLP and has 25 years of experience representing both creditors and debtors in some of the nation's largest and most complex chapter 11 cases. He has litigated a wide range of contested matters in bankruptcy courts, such as DIP financing, exclusivity and confirmation contests, and has represented clients like General Motors LLC, Peabody Energy Corp., Toys Labuan (Holding) Ltd., Intelsat Jackson Holdings S.A. and the Official Committee of Unsecured Creditors of Lehman Brothers Holdings Inc. He also has prosecuted and defended against appeals from bankruptcy court decisions beforedisctrict courts and circuit courts of appeals. Mr. Tecce has experience in complex commercial litigation in both federal and state courts involving, among other things, financial institutions, lending arrangements and shareholder disputes. He has been ranked among leading bankruptcy restructuring lawyers in *Chambers USA*, *The Best Lawyers in America* and *U.S. News and World Report*, and he has been named a Litigation Star in *Benchmark Litigation*. Previously, Mr. Tecce was with Milbank, Tweed, Hadley & McCloy LLP and clerked for Hon. Anthony J. Scirica of the U.S. Court of Appeals for the Third Circuit and Hon. John R. Padova of the U.S. District Court for the Eastern District of Pennsylvania. He received his B.S. in economics from the University of Pennsylvania, Wharton School of Business in 1992, his J.D. from Dickinson School of Law in 1995, where he was on the *Dickinson Law Review* and the Woolsack Honor Society, and his LL.M. in taxation in 1998 from Villanova University School of Law.

Conor P. Tully, CPA, CIRA, CTP is a senior managing director with FTI Consulting, Inc. in New York and is a member of its Corporate Finance & Restructuring segment. He has more than 25 years of experience in providing clients with strategic planning, financial and operational restructuring advisory and analysis in both distressed and healthy company situations. For the past 20 years, Mr. Tully has specialized in providing restructuring services to creditors in the troubled-company environment, including both formal chapter 11 proceedings and out-of-court workout situations. Over the past several years, he has also focused his practice on protecting the rights of personal-injury victims in bankruptcy cases. Mr. Tully has advised creditor committees, future claimants' representatives (FCRs) and other groups in the largest and highest-profile mass tort bankruptcy cases in recent years. He is certified in financial forensics and is accredited in business valuation. Mr. Tully previously held FINRA registered licenses series 7 and 63 from May 2001 to November 2004 with Ernst & Young Corporate Finance. He is a member of ABI, the American Institute of Certified Public Accountants, the Association of Insolvency & Restructuring Advisors and the Turnaround Management Association. Mr. Tully received his B.A. in accountancy from Manhattan College.