American Bankruptcy Institute

VALCON 2025

Conversation with Judges About Today's Hottest Topics

Brad M. Kahn, Moderator
Akin Gump Strauss Hauer & Feld LLP | New York

Hon. Lisa G. Beckerman
U.S. Bankruptcy Court (S.D.N.Y.) | New York

Hon. Marvin Isgur
U.S. Bankruptcy Court (S.D. Tex.) | Houston

2025

DRAFT 4/22/25

VALCON 2025

Judges Panel: Hot Topics in Bankruptcy

I. Introduction

a. Judge Lisa Beckerman for the Bankruptcy Court for the Southern District of New York.

b. Judge Natalie Cox for the Bankruptcy Court for the District of Nevada.

c. Judge Marvin Isgur for the Bankruptcy Court for the Southern District of Texas.

II. DIP Facilities as Sub Rosa Plans

a. In recent years, DIP financing facilities have increasingly been used to shape the terms of an eventual plan, particularly those concerning the equity value of the reorganized company. For instance, DIP credit agreements or DIP orders that provide for the equitization of a DIP loan upon emergence may (i) establish a predetermined "plan equity value," (ii) allocate a specific percentage of reorganized equity to the DIP lender, (iii) mandate a discount to the plan equity value for the DIP lender's benefit and (iv) dictate participation rights among lender groups.

b. **At what point do you believe that a DIP financing facility becomes a sub rosa plan? In other words, are there specific indicators in DIP financings that raise red flags for you from a sub rosa plan perspective?**

c. **Would you demand a valuation litigation at the outset of the case to support this kind of arrangement?**

d. **Would your thoughts change if the DIP facility itself contained mostly market rate terms, but with an added equity component?**

i. **How do you determine if a DIP was properly marketed? Do you take investment banker declarations at face value, or do you look for more specific evidence or precedent?**

ii. **Does the status of the case play a role in this analysis (i.e., a free-fall versus a pre-negotiated deal with some level of creditor support)?**

III. Liability Management Transactions – Role of the Bankruptcy Courts

a. One ongoing trend in the restructuring world is the rise of Liability Management Transactions: the various priming or uptier exchanges, unrestricted subsidiary transactions or the now-popular double dip transactions, in each case done with the stated goal of trying to extend the runway for troubled companies. Although these transactions generally take place pre-bankruptcy, in recent years disputes arising out of liability management transactions have been resolved in the bankruptcy courts.

b. **How do you view the bankruptcy court's role in reviewing these types of transactions?**

c. **If a party wanted you to affirm their liability management transaction, what considerations would you immediately start thinking about, regardless of whether they are raised by the parties in interest?**

i. **Can you consider equity or potential bad faith?**

d. **Does the form or specific type of transaction play a role in your analysis?**

i. **For example, would you look differently at a transaction that was largely done on a pro rata basis, as compared to a more punitive type of majority-only transaction?**

IV. Liability Management Transactions – Wesco / Incora

a. In July of last year, Judge Isgur issued a decision on Wesco Aircraft Hardware Corp.'s 2022 uptier transaction, one of the first on-the-merits decisions on liability management transactions issued by a bankruptcy court.

b. Judge Isgur's ruling will of course have far reaching implications on liability management transactions. Rather than analyzing the Court's decision itself, however, I want to highlight a particular question Judge Isgur raised—one that, to my knowledge, was not explicitly addressed in the ruling:

c. **Do companies have an implicit obligation to treat creditors fairly? More specifically, must companies consider whether a liability management transaction is designed to strip value from a group of non-participating lenders and, if so, refrain from proceeding with such a transaction? Does the answer change if the company is insolvent and its fiduciary duties shift to creditors?**

i. **If a company has a duty to act fairly to all its creditor constituents, then how do you go about determining whether such a transaction was done "fairly"? Is it merely compliance with the four corners of the documents, or does the consideration reach further into equitable issues?**

V. Liability Management Transactions – Serta

a. **Starting off generally, when thinking about LMEs, has *Serta* changed how you think about liability management transactions?**

b. One of the less discussed aspects of the Fifth Circuit's decision was its findings on equal treatment under section 1123(a)(4) of the Bankruptcy Code. The court determined that the expected value of the indemnification provided to two creditor classes under the plan varied significantly depending on whether those creditors had participated in the 2020 uptier exchange. As such, it held that the plan violated section 1123(a)(4) in so far as it provided for the indemnification.

i. According to the Fifth Circuit, the indemnification could be worth millions—or even tens of millions—of dollars to participating lenders, who might face litigation, while being effectively worthless to non-participating lenders. The court emphasized that "equal treatment" under section 1123(a)(4) concerns both opportunity and result.

DRAFT 4/22/25

c. However, the court distinguished between disparities arising from creditors' own actions—such as those at issue in the case before it—and disparities resulting from the application of law. For example, if a plan grants a class of creditors equity in the reorganized company, one creditor might receive greater value by acquiring a controlling stake. In such cases, the unequal treatment stems from legal consequences rather than the plan itself and, according to the Fifth Circuit, would not run afoul of section 1123(a)(4).

d. **How do you interpret this subjective view of "unequal treatment" under section 1123(a)(4) and what are the implications going forward?**

e. Inevitably more LMEs will end up being litigated in courts going forward. These litigation battles may take significant time and money away from the estates.

f. **In light of these costs, how important do you see developing a thorough record at trial being versus providing a quick resolution given the high costs of litigation and finite estate resources to prosecute these battles**?

VI. Chapter 15 Cases – Third Party Releases

a. One of the most significant decisions in our practice area in recent years was the Supreme Court's ruling in *Purdue*, in which it held that non-consensual third-party releases are impermissible under the Bankruptcy Code.

b. Not all foreign regimes will follow the US in its treatment of non-consensual third-party releases.

c. **How do you anticipate this decision will influence U.S. bankruptcy courts when determining whether to recognize foreign court orders approving such releases or restructuring plans that rely on them?**

d. **In order to have a foreign restructuring plan recognized in the U.S. bankruptcy courts, there needs to be a hearing on recognition of that foreign plan. Does recognition of the foreign court's order require strict compliance with specific provisions of the Bankruptcy Code, or with U.S. law generally, or even just U.S. public policy? Meaning, if there is no direct equivalent within the Bankruptcy Code, can recognition still be granted?**

i. **Furthermore, when granting recognition, especially in light of a situation where there is no direct equivalent to the Bankruptcy Code, what are some key considerations you want there to be in the hearing record? How thorough and complete does that recognition hearing record need to be?**

ii. **A few weeks ago, Judge Horan issued an informative decision in *Credito Real* on this topic, where he found that, notwithstanding *Purdue*, a US Bankruptcy Court can enforce a foreign reorganization plan that grants non-consensual third-party releases.**

1. **The decision not only relied on a textual analysis of sections 1507 and 1521 but also found that the considerations around public policy were largely satisfied based on the fairness of the Mexican restructuring process in that case.**

iii. **Do you see Judge Horan's decision as offering a good framework for this issue?**

iv. **In chapter 15 recognition matters, how much consideration do you give to procedural protections such as notice, opportunity to object, etc?**

On the Edge

By Michael R. Handler, Arthur J. Steinberg and W. Austin Jowers

Pitfalls of Unequal Participation Rights in Syndicated DIP Financing

Is the Juice Worth the Squeeze?

Michael R. Handler
King & Spalding
New York

Arthur J. Steinberg
King & Spalding
New York

W. Austin Jowers
King & Spalding
Atlanta

Michael Handler and Arthur Steinberg are partners with King & Spalding in New York. Austin Jowers is a partner in the firm's Atlanta office.

For senior secured lenders, superpriority debtor-in-possession (DIP) financing secured by a priming lien senior to pre-petition secured debt has an extremely favorable risk/reward profile. If a company's pre-petition secured debt constitutes a syndicated loan facility, then it will typically seek DIP financing from a group of lenders under the loan facility that constitute "required lenders" (referred to herein as the "majority lender group").

The "required lenders" are vested with most voting and consent rights under the loan agreement, including the right to direct the agent with respect to collateral matters, and usually consist of lenders holding at least 50.1 percent of the loans. Immediately after the commencement of a bankruptcy case, the lenders outside of the majority lender group (referred to herein as the "minority lenders") are frequently given the opportunity to participate in the commitments under the DIP facility in an amount equal to their *pro rata* share of the aggregate DIP commitments based on their pre-petition loan holdings as of the bankruptcy filing date.

However, the majority lender group does not always offer minority lenders an equal opportunity to participate in the DIP financing. For example, in the *JC Penney*[1] and *Ascena Retail Group Inc*.[2] bankruptcy cases, DIP financing commitments provided by the majority lender groups were not offered to minority lenders on a *pro rata* basis. Because the pre-petition secured debt held by the majority lender group and minority lenders was the "fulcrum" security entitled to a majority of the reorganized equity value of the debtors in both of these cases, the DIP financing's cost was effectively being funded by the minority lenders (*i.e.*, the majority lenders' incremental recovery from the DIP financing was coming at the direct expense of the minority lenders' recovery on their pre-petition loans).

In both cases, the objections of the minority lenders to such treatment were ultimately consensually resolved.[3] Although there is no case law directly addressing the right of minority lenders to participate in priming DIP financing arranged and funded by majority lenders, courts may consider the following issues if and when they rule on an objection by the minority lenders on such grounds.

Heightened Scrutiny over the Reasonableness of DIP Objection

DIP financing must satisfy the statutory requirements set forth in § 364 of the Bankruptcy Code. It can only be secured by liens *pari passu* or senior to liens securing pre-petition debt if junior secured financing is (1) unavailable, and (2) the pre-petition lenders' liens are adequately protected.[4] Debtors typically prefer to obtain *pari passu* or senior DIP financing from a majority lender group for the following reasons: (1) the debtors can negotiate with the majority lender group a restructuring-support agreement (RSA) describing the terms of a reorganization plan and thereby lock up an impaired accepting bankruptcy class (66 $^{2}/_{3}$ percent in amount of total claims voting; majority in number of claim holders voting); and (2) the majority lender group can direct the agent with respect to collateral matters, including consenting to the debtors' use of cash collateral and subordination of the liens securing the pre-petition debt to the DIP liens and related matters (including adequate protection).

In situations where the majority lender group proposing the DIP financing also holds the "fulcrum" security (often the pre-petition senior secured term loan), the debtor might be less likely to aggressively negotiate the economic terms of the DIP given that such holders will likely become the owners of the controlling equity interests of the reorganized debtor entity. When that dynamic is present, any "above market" economics embed-

1 *See In re JC Penney Co. Inc., et al.*, Case No. 20-20182 (Bankr. S.D. Tex.) (DRJ), Debtors' Emergency Motion for Entry of (I) an Interim and Final Order (A) Authorizing Debtors to Use Cash Collateral, (B) Granting Adequate Protection to the Pre-Petition Secured Parties, and (C) Scheduling a Final Hearing; and (II) a Final Order (A) Authorizing the Debtors to Obtain Post-Petition Financing Pursuant to Section 364 of the Bankruptcy Code, (B) Granting Liens and Superpriority Claims, (C) Modifying the Automatic Stay, and (III) Granting Related Relief [Docket No. 38] (DIP financing exclusively provided by *ad hoc* group holding 70 percent of term loans with no syndication to minority term loan lenders or *pari passu* secured noteholders).

2 *See In re Ascena Retail Grp. Inc.*, Case No. 20-33113 (Bankr. E.D. Va.) (KRH), Debtors' Motion for Entry of Final Orders (I) Authorizing the Debtors to Obtain Post-Petition Financing, (II) Authorizing the Debtors to Use Cash Collateral, (III) Granting Liens and Providing Superpriority Administrative Expense Status, (IV) Granting Adequate Protection to the Pre-Petition Lenders, (VI) Modifying the Automatic Stay, (VI) Scheduling a Final Hearing, and (VII) Granting Related Relief (Dkt No. 18) (limiting non-*ad hoc* group participation in aggregate DIP commitments to 50 percent of their *pro rata* share based on pre-petition loan holdings).

3 *See In re Ascena Retail Grp. Inc.*, Dkt. No. 565 (describing settlement embodied in first amendment to RSA providing minority *ad hoc* group of pre-petition lenders with participation rights in DIP financing in connection with their joinder to RSA); *In re JC Penney Co. Inc., et al.*, Dkt. No. 562, at ¶ LLL (describing terms of settlement providing cross-holder group that held 12 percent of senior secured first-lien term loans and 16 percent of senior secured first-lien notes with the right to participate in $53.5 million (or 11.89 percent of the $450 million aggregate roll-up DIP commitments)). In contrast to the JC Penney DIP settlement, the terms of the settlement in *Ascena* were not disclosed. The authors represented the minority *ad hoc* group in *Ascena*.

4 11 U.S.C. § 364(d).

ded in the DIP will effectively be distributed to the DIP-financing lenders at the ultimate expense of the minority lenders not participating in the DIP financing. Although the debtors will solicit competing DIP-financing offers from third parties, this is usually a challenging option since junior DIP financing is generally not available, and the debtors would expect vigorous litigation from the majority lenders over a lack of adequate protection if they propose DIP financing secured by liens senior or *pari passu* to the pre-petition secured debt.[5]

In addition to evaluating compliance with the Bankruptcy Code and applicable rules, bankruptcy courts will typically defer to the debtor's "business judgment" in deciding whether to approve the DIP financing.[6] However, in situations where the cost of the DIP financing is at the upper range of the market *and* minority lenders are excluded from *pro rata* participation, the courts might be more inclined to question the debtors' business judgment for at least two reasons.

First, the minority lenders might argue that excluding them from the ability to participate in their *pro rata* share of the DIP financing undermines the debtors' argument that the pricing and fees of the proposed DIP financing are reasonable and appropriate under the circumstances. Faced with this type of objection, a bankruptcy court could conclude that DIP financing is priced high relative to actual risk where the majority lenders are insisting on excluding or limiting the participation of minority lenders under the presumption that giving more lenders the ability to participate in a DIP financing — particularly lenders who will be harmed if they are excluded from participation — would have the effect of driving down pricing and fees. In fact, minority lenders may submit a competing DIP-financing proposal on more favorable terms than the majority lender group's proposed DIP financing to demonstrate to the bankruptcy court that, among other things, the cost of capital of the majority lender's DIP financing reflects their leverage owing to their majority position rather than the actual fair market cost of capital.

Second, since the cost of the DIP financing will likely affect the pre-petition secured lenders' recovery (if they are undersecured), the court may view unequal opportunity to participate in the DIP financing as unfair and as a way of skirting certain protections in the Bankruptcy Code and/or loan agreement requiring equal treatment among the same class of lenders with respect to plan and sale distributions. This might be particularly true if the proposed financing includes a roll-up of pre-petition debt, because in that case the pre-petition debt held by the minority lenders (and majority lenders with respect to their non-rolled up loans, if any) is being primed by both the new-money portion of the DIP financing *and* the pre-petition debt of the majority lenders rolled up as part of the DIP financing.[7] A roll-up is already subject to heightened scrutiny by the bankruptcy court because it elevates the priority of pre-petition debt outside of a reorganization plan and may therefore be inconsistent with the plan-confirmation requirement under 11 U.S.C. § 1123(a)(4), which mandates the same treatment for each claim of a particular class under a plan unless the holder agrees to less favorable treatment.[8]

Scrutiny of the *Sub Rosa* Plan Objection

Where a majority lender group conditions DIP financing on the debtors' entry into and compliance with an RSA, and the prosecution of a specified reorganization plan along the timetable set forth in the DIP credit agreement and RSA, parties-in-interest may object to the DIP financing on the grounds that it is a "*sub rosa* plan." A *sub rosa* plan is the principle, first established by the Fifth Circuit in *In re Braniff Airways Inc*. and later applied by many other courts, that a "debtor and the Bankruptcy Court should not be able to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa*," typically through the sale of substantially all assets under 11 U.S.C. § 363 or through DIP financing under 11 U.S.C. § 364.[9] The *sub rosa* plan DIP-financing objection generally seeks to deny court approval of the proposed DIP financing on the grounds that the terms thereof would lock the debtor into pursuing a particular reorganization plan, and subvert the plan-confirmation process and accompanying protections afforded to parties of interest in connection therewith.[10]

Exclusion of minority lenders from *pro rata* participation in a DIP financing that has elements of a *sub rosa* plan might result in heightened scrutiny from the bankruptcy court on the grounds that such financing locks the debtors into a reorganization plan that cannot satisfy the plan-confirmation requirement set forth in § 1123(a)(4).[11] Essentially, minority lenders could argue that § 1123(a)(4) is violated when the DIP financing converts into exit financing and the minority lenders are not given the same opportunity to participate therein by virtue of their exclusion from or limited participation.[12]

Section 1123(a)(4) may still constitute grounds for denying a syndicated DIP financing that does not allocate any commitments to minority lenders on a *pro rata* basis, even if the proposal does not convert into exit financing. For example, the U.S. Bankruptcy Court for the Southern District of

5 *See In re LSTAP US LLLP*, 2011 WL 671761, Case No. 10114125, at *3 (Bankr. D. Del. Feb. 18, 2011) (citing *In re Swedeland Dev. Grp. Inc.*, 16 F.3d 552 (3d Cir. 1994)).

6 *Official Comm. of Subordinated Bondholders v. Integrated Res. Inc. (In re Integrated Res. Inc.)*, 147 B.R. 650, 656 (S.D.N.Y. 1992) ("The business-judgment rule 'is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action was in the best interests of the company.'"); *In re Los Angeles Dodgers LLC*, 457 B.R. 308, 313 (Bankr. D. Del. 2011) ("Under the [business-judgment rule], courts will not second-guess a business decision, so long as corporate management exercised a minimum level of care in arriving at the decision.").

7 This article does not address the argument made by the cross-holder group in *JC Penney* that a non-*pro rata* DIP financing with a roll-up of pre-petition debt violates the *pro rata* sharing provision of the applicable pre-petition credit agreement requiring that any term loan lender share ratably in any amount that it receives in payment of obligations due under the term loan credit agreement with other term loan lenders who may not receive the same proportional amount. *See JC Penney*, Case No. 20-20182, Dkt. 469 ¶ 28, Objection of the *Ad Hoc* Cross-Holder Group, Dkt. 469.

8 *See, e.g.*, 3 *Collier on Bankruptcy* ¶ 364.06[2] (Richard Levin & Henry J. Sommer eds., 16th ed.) (describing how practice of roll-ups "is of questionable validity under the general bankruptcy principle favoring equal treatment of similarly situated creditors and disfavoring payment of pre-petition debt outside of a reorganization plan").

9 *Pension Benefit Guar. Corp. v. Braniff Airways Inc. (In re Braniff Airways Inc.)*, 700 F.2d 935, 940 (5th Cir. 1983).

10 *See, e.g., In re Belk Props. LLC*, 421 B.R. 221, 225-26 (Bankr. N.D. Miss. 2009) (denying motion to approve secured DIP facility where DIP financing (and entry of DIP order) made reorganization plan "*fait accompli*").

11 *See In re Latam Airlines Grp. SA*, 620 B.R. 722, 819 (S.D.N.Y. Bankr. 2020) (holding that a provision in DIP financing providing the lenders, who were pre-petition equityholders, the ability to exchange DIP claims for equity at 20 percent discount to plan value constituted an impermissible *sub rosa* plan because it "necessarily determines plan terms giving the Debtors the right to distribute equity in the reorganized Debtors to the [DIP lenders] — at a 20 percent discount to plan value — that will not be subject to court review").

12 *See In re Washington Mut. Inc.*, 442 B.R. 314, 360 (Bankr. D. Del. 2011) (holding that plan that excluded small creditors of class from participating in rights offering available to large creditors violated § 1123(a)(4)).

continued on page 86

On the Edge: Pitfalls of Unequal Participation Rights in DIP Financing

from page 25

New York in *In re LATAM Airlines Group S.A.*, in denying approval of the proposed DIP financing, found that it violated the absolute-priority rule because one of its tranches was being funded exclusively by shareholders on account of their pre-existing equity holdings and could be repaid in equity at a 20 percent discount to plan value.[13] The court specifically rejected the debtors' argument that § 1129 "only applies in a plan-confirmation process" and not in a "pre-confirmation loan" context.[14] Thus, minority lenders could argue that § 1123(a)(4) should similarly apply with respect to allocation of DIP-financing commitments and require providing minority lenders with the opportunity to participate in such commitments *pro rata*, even if there is not a DIP-to-exit-financing component, because the majority lenders' participation in the DIP-financing commitments is on account of their pre-petition loan holdings.

13 *In re Latam Airlines Grp.*, 620 B.R. at 801.
14 *Id.* at 798.

Conclusion

Failure to offer minority lenders the opportunity to participate in their *pro rata* share of DIP financing commitments based on their pre-petition loan holdings could well result in minority lenders organizing and objecting to the proposal on various grounds, including those set forth herein. This, in turn, may result in higher professional fee costs and an increased risk of the bankruptcy court ultimately denying the DIP financing proposal, among other things. Thus, in deciding whether to offer *pro rata* participation in a DIP financing to minority lenders, the majority lenders must decide whether "the juice is worth the squeeze." abi

AMERICAN BANKRUPTCY INSTITUTE

New York City Bankruptcy Conference

CONCURRENT SESSION

Recent Developments in DIP Financing

Brett H. Miller, Moderator
Willkie Farr & Gallagher LLP

Kathryn A. Coleman
Hughes Hubbard & Reed LLP

Robert J. Feinstein
Pachulski Stang Ziehl & Jones

Brad M. Kahn
Akin Gump Strauss Hauer & Feld LLP

Hon. John K. Sherwood
U.S. Bankruptcy Court (D. N.J.)

Eli Silverman
Ducera Partners LLC

Andrew D. Sorkin
Latham & Watkins LLP

2024

AMERICAN BANKRUPTCY INSTITUTE

Recent Developments in Debtor-in-Possession Financing

ABI New York City Bankruptcy Conference

May 9, 2024

WILLKIE

Executive Summary

- Debtors and lenders continue to push the boundaries on what a bankruptcy court will approve in a DIP loan.
- This presentation covers the following recent trends and innovations in DIP financing:
  - The Expanding Role of DIPs in Lender-on-Lender Violence
    - DIPs Excluding Minority Lenders
    - DIPs as Step-Two in LME
  - Expansion of Permissible DIP Terms
    - Equity Conversion Features
    - Expanded Secured Lender Protections (e.g., roll-up DIPs, related issues)
    - DIP Lenders as Buyers
- This presentation also explores some potential reforms to these expansions.

WILLKIE

Expanding Role of DIPs in Lender-on-Lender Violence: DIPs Excluding Minority Lenders

- In both the *Party City* and *Cineworld* bankruptcies, majority groups of prepetition secured lenders provided the debtors with DIP loans.
- The DIP loans in each case included a mechanisms whereby the lenders would obtain reorganized equity at a discount (e.g., backstop rights, equity conversion features).
- Certain minority lenders were not permitted into the DIP lender group and were therefore excluded from capturing these enhanced economics.
- In both cases, minority lenders objected and argued that the proposed mechanics provided the group of DIP lenders with additional windfall at the expense of the minority lenders.
  - In *Cineworld,* the minority lenders argued the ad hoc lender group had manufactured the need for a backstop by excluding other lenders. The minority lenders also noted that the terms of the backstop were discriminatory, allowing the ad hoc lender group to recover disproportionate fees by virtue of providing the backstop.
  - In *Party City,* the minority lenders argued that the disproportionate recovery obtained by the ad hoc group of first lien noteholders violated the minority lenders' right to receive *pari passu* treatment with similarly situated creditors.
- The court overruled the objection in *Party City* and the objection was settled in *Cineworld.*

WILLKIE

Expanding Role of DIPs in Lender-on-Lender Violence: DIPs as "Step 2" of LME

- ***Step 1:*** Liability Management Transaction
- ***Step 2:*** DIP Financing from favored LME participants
  - Frequently including stringent case-control provisions, ensures protection from LME challenges.
- ***Step 3:*** Case-exit strategy devised by favored LME participants
  - Can be exit financing, equity, funded backstop, or any combination.
- Examples:
  - *GOL Linhas Aéreas Inteligentes S.A.*
  - *Wesco/Incora*

WILLKIE

AMERICAN BANKRUPTCY INSTITUTE

Expansion of Permissible DIP Terms: Equity Conversion Features

- *SAS AB*
  - $700 million DIP with $350 million immediately available and $350 million available upon the satisfaction of certain second draw conditions precedent in the DIP creditor agreement.
    - Cost Savings Milestones
  - Call Option: The DIP lender had the ability to convert all of a portion of its DIP loans into reorganized debtor equity under a plan based on $3.2 billion total enterprise value.
  - Tag Right: Gave the DIP lenders the right to subscribe for up to 30% of a new money equity raised with a third party on the same terms made available to the third party.
  - Termination Rights: the debtors could terminate these equity conversion features for distinct termination fees.
    - Call Option Termination Fee: $19.5 million
    - Tag Right Termination Fee: $21.0 million

- *Enviva Partners*
  - Enviva's $500 million DIP facility provided $100 million open to eligible shareholders through a subscription process. The shareholders would receive the right to convert their tranche loans to reorganized equity at a discount to plan value.
  - The official committee of unsecured creditors objected on the basis that this equity conversion made the DIP an illegal "sub rosa" plan and violated the Bankruptcy Code's absolute priority rule.
  - The Court approved the debtors' DIP over the committee's objection.

WILLKIE

Expansion of Permissible DIP Terms: Roll Ups | *Instant Brands Acquisition Holdings, Inc.*

- Debtors and lenders have tested the limits of roll-ups in recent DIPs by seeking the ability to make large refinancing payoffs upon entry of the interim order.

- The *Instant Brands* DIP consisted of an ABL DIP facility and a Term Loan DIP facility.
  - The ABL DIP facility was a postpetition continuation and replacement of the debtors' prepetition asset-based financing program.
  - The Term Loan DIP facility provided upon entry of the interim order $132,500,000 of liquidity, of which $55,000,000 was used to pay off a prepetition equity sponsor to facilitate the release of liens and guarantees granted in a prior transaction.

- The U.S. Trustee voiced that the $55,000,000 payoff should be subject to challenge, but Judge Jones stated that he was "relatively comfortable" with the transaction in light of the "bigger picture."

WILLKIE

Expansion of Permissible DIP Terms: Roll Ups | *Monitronics International Inc.*

- Similar to *Instant Brands*, the debtors in *Monitronics* sought approval of a $398.6 million DIP facility on an interim basis, which included an indefeasible payment of $294 million to refinance first-out exit loans from the company's prior bankruptcy. The DIP was backstopped by the ad hoc group of 2019 take-back facility lenders, who held a large portion of the first-out exit facility loans from the prior plan.

- At the first day hearing, the U.S. Trustee objected to the indefeasible payment of all $294 million and argued that it should be subject to clawback in the event of a successful challenge to the first-out exit lenders' liens pending a final DIP order. Otherwise, any such challenge would be "superfluous."

- The court approved the DIP over the U.S. Trustee's objection, but only did so after calling the DIP declarants to the stand to testify as to the necessity of having sufficient liquidity.
  - The U.S. Trustee also examined the DIP declarants who further testified that the indefeasible payment was a crucial element of the DIP and therefore the RSA.

WILLKIE

Expansion of Permissible DIP Terms: Additional Roll-Up Issues

- Roll-ups in recent DIP financings have continued in popularity and are routinely approved, even those with relatively extreme new money to roll-up ratios.
- *Ebix, Inc.*: $105 million DIP, which included a $70 million roll-up. The Bankruptcy Court for the Northern District of Texas approved the financing over the U.S. Trustee's objection to the roll-up.
  - The U.S. Trustee had filed an objection arguing that the roll-up inappropriately grants a superpriority claim on avoidance actions, which could be a potentially valuable source of recovery for unsecured creditors.
- *Bed Bath & Beyond*: $240 million DIP, which included $40 million in new money and a $200 million rollup of prepetition FILO secured obligations (resulting in a 1:5 roll-up ratio).
  - The full amount of the DIP, both new money and the rollup, was authorized upon entry of the interim order.
- *SiO2*: $120 million DIP, consisting of $60 million in new money loans and a $60 million rollup of prepetition loans.
  - $12.4 million in new money and an equal amount of the roll-up was granted on an interim basis, with the balance of the new money and roll-ups subject to entry of a final order.
- *Acorda Therapeutics*: $60 million DIP, consisting of $20 million in new money and a $40 million rollup of prepetition notes, subject to entry of a final order.
  - The UCC filed an objection arguing, among other things, that the roll-up disadvantages the unsecured creditors and the DIP exit fee and ticking fee should not be charged against the rolled-up amounts under the DIP.
  - The debtors filed a reply stating that the terms of the DIP had been modified so that the ticking fee will not apply to the rolled-up amounts, the DIP liens will not attach to avoidance actions, and challenges to the roll-up will be preserved.
- *Vice Media*: $60 million DIP, which included $10 million in new-money and a $50 million rollup of prepetition term loans (resulting in a 1:5 roll-up ratio).

WILLKIE

AMERICAN BANKRUPTCY INSTITUTE

Expansion of Permissible DIP Terms: Waivers

- While not new, it is now quite commonplace for a DIP to include provisions waiving the following: (i) the right to surcharge collateral under 506(c) of the Bankruptcy Code, (ii) the rights associated with the "equities of the case" exception under 552(b) of the Bankruptcy Code, and (iii) the equitable doctrine of "marshaling."
- *Instant Brands*: Waivers of 552(b) and marshaling effective upon entry of the interim order; waiver of 506(c) subject to the final order.
- *Humanigen*: Waivers of 506(c), 552(b), and marshaling, subject to the final order.
- *Acorda Therapeutics*: Waivers of 506(c) and 552(b), subject to the final order.
  - The UCC filed an objection to final approval of the DIP arguing, among other things, that the estate waivers are inappropriate here because they have the "net effect" of limiting estate recoveries and essentially pushes the costs of liquidating secured lenders' collateral onto the unsecured creditors.
  - The debtors filed a response arguing that the waivers are common in DIPs, reflect the sound business judgment of the debtors, and "are a part of the bargain" for the debtors to obtain the DIP.
- *Diamond Sports Group*: The debtors waived all avoidance actions under section 547 of the Bankruptcy Code.
- *WeWork*: Waivers of 506(c), 552(b), and marshaling.
  - Landlords objected to the waivers, stating that the DIP budget failed to account for stub rent. The DIP should preserve the landlords' rights under existing letters of credit and limit the scope of lenders' liens on leasehold interests and the lenders' remedies in the event of default.
  - The final order established a segregated stub rent reserve and limited the lenders' ability to seek recovery from the proceeds of avoidance actions. The waivers of 506(c) and marshaling remained.

WILLKIE

9

Expansion of Permissible DIP Terms: DIP Lenders as Buyers

- Balancing need for tight sale timeline with challenge period
  - *Shoes for Crews / Never Slip*
    - The debtors sought to terminate the 75-day challenge period through their bid procedures motion for the sale of all their assets and entry into a stalking horse asset purchase agreement with their DIP lender.
    - The U.S. Trustee objected and Judge Silverstein requested the shortened challenge period be pursued via a separate motion.
- DIP Lender provides financing to its own deal
  - *Sorrento Therapeutics*

WILLKIE

10

Potential Reforms

- ***Increased Role of Bankruptcy Judges***
  - Pushing back on requested first day relief prior to the formation of a creditors' committee.
  - Can the market always reveal the terms of a fair DIP?

- ***Local Rules***
  - Relying on local rules allowing pushback on roll-ups.

- ***Independent Committees***
  - Increased role of independent directors and board members.

WILLKIE

Clerk Commentary

By Evan Miller[1]

Sweet Dreams, or a Nightmare? The Downfall of a King-Sized LME

Evan Miller
U.S. Bankruptcy Court (D. Haw.)
Honolulu

Evan Miller is a term law clerk to Hon. Robert J. Faris of the U.S. Bankruptcy Court for the District of Hawaii in Honolulu.

Distressed firms use liability management exercises (LMEs) to access cash over lenders' objections. Two types of LMEs, dropdowns and uptiers, have grown in popularity. This article describes how LMEs operate in bankruptcy and how recent cases might (or might not) predict the future of LMEs.

In a dropdown, the borrower drops its collateral down to a wholly owned subsidiary.[2] Dropdowns are possible because many loan documents give "investment baskets" to borrowers, which allow borrowers to invest noncash assets into unrestricted subsidiaries. The lenders' lien is released, and the subsidiary issues new debt backed by the asset. The lenders who participate in the dropdown move their debt to the top of the repayment order, while nonparticipating lenders might be in trouble should a default occur.

Uptiers also improve participating lenders' relative position, but function differently than a dropdown. In an uptier transaction, a borrower modifies its loan agreements to permit the issuance of additional debt. This newly issued debt is then elevated to a senior position, ranking above existing obligations in terms of repayment priority. Most loan documents only require that a majority of lenders make these amendments. To achieve sufficient consensus, the borrower offers superpriority debt in exchange for support to amend the loan documents.

By invoking the "open market" purchase provision in the loan documents, a borrower is able to circumvent its obligation to pay all lenders equally.[3] The open-market exception empowers the borrower to buy old debt from the participating lenders with new superpriority debt. Participating lenders move to the front of the repayment line.

Uptiers received widespread attention in a recent appeal arising from Serta Simmons Bedding's bankruptcy.[4] After encountering economic misfortunes, Serta pursued an uptier transaction.

Refinancing

In 2016, Serta refinanced its debt with three credit facilities, the relevant facility in this dispute being the first-lien $1.95 billion term loan (hereinafter the "2016 credit agreement").[5] A simple majority could amend the 2016 credit agreement unless the amendment directly and adversely affected another lender's "sacred rights."

One of the lenders' sacred rights was the right to *pro rata*, or equal sharing of payments. Under the *pro rata* sharing of payments, "no lender would have a superior right to the value of the collateral over any other lender."[6] If the lenders received any excess value, the loan documents directed that value to be shared ratably among all lenders. Serta could not alter the right to *pro rata* payment unless it obtained consent from every lender that would directly and adversely suffer from non-*pro rata* treatment.

Serta's 2016 Credit Agreement featured two exceptions to *pro rata* treatment: (1) a Dutch auction, and (2) an open-market-purchase provision. Serta could make non-*pro rata* payments to its lenders — such as purchasing its debt from its lenders — by following the detailed procedures for a Dutch auction or making an open-market purchase.[7] The 2016 credit agreement did not define an open-market purchase.[8]

Competition

Beginning in 2019, Serta faced severe economic headwinds and hired restructuring experts to explore potential solutions for its liquidity issues.[9] Serta predicted that its cash would run out in July 2020.

Serta's first-lien lenders moved quickly. One group (the "uptier lenders") attempted to propose an LME that would include all first-lien lenders, but the debtor did not respond. The uptier lenders later discovered that Serta had been in discussions with another lender faction (the "dropdown lenders") to negotiate a dropdown.[10] Both lender factions rested their proposals on the open-market-purchase exception to nonratable treatment. Serta invited the uptier lenders to submit a proposal to compete with the

1 The views expressed in this article belong solely to the author and do not reflect the views of Judge Faris.
2 Vincent S. J. Buccola & Greg Nini, "The Loan Market Response to Dropdown and Uptier Transactions," 53 *J. Legal Stud.* 489, 496-97 (2024).
3 *Id.* at 502.
4 *In re Serta Simmons Bedding LLC*, No. 23-90020, 2023 WL 3855820, at *4 (Bankr. S.D. Tex. June 6, 2023).
5 *N. Star Debt Holdings LP v. Serta Simmons Bedding LLC*, No. 652243/2020, 2020 WL 3411267, at *1 (N.Y. Sup. Ct. June 19, 2020).
6 *Id.*
7 *Id.* at *4.
8 *Excluded Lenders v. Serta Simmons Bedding LLC (In re Serta Simmons Bedding LLC)*, 125 F.4th 555, 568 (5th Cir. 2024), as revised (Jan. 21, 2025), as revised (Feb. 14, 2025).
9 *Serta Simmons Bedding*, 2023 WL 3855820 at *3.
10 *Id.* at *4. The proposed dropdown would remove the most valuable collateral from the 2016 credit agreement's collateral base. *Id.*

dropdown lenders' proposal and accepted the uptier lenders' proposal.[11] The dropdown lenders immediately realized that they had been "played" and "outmaneuvered."[12] Serta's decision "had little precedent."[13]

The dropdown lenders sued Serta in New York state court to enjoin the 2020 uptier transaction.[14] They alleged, *inter alia*, that the 2020 uptier transaction breached the 2016 credit agreement and violated the duty of good faith and fair dealing. The state court denied the injunction because, in part, it believed that the open-market provision in the 2016 credit agreement could be read to allow for an uptier. The court doubted that the drop-down lenders would be able to successfully challenge the 2020 uptier's legality.[15]

With the state court injunction defeated, the 2020 uptier closed as anticipated.[16] The parties amended the 2016 credit agreement to allow more debt and superpriority liens.[17] Serta received $200 million in new money with $875 million in exchanged loans that would be paid ahead of the other nominal first-lien lenders.[18] Sensing litigation risk, the uptier lenders negotiated an indemnity clause that would protect them if other lenders challenged the 2020 uptier.[19]

In 2022, some of the objecting lenders tried again to stop the 2020 uptier in New York federal court.[20] They sued for breach of contract and breach of the implied covenant of good faith and fair dealing. Serta moved to dismiss the claim, and the trial court denied the motion to dismiss, stating that the dropdown lenders had sufficiently alleged an inappropriate loan repurchase that did not occur in the open market.[21]

Serta's Bankruptcy

In January 2023, Serta filed a chapter 11 petition in the Southern District of Texas.[22] The uptier lenders filed an adversary proceeding to determine, *inter alia*, whether the 2020 uptier violated the 2016 credit agreement, or the duty of good faith and fair dealing. Serta and the uptier lenders prevailed on those claims at summary judgment, and the nonparticipating lenders appealed.

The parties then litigated the pre-petition indemnity at confirmation. The initial plan featured the pre-petition indemnity provisions as an executory contract that Serta would assume. After several amended plans, the pre-petition indemnity became as a "settlement indemnity" under § 1123(b)(3). Rather than indemnify the lenders who participated in the 2020 uptier, it indemnified lenders who then owned debt issued from the 2020 uptier.[23]

The bankruptcy court confirmed the plan,[24] holding that the open-market provision allowed Serta to make non-*pro rata* payments to the uptier lenders. The court held that the 2020 uptier was the result of "good-faith, arm's-length negotiations."[25] The court also upheld the settlement indemnity as a valid business-judgment exercise.[26] The bankruptcy court viewed the entire dispute as "[s]ophisticated financial titans engag[ing] in a winner-take[s]-all battle."[27]

While this might seem like a "hard result," this decision would be helpful because it would prevent "unrestrained behavior."[28] According to the bankruptcy court, if lenders did not like this outcome, they could draft less permissive agreements.[29] The dropdown lenders appealed the plan confirmation to the Fifth Circuit.[30]

Reversal

On Dec. 31, 2024, the Fifth Circuit vacated the bankruptcy court's decision in the adversary proceeding and remanded it back to the bankruptcy court to resolve the claims of nonparticipating lenders in the 2020 uptier. The panel reversed the bankruptcy court's approval of the indemnity clause.[31]

The Fifth Circuit held that the term "open-market purchase" meant a purchase on the secondary market for syndicated loans, not a competitive, arm's-length negotiation between two parties.[32] Dictionary definitions of "open market" pointed toward one market, one forum — where buyers and sellers freely competed.[33] With this definition in mind, the Fifth Circuit analyzed the Federal Reserve's "open market operations."[34] The Federal Reserve must purchase securities on the open market,[35] which meant the open securities market. If an open market is one appointed place for all buyers and sellers to compete on price, then the 2020 uptier was not an open market purchase because the uptier and dropdown lenders were competing with each other, not the open market.

The panel found further support in its holding by evaluating the other exception to *pro rata* treatment, the Dutch auction.[36] If the uptier lenders' argument was correct, a Dutch auction would also be an open-market purchase because it was a competitive process between the borrower and its lenders. Applying such an expansive definition would render the Dutch auction provision meaningless, an outcome that New York contract law would not countenance.

The Fifth Circuit also struck the indemnity provision from the confirmed plan.[37] The Bankruptcy Code prohibits "any claim for reimbursement or contribution of an entity that is liable with another the debtor ... to the extent that ... such claim for reimbursement or contribution is contingent as of the time of allowance or disallowance of such claim for

11 *Id.* at *5. The bankruptcy court stated several times that this process was a "competition" and "competitive."
12 *Id.*
13 Buccola & Nini, *supra* n.2 at 502.
14 *N. Star v. Serta*, 2020 WL 3411267 at *1.
15 *Id.*
16 *LCM XXII Ltd. v. Serta Simmons Bedding LLC*, No. 21 CIV. 3987 (KPF), 2022 WL 953109, at *4 (S.D.N.Y. March 29, 2022).
17 *Excluded Lenders v. Serta*, 125 F.4th at 569.
18 *Serta Simmons Bedding*, 2023 WL 3855820, at *5.
19 *Excluded Lenders v. Serta*, 125 F.4th at 569.
20 *LCM XXII Ltd. v. Serta*, 2022 WL 953109 at *5.
21 *Id.* at 8.
22 *Excluded Lenders v. Serta*, 125 F.4th at 569.
23 *Serta Simmons Bedding*, 2023 WL 3855820 at 10.
24 *Id.* at 12.
25 *Id.*
26 *Id.* at 10.
27 *Id.* at 14.
28 *Id.*
29 *Id.*
30 *Excluded Lenders v. Serta*, 125 F.4th at 571.
31 *Id.*
32 *Id.* at 579.
33 *Id.*
34 *Id.* at 580.
35 *Id.*
36 *Id.* at 581.
37 *Id.* at 593.

continued on page 57

Clerk Commentary: Sweet Dreams, or a Nightmare? A King-Sized LME

from page 33

reimbursement or contribution."[38] The uptier lenders made a claim against Serta that was contingent on legal challenges to the 2020 uptier for which the uptier lenders and Serta were jointly liable.[39] Thus, § 502(e)(1)(B) of the Bankruptcy Code flatly prohibited the settlement indemnity.[40]

Looking to *Czyzewski v. Jevic Holding Corp.*,[41] the panel looked for a "work-around" to § 502(e)(1)(B).[42] The bankruptcy court's reliance on § 1123(b)(3) was misplaced because § 1123(b)(3) did not "affirmatively provide for back-end resurrection of claims already disallowed on the front end."[43]

Although the indemnity may have changed forms throughout the plan-confirmation process, the settlement indemnity operates the same way as a pre-petition indemnity. Both indemnities covered the same liability, and although the parties were not identical, the settlement indemnity was functionally the same as the pre-petition indemnity.

The Fifth Circuit held that the settlement indemnity was impermissible independent of its failure to comply with § 502(e)(1)(B), because the Code provides that "a plan shall ... provide the same treatment for each claim or interest of a particular class."[44] The Fifth Circuit cited case law from other jurisdictions for the proposition that intraclass treatment need not be identical, but should result in equal treatment.[45] The panel declined to define the "exact scope" of § 1123(a)(4), but held that the settlement indemnity was comfortably outside of § 1123(a)(4)'s outer bounds.[46] All relevant lenders received settlement indemnity, but only the uptier lenders stood to benefit from the "millions or tens of millions" in potential value flowing from the settlement indemnity, while others received nothing. Such a disparate result violated § 1123(a)(4).[47] The Fifth Circuit concluded that all contracts should be read on their own terms, but the open-market exceptions in other loan documents likely cannot bear the weight of an uptier.[48]

Aftermath

The uptier lenders sought an *en banc* rehearing, arguing that the Fifth Circuit's decision upset the lending market and should have sent the definitional question of open-market purchase to the New York state courts.[49] The uptier lenders felt justified in their request because a New York state court upheld a similar uptier the same day that the Fifth Circuit decided *Serta*.[50] The uptier lenders also argued that reversing the indemnity provision was an unlawful altering of the parties' contractual expectations.[51] The Fifth Circuit denied the petition for rehearing.[52]

The Fifth Circuit decision contains two important takeaways for the future of LMEs. First, broad, ill-defined open-market provisions will not reliably hold the weight of an uptier. Second, indemnity clauses tying the participating lenders to the debtor have a dubious future in bankruptcy under § 502(e)(1)(B). If LMEs are just rearranging the chairs on the Titanic, an indemnity clause may be as useful as a parachute on a sinking ship.

In reading the tea leaves from the *Mitel* bankruptcy, filed in the Southern District of Texas after the *Serta* decision, it is possible that restructuring professionals will be quicker to cut deals instead of litigating an LME to finality. Despite prevailing recently on its contentious uptier in New York state court,[53] no creditors objected to the plan and the bankruptcy court confirmed the plan on April 17, 2025.[54] If Mitel achieves its restructuring objectives, it will consummate the plan by May 23, 2025.[55] Perhaps this strategy evolved in *Serta*'s shadow. Perhaps it did not. Only time will tell how many sleepless nights restructuring professionals must endure as they navigate the stormy waters of LMEs. abi

38 11 U.S.C. § 502(e)(1)(B).
39 *Excluded Lenders v. Serta*, 125 F.4th at 589-90.
40 *Id.* at 590.
41 580 U.S. 451 (2017).
42 *Excluded Lenders v. Serta*, 125 F.4th at 590.
43 *Id.*
44 11 U.S.C. § 1123(a)(4).
45 *Excluded Lenders v. Serta*, 125 F.4th at 591.
46 *Id.*
47 *Id.* at 591-92.
48 *Id.* at 593.
49 *Excluded Lenders v. Serta Bedding LLC*, Case No. 23-20181 (5th Cir.), Docket No. 277.
50 *Id.* at 9-10; *see also Ocean Trails CLO VII v. MLN Topco Ltd.*, 2024 WL 5248898, at *2 (Dec. 31, 2024).
51 *Excluded Lenders v. Serta Simmons Bedding LLC*, Case No. 23-20181 (5th Cir.), Docket No. 277 at ¶ 10-19.
52 *Id.*, Docket No. 284-1 at ¶ 4.
53 *See generally Ocean Trails CLO VII v. MLN Topco Ltd.*, 2024 WL 5248898 (Dec. 31, 2024).
54 *In re MLN US HoldCo LLC*, Case No. 25-90090 (S.D. Tex.), Docket No. 19 at ¶ 38; ECF at 263..
55 *Id.* at 41.

Help Center

AMERICAN BANKRUPTCY INSTITUTE

View Edit Track Log

Liability Management Transactions: The Beginning of the End?

Committee: Asset Sales

Rajat Prakash

Senior Finance Executive; Houston

Date Created: Fri, 2025-03-07 12:46

While corporate restructuring is an option financially distressed companies often proactively explore to reduce their debt burden, another alternative that has recently gained some notoriety is a liability management transaction (LMT). Put simply, an LMT is a seemingly clever maneuver to modify capital structures by shifting collateral around to benefit one set of creditors at the expense of others. This assists the company with fresh capital, suspended/waived debt service obligations, extended maturities, or some combination thereof.

The group of creditors benefiting from this trade typically receive secure senior priority, increased collateral and potentially stronger protection via favorable covenants. The remaining lenders are exposed to lower ranks in the repayment hierarchy with weaker protections, and the choice to litigate or swallow this bitter pill.

Some notable LMTs in the recent past include Serta, Rackspace, Apex Tool, Altice France and Cumulus Media. These transactions include the most common types of LMTs — such as uptiering, dropdown, amend and extend, and double-dips, which are defined as follows:

- *Uptier*: An uptier transaction typically involves a subset of lenders amending financing documents and securing a senior position in the capital structure in exchange for offering fresh capital to the borrower.

- *Dropdown*: In a dropdown transaction, borrowers utilize the restricted payments provision in credit documents to shift collateral from restricted subsidiaries to unrestricted ones. Since unrestricted subsidiaries are not controlled by credit documents, this collateral can now be used to raise fresh capital while simultaneously weakening the recovery potential of existing creditors of restricted subsidiaries.
- *Amend and Extend*: The least controversial tactic, this includes borrowers working together with creditors to amend credit documents to extend maturities. This additional runway helps borrowers preserve cash flow to invest in the business, but might not be sufficient in a distressed environment.
- *Double-Dip*: A double-dip transaction is used to solidify the claims of lenders by raising capital at a nonguarantor subsidiary, which then lends the amount to the restricted subsidiaries in exchange for an intercompany receivable. The lenders to the nonguarantor subsidiaries have a guarantee from the parent, as well as a claim on the intercompany receivable, which improves the potential for maximum recovery twofold in a restructuring.

One LMT that recently garnered some attention is the uptiering exercise by Serta. The company's credit agreement required *pro rata* treatment for similarly situated lenders, with the exception of open-market purchases. The company, facing some operational headwinds, decided to raise additional capital from certain lenders in 2020 by offering them senior positions in the capital structure. The remaining lenders litigated, claiming violation of good faith and breach of *pro rata* treatment covenant.

While the bankruptcy court ruled in favor of Serta in 2023, the Fifth Circuit reversed that decision in 2024 by adjudicating a violation of open-market purchase and *pro rata*-treatment requirements. While borrowers and their counsel could be expected to continue attempting workarounds, the *Serta* decision would no doubt compel companies considering LMTs to revisit their strategies.

Of late, one defensive play by lenders who anticipate subordination as a result of LMTs is entering into cooperation agreements. These agreements effectively require creditors to negotiate collectively, instead of make individual side deals with the borrower. Lenders who are part of cooperation agreements are restricted in their ability to participate in the borrower's debt, whereas those who opt out have unrestricted participation, but risk economic loss should the cooperation agreement group prevail in a restructuring event.

The impact on the borrower is potentially limited liquidity on its debt given restrictions on cooperation-agreement creditors. This results in separate market prices for debt invested by creditors as part of cooperation agreements and instruments outside of these agreements — instructive for potential investors in distressed companies in terms of market confidence (and therefore demand) in debt that is a vital part of cooperation agreements.

In order to mitigate any risk of LMTs by cooperation agreements, companies and sponsors have attempted modifying credit documents to prohibit cooperation agreements, introduce nondisclosure agreements among creditors, and limit the voting ability of creditors in debt transactions and in credit documents. In an age where all parties to a credit agreement are backed by their respective armies of lawyers, whose hourly fees could easily accumulate to exorbitant amounts, it is not unreasonable to assume that the number of LMTs could drastically reduce in the future, since these are typically undertaken by financially distressed and highly leveraged companies that might find the entire exercise cost-prohibitive — especially given the frequent and protracted volleys among creditors, courts, lawyers and the borrower. In case an LMT is one of the limited options for a borrower, its executives will need to comb though credit agreements to appreciate LMT opportunities (as well as assess litigation or relationship risks), and proactively address any concerns by working together with counterparties and ensuring impervious documentation along with unambiguous interpretation.

In summary, while LMTs have been common over the last few years, the recent *Serta* verdict — along with preemptive strategies like cooperation agreements among creditors, as well as lengthy (and expensive) legal disputes — could very well force borrowers and lenders to align on credit document interpretation, thereby causing LMTs to perish naturally.

[+] FEEDBACK

FEBRUARY 11, 2025

In Lender-on-Lender Violence, an 'Uptier' Financing Bites the Dust, this Time in Houston

> Fancy drafting by 'brilliant financiers and lawyers,' the judge said, didn't validate an uptier transaction when the 'effect' was to release collateral without a two-thirds vote.

As a sequel to the Fifth Circuit's remarkable *Serta Simmons* opinion at the end of December, Bankruptcy Judge Marvin Isgur of Houston overturned a different "uptier" transaction that emerged from a tussle among sophisticated lenders in what's being called lender-on-lender violence.

Judge Isgur distilled the practical effect of a series of simultaneous transactions to conclude that the top dogs had violated the terms of the governing bond indenture when they provided $250 million in new funding designed to put their larger, existing debt above everyone else's.

Among other things, the Fifth Circuit decided in *Serta Simmons* that the debtor's uptier financing before bankruptcy was not a permissible "open market purchase" and thereby violated the rights to ratable treatment that belonged to lenders who were not permitted to put their debt on top of the pile. *Excluded Lenders v. Serta Simmons Bedding LLC (In* *re Serta Simmons Bedding LLC)*, 23-20181 (5th Cir. Dec. 31, 2024). To read ABI's report, **click here**.

The January 17 opinion by Judge Isgur didn't turn on the open market purchase. He identified other grounds in finding that a breach of contract occurred in implementing the uptier financing.

The Existing Debt

Judge Isgur conducted a 35-day trial over six months with 21 witnesses and hundreds of exhibits. His explication of the facts reads like the detail in a doctoral dissertation. To understand the gravity of the holdings in his report and recommendations, a cursory summary of the uptier transaction is sufficient.

The debtor had two series of senior secured notes, one for $650 million due in 2024 and another for $900 million due in 2026. In addition, there was $525 million in unsecured notes. The indentures for both secured issues required a two-thirds vote to authorize a non-*pro rata* transaction, including the release of collateral.

Facing a liquidity crisis, the debtor received proposals from existing noteholders. The superior proposal came from a group called the Majority, which held more than two-thirds of the 2024 notes. As Judge Isgur said, their proposal was not "actionable" because they "did not control two-thirds of the 2026 Notes."

To skirt the problem, Judge Isgur said that the majority "decided to proceed by sleight of hand."

The indenture for the pivotal 2026 notes only required a majority vote to issue new notes. By issuing another $250 million in 2026 secured notes to themselves, the Majority would then claim to control more than two-thirds of the enlarged issue, thus allowing them to vote to allow the release of collateral. That's what they did.

The Uptier Transaction

In automatic, simultaneous transactions, the Majority authorized the issuance to themselves of $250 million in new 2026 secured notes. Then holding more than two-thirds of the 2026 notes, the majority modified the indenture to allow the release of collateral. Next, the majority exchanged their outstanding secured and unsecured notes for, as Judge Isgur put it, "new, super-senior first-lien and second-lien notes."

In other words, the Majority invested $250 million and moved their existing secured and unsecured notes into a super-priority category ahead of everyone else.

Before bankruptcy, an investor group called the Minority had sued in state court, alleging that they had been stripped of their liens. They wanted the state court to declare the transaction null and void and unenforceable. They also wanted the state court to unwind the transaction.

The debtor filed a chapter 11 petition, stopping the suit in state court. On the day of filing, the debtor filed an adversary proceeding asking Judge Isgur to declare that the uptier transaction was valid and enforceable. The Minority answered with counterclaims asking Judge Isgur to declare breach of contract.

In his January 17 opinion, Judge Isgur ruled on the breach of contract claims, leaving remedies for later determination. Because the Majority held more than two-thirds of the 2024 notes, there was no breach of contract. The opinion therefore focused on the question of whether the uptier financing breached the indenture for the 2026 notes.

Good Faith Wasn't an Issue

The contract claims were governed by New York law, where "the good faith of a breaching party to a contract does not insulate the breaching party from liability," Judge Isgur said. Facing a "severe liquidity crisis," he said that the debtor "acted in what it sincerely believed was its best interest." However, he went on to say, "Not all actions taken in the best interest of a party are done in good faith."

Nonetheless, Judge Isgur made no findings about the debtor's good faith. Rather, he ruled on whether the transaction complied with the indenture, adding that the debtor's and the Majority's "mental states have no effect on any contract-based claims."

The outcome turned on the provision in the 2026 indenture, which said that "no amendment, supplement or waiver may (1) have the effect of releasing all or substantially all of the Collateral from the Liens . . . or altering the priority of the security interests of the Holders of the 2026 Secured Notes in the Collateral . . . ."

The critical words were "have the effect of." That is to say, did the issuance of the $250 million in additional notes "have the effect of" releasing collateral? Judge Isgur determined that he was obliged to look "beyond the contract to the resulting effect."

As a fact, Judge Isgur found that the Majority would not have bought the additional $250 million in notes without the uptier, and that the completion of the uptier occurred automatically upon the purchase of the $250 million in notes. In other words, the uptier was the "inevitable result" of the sale of the new notes.

Judge Isgur ruled that the transaction "failed" at the issuance of the new notes and "did not release the liens securing the 2026 Notes." As a result, he held that the "2026 Notes remain secured by first liens."

Judge Isgur declared "that the rights, liens, and interests that were for the benefit of all of the holders of 2026 Notes . . . remained in full force and effect . . . ."

Opinion Link

https://abi-opinions.s3.us-east-1.amazonaws.com/Wesco+breach+opinion.Pdf

Case Details

Case Citation	Wesco Aircraft Holdings Inc. v. SSD Investments Ltd. (In re Wesco Aircraft Holdings Inc.), 23-3091 (Bankr. S.D. Tex. Jan. 17, 2025)
Case Name	Wesco Aircraft Holdings Inc. v. SSD Investments Ltd. (In re Wesco Aircraft Holdings Inc.)
Case Type	Business
Court	5th Circuit Texas Texas Southern District
Bankruptcy Tags	Claims Financial Advisors Venue/Jurisdiction Business Reorganization Finance and Banking Investment Banking Lender Liability

Comments

Submitted by Kevin Gleason on February 11, 2025

Bill, please explain why the Bankruptcy Court did not have jurisdiction to resolve this. Why is it an R&R?

delete edit reply

Add new comment

Your name

ckanon@abi.org

JANUARY 13, 2025

Fifth Circuit Bans Uptier Financings for Violating the Principle of Ratable Treatment

> The Fifth Circuit declines to adopt a securities industry guidebook for what's a permissible financing.

In a remarkable opinion, the Fifth Circuit banned so-called uptier financings. The decision by Circuit Judge Andrew S. Oldham included an equally remarkable discussion of equitable mootness where the Fifth Circuit had no hesitation in reversing confirmation of a consummated chapter 11 plan that may mean millions of dollars in losses for some creditors.

Given the gravity of the December 31 opinion, we will deal with uptier financing today. Tomorrow, we will cover equitable mootness and issues related to relief that an appeals court can grant on reversing plan confirmation.

The Norm of Ratable Treatment

Judge Oldham began his opinion by saying, "Ratable treatment is an important background norm of corporate finance." It is, he said, "a lender's 'sacred right' under syndicated loan agreements."

"The norm of ratable treatment," Judge Oldham said, "provides that the borrower may not choose to repay only one of its lenders. Rather, it must proportionally allocate [the repayment] among the relevant lenders according to their share of the outstanding debt."

"Uptiers," Judge Oldham said, "are a relatively new and controversial exception to the ratable treatment norm . . . . They are controversial because, according to critics, uptiers create a zero-sum game of 'lender-on-lender violence.'"

Judge Oldham said that an uptier financing works by amending

> the terms of a credit facility to allow the issuance of new super-priority debt. Because a majority of lenders in the existing facility must typically consent to such an amendment, the borrower purchases consent by allowing these lenders to exchange their existing debt for new super-priority debt, often at an above-market price . . . . Since not all of the lenders participate in the uptier, the uptier is a non-*pro rata* transaction that violates the norm of ratable treatment.

Judge Oldham said that the advantages of an uptier include "play[ing] lender groups off of each other and avoid[ing] the expense of dealing with holdouts." Furthermore, "[t]he costs of an uptier transaction are borne entirely by the minority lenders, who end up with subordinated debt worth less than before."

The Serta Simmons Uptier Financing

Having extolled the virtues of ratable treatment, Judge Oldham described the uptier financing by bedding-maker Serta Simmons Bedding LLC.

In 2016, the company had sold a series of syndicated loans yielding $1.95 billion in first lien debt and $450 million in second lien loans.

To protect "the sacred right of *pro rata* sharing," Judge Oldham described the 2016 loan agreement as having a provision preventing the company from "pay[ing] its obligations to one lender while offering nothing to the rest." As further protection, he said that the agreement included another provision that "generally requires [the] unanimous consent of any affected lender to waive, amend, or modify" the *pro rata* sharing requirement. Other provisions in the agreement could be modified by a simple majority vote of lenders.

There were two exceptions to the *pro rata* repayment requirement. One was a "Dutch option," and the second was an "open market purchase." The loan agreement, Judge Oldham said, did not define "open market purchase." The "patent ambiguity in the undefined term," he said, "forms the foundation of this case."

With the company facing financial difficulty, Judge Oldham described how the company cobbled together an uptier financing in 2020 with some but not all of its first and second lien lenders. The parties and Judge Oldham called them the "Prevailing Lenders."

The Prevailing Lenders provided new $200 million financing in the form of first-out, super-priority debt. They traded $1.2 billion in existing financing for $875 million in second-out, super-priority debt. Overall, the deal gave the company more cash and less debt. However, Judge Oldham said that the deal allowed the Prevailing Lenders "to jump the creditor line and get paid before their erstwhile first and second lien comrades."

Anticipating litigation in the future, the Prevailing Lenders voted by a bare majority to amend the 2016 loan agreement to allow the uptier financing. They also labeled the uptier financing an "open market purchase."

There was more. The company agreed to indemnify the Prevailing Lenders for any losses or liabilities they might incur as a consequence of the uptier financing.

The Serta Simmons Chapter 11 Case

The company filed a chapter 11 petition in early 2023 in Houston. The case was assigned to Bankruptcy Judge David R. Jones, who resigned several months later.

Immediately, the debtor filed an adversary proceeding seeking a declaration that the uptier financing did not violate the 2016 loan agreement. Opposition came from lenders in the 2016 financing who were not among the Prevailing Lenders. The parties and Judge Oldham referred to the opponents as the "Excluded Lenders."

The bankruptcy court granted summary judgment to the Prevailing Lenders and held that the uptier financing was a permitted "open market purchase." The bankruptcy court certified a direct appeal, which the Fifth Circuit accepted.

After dismissing counterclaims for breach of contract asserted by the Excluded Lenders in the adversary proceeding, the bankruptcy court entered final judgment in favor of the debtor and the Prevailing Lenders. Again, the Fifth Circuit accepted a direct appeal.

The Chapter 11 Plan

Because the prepetition indemnification of the Prevailing Lenders would not survive confirmation of the debtor's chapter 11 plan, the plan gave the Prevailing Lenders a new indemnification. The bankruptcy court confirmed the plan and approved "the settlement indemnity [as] a fair and equitable component of a § 1123(b)(3) settlement," Judge Oldham said.

The Fifth Circuit accepted a direct appeal of the confirmation order.

Appellate Jurisdiction

Having consolidated four appeals, Judge Oldham first addressed the Fifth Circuit's appellate jurisdiction and the jurisdiction of the bankruptcy court. Meticulously but quickly, he decided that the bankruptcy court had jurisdiction and power to enter final judgments, with one exception.

The exception was state law breach-of-contract claims by the Excluded Lenders against the Prevailing Lenders, where the bankruptcy court did not have constitutional power to enter a final judgment under *Stern v. Marshall*, 564 U.S. 462, 482 (2011). However, Judge Oldham held that the lack of objection by the debtor and the Prevailing Lenders was implied consent under *Wellness International Network, Ltd. v. Sharif*, 575 U.S. 665 (2015), allowing the bankruptcy court to enter final judgment dismissing the Excluded Lenders' counterclaims.

Judge Oldham also held that the Fifth Circuit had appellate jurisdiction under 28 U.S.C. § 158(d).

It Wasn't an Open market Purchase

On the merits, Judge Oldham first undertook *de novo* review of the bankruptcy court's decision on summary judgment holding that the uptier financing was a permissible open market purchase. Under New York law governing the 2016 financing, he explained why the uptier financing was not an open market transaction.

By referencing dictionaries and by analogy to the Federal Reserve's open market activities, Judge Oldham concluded that "an open market purchase is a purchase of corporate debt that occurs on the secondary market for syndicated loans."

Judge Oldham added that "the words 'open market' point to a specific 'market,' not merely a general context where private parties engage in non-coercive transactions with each other." He rejected the idea "that there is an open market wherever there is competition." Properly, he said, "an open market is one tied to a specific market, like the stock market or the commodities market or the securities market."

Applied to the case at hand, Judge Oldham said that "an open market purchase occurs on the specific market for the product that is being purchased . . . , and the market for that product is the 'secondary market' for syndicated loans."

If the company had wanted to effect an "open market purchase and thereby circumvent the sacred right of ratable treatment," Judge Oldham said, "it should have purchased its loans on the secondary market. Having chosen to privately engage individual lenders outside of this market," he said that the debtor "lost the protection of" the provision in the 2016 loan agreement that gave an exception for open market purchases.

For the same reason that the uptier financing was not an open market transaction, Judge Oldham decided that it also was not subject to the exception for Dutch auctions.

Other Rejected Arguments

Of significance in future cases dealing with syndicated loans, Judge Oldham rejected the Prevailing Lenders' reliance on "a guide published by the Loan Syndications and Trading Association" (LSTA) to show "that industry usage supports their expansive definitions of 'open market purchase.'"

While the "LSTA guide carries some weight," Judge Oldham said, "it is not binding authority." Even if it were dispositive, he said that "its discussion of open market purchases does not support the 2020

Uptier."

Holding "that the 2020 Uptier was not a permissible open market purchase within the meaning of the 2016 Agreement," Judge Oldham reversed "the bankruptcy court's contrary ruling."

In one paragraph, Judge Oldham ruled in favor of the Excluded Lenders in their appeal from the bankruptcy court's denial of their counterclaims for breach of contract. He said that the counterclaims were "largely based" on the issue of open market purchases.

Judge Oldham reversed and remanded for reconsideration of the Excluded Lenders' breach of contract claims. In words the bankruptcy court likely will not ignore on remand, he added that "the Excluded Lenders have a strong case that [the debtor] and the Prevailing Lender plaintiffs breached the 2016 Agreement."

Observations

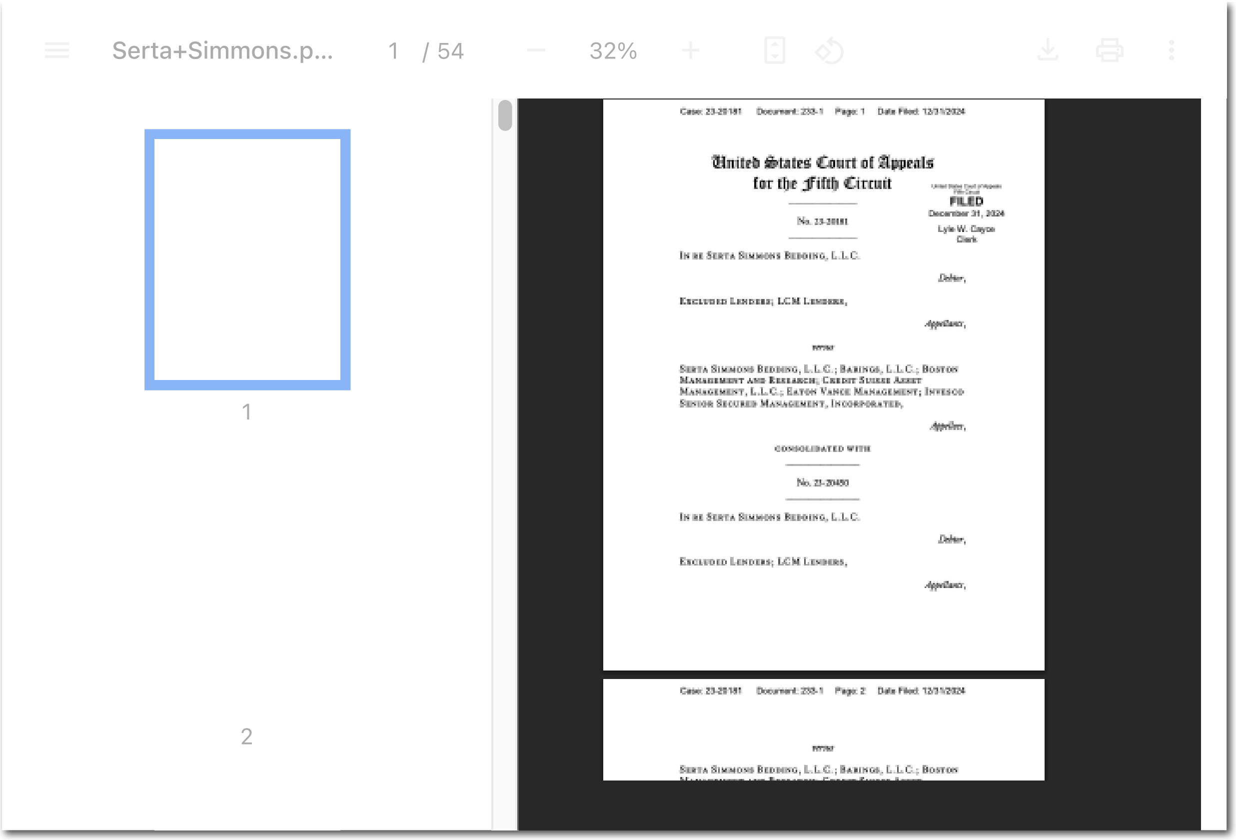
Prof. Stephen J. Lubben provided ABI with the following commentary:

> The Court's ruling on "open market purchases" was refreshingly sensible, compared to the typical hyper-literalism we normally see in corporate finance decisions. Too often courts say [that] "while the parties might not have intended this result, it was not technically prohibited, and the parties are sophisticated, so too bad for you."
>
> That just encourages even more outrageous abuse in the next case. I am hopeful that the *Serta* decision will reset the situation with regard to aggressive "liabilitymanagement transactions," which are often little more than a flagrant attempt to favor one group over another in the forthcoming chapter 11 case.

Among the commentators cited in his opinion, Judge Oldham included Prof. Lubben's "Holdout Panic," 96 Am. Bankr. L.J. 1 (2022). Prof. Lubben occupies the Harvey Washington Wiley Chair in Corporate Governance & Business Ethics at Seton Hall University School of Law.

Opinion Link

PREVIEW



Case: 23-20181 Document: 233-1 Page: 1 Date Filed: 12/31/2024

United States Court of Appeals
for the Fifth Circuit

United States Court of Appeals
Fifth Circuit
FILED
December 31, 2024
Lyle W. Cayce
Clerk

No. 23-20181

In re Serta Simmons Bedding, L.L.C.

Debtor,

Excluded Lenders; LCM Lenders,

Appellants,

versus

Serta Simmons Bedding, L.L.C.; Barings, L.L.C.; Boston Management and Research; Credit Suisse Asset Management, L.L.C.; Eaton Vance Management; Invesco Senior Secured Management, Incorporated,

Appellees,

consolidated with

No. 23-20450

In re Serta Simmons Bedding, L.L.C.

Debtor,

Excluded Lenders; LCM Lenders,

Appellants,

Case: 23-20181 Document: 233-1 Page: 2 Date Filed: 12/31/2024

versus

Serta Simmons Bedding, L.L.C.; Barings, L.L.C.; Boston

https://abi-opinions.s3.us-east-1.amazonaws.com/Serta+Simmons.pdf

Case Details

Case Citation	Excluded Lenders v. Serta Simmons Bedding LLC (In re Serta Simmons Bedding LLC), 23-20181 (5th Cir. Dec. 31, 2024)
Case Name	Excluded Lenders v. Serta Simmons Bedding LLC (In re Serta Simmons Bedding LLC)
Case Type	Business
Court	5th Circuit
Bankruptcy Tags	Claims Financial Advisors Plan Confirmation Venue/Jurisdiction Business Reorganization Finance and Banking Investment Banking Lender Liability

AMERICAN BANKRUPTCY INSTITUTE Health Care Program

Liability Management Transactions and Out-of-Court Workouts

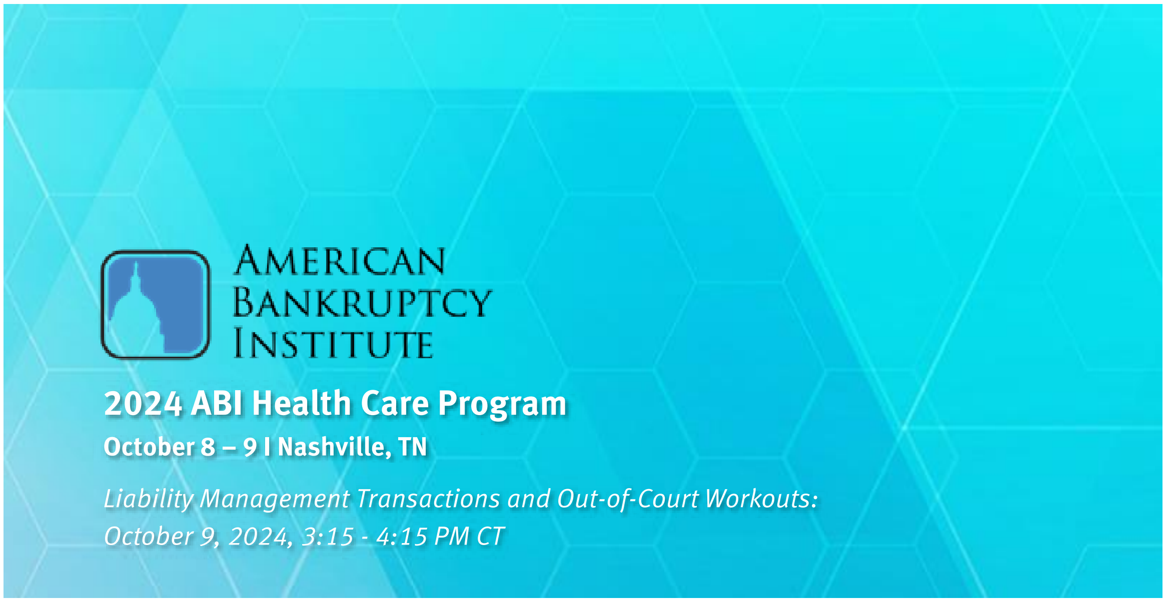
Alexander V. Rohan
Miller Buckfire & Co., LLC | New York

Erin Ryan
Fried, Frank, Harris, Shriver & Jacobson LLP | New York

Andy Serbe
Debtwire | Los Angeles

Rob Shapiro
Berkeley Research Group, LLC | Boston

2024


American Bankruptcy Institute
2024 ABI Health Care Program
October 8 – 9 I Nashville, TN
Liability Management Transactions and Out-of-Court Workouts:
October 9, 2024, 3:15 - 4:15 PM CT

Presenters

Alexander V. Rohan
Miller Buckfire & Co., LLC | New York

Erin Ryan
Fried, Frank, Harris, Shriver & Jacobson LLP | New York

Andy Serbe
Debtwire | Los Angeles

Rob Shapiro
Berkeley Research Group, LLC | Boston

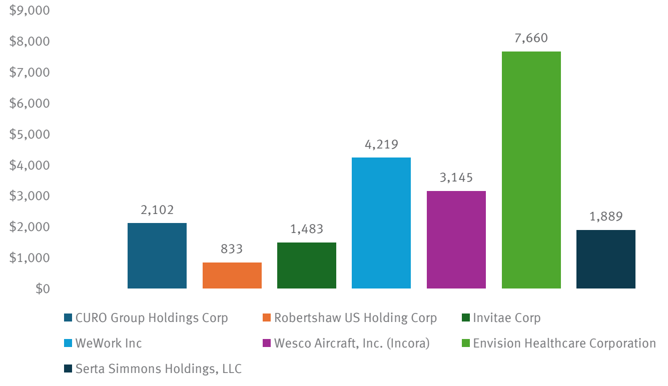
Liability Management Overview

Recent trends in capital markets, including extended leverage profiles, bespoke structuring and loose covenant packages have allowed for creative liability management solutions for companies facing financial distress

- **Liability management transactions encompass a broad array of strategies a company may pursue to manage capital structure and liquidity needs as market and business-specific challenges emerge**
  - —Liability management structures may provide an opportunity for existing stakeholders or new investors to deploy capital to support the business and achieve suitable risk-adjusted returns on investment
- **These strategies can be pursued opportunistically based on an attractive dislocation in market conditions and company fundamentals or preemptively to avoid a broader, more costly restructuring**
- **The complexity of the situation and stakeholders will help inform the range of public or private capital alternatives, which includes utilizing the existing asset base or capital structure to generate liquidity or reduce leverage, structuring an injection of new capital or pursuing a more holistic restructuring out-of-court or in-court**
- **A company and its advisors must consider a variety of factors in evaluating solutions including company stress, corporate governance, stakeholder management, structuring limitations imposed by the existing capital structure, tax implications and litigation risk, among others**

Common Liability Management Goals	
✓ Extend maturity runway or address near-dated maturities	✓ Preemptively address anticipated covenant defaults
✓ Provide source of new money to support the business	✓ Capture attractive return on debt retirements
✓ Deleverage the balance sheet	✓ Free up collateral and assets to unlock value
✓ Reduce debt service burden	✓ Modify existing debt documents

Recent Chapter 11 Filings Involving LMTs



Case	Petition Date	Case Status	Liabilities
CURO Group Holdings Corp	25 Mar 2024	Confirmed	2,102
Robertshaw US Holding Corp	15 Feb 2024	Confirmed	833
Invitae Corp	13 Feb 2024	Confirmed	1,483
WeWork Inc	6 Nov 2023	Confirmed	4,219
Wesco Aircraft, Inc. (Incora)	1 Jun 2023	Pending	3,145
Envision Healthcare Corporation	15 May 2023	Confirmed	7,660
Serta Simmons Holdings, LLC	23 Jan 2023	Confirmed	1,889

Source: Debtwire

Page 4

Healthcare Chapter 11 Filings YTD Through October 1, 2024

Case	Filling Date	Filing Strategy	Pre-Petition Debt (USDm)	Debtor Legal Advisor	Debtor Financial Advisor	Subsector	Court	Judge
Biolase Inc.	1 Oct 2024	PreFiling Sale Process	16	Pillsbury Winthrop Shaw Pittman	B. Riley Advisory Services / SSG Capital Advisors	Medical Tech	Delaware	Karen B. Owens
Tarrant County Senior Living Center	1 Oct 2024	PrePack Plan	207	Butler Snow		Hospital / Treatment Center	Texas Northern	Scott W. Everett
Nuvo Group USA Inc.	22 Aug 2024	Free Fall	24	Hughes Hubbard & Reed	Intrepid Investment Bankers / Teneo	Pharmaceuticals	Delaware	Mary F. Walrath
Guardian Elder Care at Johnstown LLC	29 Jul 2024	PreFiling Sale Process	79	Saul Ewing LLP	Eisner Advisory Group	Hospital / Treatment Center	Pennsylvania Western	Jeffery Deller
Midwest Christian Villages Inc.	17 Jul 2024	Free Fall	76	Dentons	B.C. Ziegler & Company	Hospital / Treatment Center	Missouri Eastern	Kathy Suratt-States
DermTech Inc.	18 Jun 2024	PreFiling Sale Process		Wilson Sonsini Goodrich & Rosati	Cowen & Company	Equipment / Services	Delaware	JohnT. Dorsey
Vyaire Medical Inc.	9 Jun 2024	PreFiling Sale Process	534	Kirkland & Ellis, LLP	AlixPartners, LLP	Equipment / Services	Delaware	Brendan L. Shannon
Optio Rx LLC	7 Jun 2024	Pre-Arranged Plan	128	Chipman Brown Cicero & Cole, LLP	Paladin Management Group, LLC	Equipment / Services	Delaware	Thomas Horan
LaVie care Centers LLC	2 Jun 2024	Free Fall	682	McDermott Will & Emery, LLP	Stout Capital, LLC	Hospital / Treatment Center	Georgia Northern	Paul Baisier
South Hill Operations LLC	17 May 2024	PreFiling Sale Process	61	Whiteford Taylor & Preston, LLP	Ankura Consulting	Hospital / Treatment Center	Pennsylvania Western	Grace E. Robson
Gamida Cell Inc.	13 May 2024	PrePack Plan	79	Cooley	Moelis & Co.	Pharmaceuticals	Delaware	J. Kate Stickles
ProSomnus Inc.	7 May 2024	Pre-Arranged Plan	38	Polsinelli	Gavin / Solmonese	Medical Tech	Delaware	John T. Dorsey
Steward Health Care System LLC	6 May 2024	Free Fall	1176	Weil Gotshal & Manges	Cain Brothers & Company / Lazard Freres & Co. / Leerink Partners	Hospital / Treatment Center	Texas Southern	Christopher M. Lopez
Tampa Life Plan Village Inc.	5 Apr 2024	PreFiling Sale Process	87	Akerman, LLP	Colliers International Florida, LLC	Hospital / Treatment Center	Florida Middle	Roberta A. Colton
Acorda Therapeutics. Inc.	1 Apr 2024	PreFiling Sale Process	207	Baker & Mckenzie	Ducera Partners / Leerink Partners	Pharmaceuticals	New York Southern	David S. Jones
Eiger BioPharmaceuticals Inc.	1 Apr 2024	PreFiling Sale Process	42	Sidley Austin	Alvarez & Marsal; SSG Capital Advisors	Pharmaceuticals	Texas Northern	Stacey Jernigan
Petersen Health Care Inc.	20 Mar 2024	Free Fall	296	Winston & Strawn	Getzler Henrich & Associates	Hospital / Treatment Center	Delaware	Thomas Horan
miR Scientific LLC	15 Mar 2024	PreFiling Sale Process	14	Forman Holt		Medical Tech	New Jersey	Christine M. Gravelle
Invitae Corp	13 Feb 2024	PreFiling Sale Process	1483	Kirkland & Ellis, LLP	Moelis & Co.	Services	New Jersey	Michael B. Kaplan
Sientra Inc.	12 Feb 2024	PreFiling Sale Process	73	Kirkland & Ellis, LLP	Stifel Financial / Miller Buckfire	Services	Delaware	John T. Dorsey
The Center for Special Needs Trust Administration	9 Feb 2024	Free Fall		Stichter Riedel Blain & Postler PA	Nperspective Advisory Services	Services	Florida Middle	Roberta A. Colton
Senior Choice Inc	8 Feb 2024	PreFiling Sale Process	16	Duane Morris	FTI Consulting	Hospital / Treatment Center	Pennsylvania Western	Jeffery Deller
Cano Health, LLC	4 Feb 2024	Pre-Arranged Plan	1233	Weil Gotshal & Manges	Houlihan Lokey / AlixPartners	Hospital / Treatment Center	Delaware	Karen B. Owens
NanoString Technologies Inc.	4 Feb 2024	Free Fall	282	Willkie Farr & Gallagher	AlixPartners; Perella Weinberg Partners / Tudor	Medical Tech	Delaware	Craig Todd Goldblatt
DMK Pharmaceuticals Corporation	2 Feb 2024	Free Fall	14	Nelson Mullins Riley & Scarborough	Rock Creek Advisors	Pharmaceuticals	Delaware	Mary F. Walrath
Neuragenex Treatment Centers LLC	26 Jan 2024	Free Fall		Tiffany & Bosco	Legion Financial		Arizona	Eddward P. Ballinger
Eye Care Leaders Portfolio Holdings LLC	16 Jan 2024	Free Fall	123	Gray Reed & McGraw	B. Riley Advisory Services	Services	Texas Northern	Michelle V. Larson
Athersys Inc.	5 Jan 2024	PreFiling Sale Process	44	McDonald Hopkins	Outcome capital	Pharmaceuticals	Ohio Northern	Jessica E. Price Smith
Humanigen Inc.	3 Jan 2024	PreFiling Sale Process	44	Potter Anderson & Corroon	SC&H Group	Pharmaceuticals	Delaware	Brendan L. Shannon

Source: Debtwire

Non-Pro Rata Uptier: Serta Simmons

The Transaction	▪ **After receiving competing proposals for two different types of LMTs, Serta effected a non-pro rata uptier transaction whereby the Company:** — Incurred newly funded superpriority first out debt; — Exchanged existing first lien loans at 74% and second lien loans at 39% into new second out debt; and — Created a basket for superpriority third-out debt which would rank ahead of pre-existing first lien debt ▪ **This transaction was effected by the use of the "open market purchase" provisions of the existing debt documents. This effectively resulted in a debt-for-debt exchange without triggering a requirement that such exchange occur on a pro-rata basis**
Court Ruling	▪ **Overruling objections by non-participating lenders, the court found parties were aware that the credit documents were "loose" and the implications of such flexibility in the language** ▪ **The court found that sophisticated parties know what words they want to choose in these agreements, and this "could have easily been avoided" by adding a sentence or two in the documents** ▪ **"Sophisticated financial titans engaged in a winner-take-all battle. There was a winner and a loser."**
Key Drafting Takeaways	▪ **Pay attention to flexibility and carve-outs, especially with regard to "sacred rights."** — Lenders should consider including an anti-subordination provision, which blocks the ability to incur priming debt ▪ **Lenders should consider including restrictions on non-pro-rata open market purchases used in connection with a debt exchange** — For example, limiting such purchases to cash or up to a capped amount, or prohibiting altogether — "Open market purchase" was not a defined term in Serta Simmons, and ambiguity may not always benefit the lenders

Page 6

Drop Down: J. Crew

The Transaction	▪ **J. Crew effected a drop-down transaction by which the Company distributed its trademarks (its most valuable asset) to a foreign non-Guarantor Restricted Subsidiary, pursuant to a clause in the Credit Agreement which permitted unlimited investments in such subsidiaries** ▪ **Using "trap door" baskets, the non-Guarantor Restricted Subsidiary then transferred the trademarks to an Unrestricted Subsidiary** — These baskets allowed (i) intercompany investments by loan parties in restricted subsidiaries that were not loan parties, and (ii) investments by non-loan party restricted subsidiaries, financed with the proceeds received from intercompany investments in such non-loan party restricted subsidiaries ▪ **The Unrestricted Subsidiary issued notes secured by the trademarks to the holders of the parent company's debt. This resulted in the previously unsecured debt having a first priority lien on the Company's most valuable asset**
Key Drafting Takeaways	▪ **Most lenders are now keenly aware of the "trap door" basket risk and how to mitigate it:** — Restrictions on the types of assets that can be transferred (i.e., prohibit the transfer of material IP or other "crown jewel" assets); and — Restrictions on investments, including the party in which the investment can be made (i.e., prohibit investments by non-loan party restricted subsidiaries in unrestricted subsidiaries) ▪ **Lenders should consider other protective measures against leakage, including:** — Clearly defined parameters on designating unrestricted subsidiaries; — A cap on the assets held or generated by unrestricted subsidiaries; — Limit the ability to transfer any assets to non-loan parties that are scheduled as material or is material to the underlying business of the borrower; and — Prohibit automatic lien release when collateral is transferred to non-loan parties or affiliates

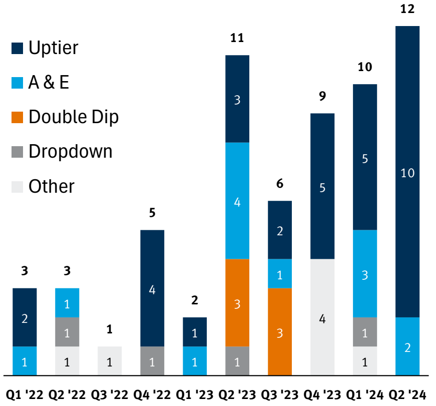
Page 7

Fried Frank BRG Debtwire STIFEL | MILLER BUCKFIRE A Stifel Company

Growth in LM Activity

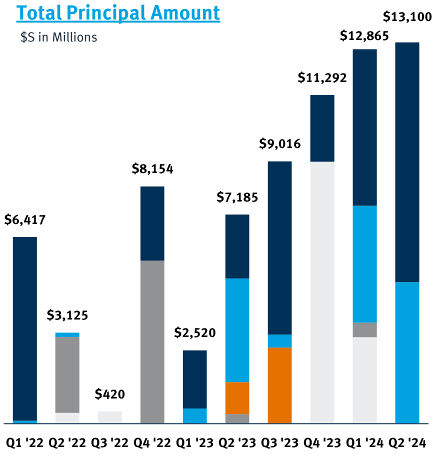
LMEs are increasingly prevalent, with increasingly creative structures (such as drop downs and double dips)

Total Transactions



Total Principal Amount

$S in Millions



Of the four drop downs since the start of 2022, three have occurred in healthcare

Sources: Proprietary BRG analysis utilizing Reorg LME Tracker and Debtwire data

Page 8

Types of Out of Court LMEs

There are numerous types of LMEs, each with their own considerations

	Basket Capacity	New Money	Discount Capture	Rate Relief	Execution Risk	Reputational Risk
Amend and Extend	○	◔	○	◔	🟢	🟢
Uptier	○	◑	◑	◑	🟡	🟡
Double Dip	●	●	◔	◔	🟡	🔴
Drop Down	●	●	●	●	🔴	🔴

Drop Down Consideration

There are many considerations to take into account when determining the feasibility of a drop down transaction

Key Considerations

- Ability for drop down assets to operate independently
- Determining the allocation and valuation methodology to distribute shared services costs
- Potential for additional business expenses (e.g., tax filings, audit, tracking shared services, potential additional FTEs)
- Establishing funding mechanisms and accounting protocols to provide required funds
- Determining any intercompany loan arrangement and associated interest expense
- Calculating the fair market value for all balance sheet items transferred after separation
- Navigating any state and local business license and tax implications
- Identifying and negotiating any lease agreements that would require landlord approval for assignment
- Establishing an appropriate and feasible timeline for when financial statements will be produced for new and existing debtholders
- Identifying, reviewing, inventorying, and assigning agreements and contracts
- Identifying and establishing the new G/L structure to handle changed accounting and intercompany activity needs
- Establishing new processes and procedures for inventory accounting, billing, and payment processing
- General legal entity business clean up

Fried Frank BRG Debtwire STIFEL | MILLER BUCKFIRE A Stifel Company

Borrower and Capital Structure Considerations – Life Sciences / Biotech

Typical Characteristics	▪ **Public companies with a mix of institutional and retail investors, typically more retail in distressed / low market cap situations** ▪ **Vast majority of companies have pre-revenue products in development awaiting data read-outs** ▪ **Significant liquidity required to fund development and commercialization** — Costs can include the outsourcing of testing and manufacturing to CROs / CMOs ▪ **Dependent on the performance of a single or limited number of drugs / products** ▪ **Board and management tend to have strong scientific and medical backgrounds** ▪ **Employee compensation weighted toward equity** ▪ **Limited collateral, the value of which may be difficult to realize in a distressed sale process** — Tends to consist of intellectual property, clinical data, equipment and leases ▪ **Reliant on equity capital markets to meet funding needs** ▪ **Limited traditional debt capital, mostly private unitranche venture debt from one or two investors** — Secured Term Loans • Small in size; narrow universe of lenders that require equity features • Covenant-lite, including MAC / MAE clauses, DACAs and min. liquidity — Unsecured Convertible Bonds • Covenant-lite with returns tied to equity upside
Signs of Stress	▪ **Market capitalization < cash** ▪ **Distressed trading prices for debt with equity-like yields** ▪ **Unfavorable data for key drugs** ▪ **Turnover of senior leadership** ▪ **Inability to fund ongoing cash needs through next testing milestone** ▪ **Inability to access traditional equity capital markets** ▪ **Resorting to non-traditional sources of liquidity:** — ATMs — PIPEs — Reverse merger — Vendor financing — Out-licensing core IP — Clinical development agreement

Page 11

Fried Frank BRG Debtwire STIFEL | MILLER BUCKFIRE A Stifel Company

Stakeholder Considerations & Best Practices

Secured Lenders	▪ **Tend to be few in number, making negotiations more straightforward** ▪ **Very sensitive to liquidity and focused on recovering (or protecting) par** ▪ **Lack of collateral value in a distressed situation will drive aggressive behavior** — Can seek to sweep cash via DACA using MAC / MAE ▪ **Timing and tone of discussions are very important so as not to accelerate aggressive behavior** ▪ **Usually unwilling to provide additional capital or allow new capital that dilutes existing collateral**
Convertible Bondholders	▪ **Likely to be more amenable to funding the business** ▪ **Can be a source of liquidity and deleveraging via up-tier exchange** — Can "trade" for favorable new money terms in return for higher up-tier exchange rate and warrants • Some bondholders prefer to work directly with the borrower or with a limited number of holders
"Technical" Equity Investors	▪ **Can be a source of rescue or bridge capital but with significant dilution to existing equity** — Less focused on fundamentals and seek to create option value via warrants by quickly selling equity to recover the underlying investment — Will result in significant dilution and trading volatility in the Issuer's stock — Usually limited in amount and impact, but can buy precious time

Best Practices

- **Confirm DACA is in full effect**
- **Confirm the location of cash and understand where data is stored both internally and externally**
- **Evaluate relevant covenants, including MAC / MAE clauses**
- **Evaluate obligations to third-party contractors and vendors**
- **Determine funding needs for next testing or business millstone**
  - — Determine "red line" for a "safe landing" in ch. 11 or other process
    - Ch. 11 preparation and case costs (assume no DIP)
    - D&O tail policy
  - — Determine if any repaid obligations can be re-borrowed
  - — Evaluate ability to repay some or all outstanding secured debt if it helps with capital raise or if at risk of cash sweep
- **Talk to advisors as early as possible to determine the range of options and ability to protect the board and management in a downside scenario**
  - — The ability to conduct parallel processes for financing, M&A and restructuring will increase the probability of a successful outcome
- **If an out-of-court solution requires approval from shareholders (e.g., sale / change of control), evaluate the impact of an unsuccessful vote and what a "Plan B" might look like**
  - — Hard to predict outcome if shareholders are predominantly retail investors
  - — Timing for a vote will impact liquidity

Page 12

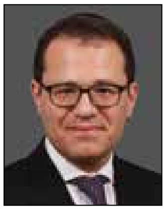
Importance of Third-Party Processes

Overview	▪ **Over the last few years, we have observed a high correlation between successful out-of-court restructurings involving certain healthcare companies and the presence of a third-party marketing process** — This has been more common with smaller capital structures and lender groups in the Life Sciences and MedTech space, but we have also observed this in senior housing deals where the lenders are highly coordinated and aligned
Benefits	1 **When dealing with sophisticated stakeholders (lenders and shareholders), a third-party marketing process or limited market check can help with obtaining material concessions** — Depending on timing and sensitivities around the Company's situation, this can include a traditional debt or equity capital raise in parallel with a sale of the Company • It can also include a more limited approach to generate faster feedback and potential interest, which can be used to determine whether a more fulsome process is warranted 2 **The results of the process will provide the board with an independent assessment of the Company's prospects and allow the advisors to craft an appropriate strategy for addressing stakeholders while setting realistic expectations** 3 **When dealing with stakeholders, the process results will provide real-time market data that can be evaluated in connection with restructuring discussions** — Creditors will have greater clarity as to their options and will better understand why they are being asked to support or participate in a restructuring • This can result in more favorable terms for a lender-supported restructuring if a competitive process is conducted — Shareholders who may have been reluctant to provide incremental capital in lieu of a third-party solution may be more willing to fund the Company rather than be diluted — Board and management can rely on the success of the process or lack thereof to support a transaction that may adversely impact or dilute shareholders

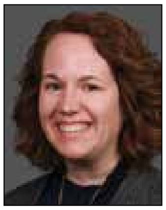
Turnaround Topics

By Sean Scott, Adam Wolk, Meir Dominitz and Lisa Holl Chang

The Dizzying Impact of LMTs: Where We Are Now



Meir Dominitz
Mayer Brown LLP
New York



Lisa Holl Chang
Mayer Brown LLP
Chicago

Sean Scott and Lisa Holl Chang are partners in Mayer Brown LLP's Restructuring Practice in Chicago. Adam Wolk and Meir Dominitz are partners in the firm's Banking and Finance Practice in New York.

In recent years, the U.S. leveraged-loan market has received a crash course in liability-management transactions (LMTs). This article looks at the evolving mechanics of LMTs (including drop-down, uptiering and double-dip transactions), the opportunities for borrowers, the potential risks to lenders and the market's response to the growing use of LMTs. By becoming familiar with the shared tools by which LMTs are executed, borrowers and lenders can understand how the transactions can be utilized and how to mitigate any potential associated risk.

Background

LMTs have become an increasingly prevalent method for borrowers and private-equity sponsors to adjust their capital structures when facing financial headwinds, navigating uncertain market conditions or weathering financial distress. Although their specific techniques vary, LMTs rely on technical — and sometimes aggressive, depending on one's perspective — interpretations of existing credit documentation to manage existing debt and raise new capital.

As borrowers have increasingly used drop-down and uptiering transactions to move collateral out of the scope of existing lenders' security interest, many lenders have become wary of the growing use of such transactions. How did we get to where we are now? Let's start with J. Crew and drop-downs.

Asset Drop-Downs Put LMTs on the Map

LMTs shook U.S. leveraged-loan markets seven years ago when certain household names — including J. Crew, Neiman Marcus Group and PetSmart — began using drop-down transactions to move valuable collateral assets beyond the reach of existing lenders. The transactions used credit-agreement baskets that technically permitted such an action, but lenders perceived these as "loopholes," since those baskets were not intended to permit the end result. While the specifics of each drop-down transaction varied, they all had at least one thing in common: The borrower executed the LMT *without* the consent of members of the existing lender group.

How Drop-Down Transactions Work

In drop-down transactions, the borrower identifies one or more existing baskets in the negative covenants provisions of its credit documentation that permit it to transfer certain assets to an affiliated entity. The motivation behind these transactions is often to use the transferred assets as collateral to secure new debt, and the assets are transferred simultaneously with the incurrence of such new debt.

Drop-down transactions typically rely on baskets under the "permitted investments" and "restricted payments" negative covenants. Accordingly, the specificity, clarity and scope of what is permitted and restricted in these baskets define how much the lender group will be protected from the adverse consequences of drop-down transactions.

A common thread with these transactions is the use of unrestricted subsidiaries, which are entities within the corporate family that are not required to comply with the provisions of the credit agreement, including by joining the credit agreement as a guarantor or pledgor. Each of the transactions described herein used a combination of permitted investments, restricted payments and unrestricted subsidiaries provisions to move valuable collateral out of the reach of the existing lender group.

The "J. Crew Trap Door"

In 2016, J. Crew[1] executed a transaction that took the market by such surprise that it became known as the "J. Crew trap door." Because the permitted investment baskets allowed the company to make investments in entities not subject to the terms of their credit agreement or the liens of the lenders (*i.e.*, unrestricted subsidiaries), J. Crew designed certain transactions to move valuable collateral out of lenders' reach for the purpose of securing new indebtedness. Specifically, the credit agreement permitted the following: (1) up to $150 million of investments *made* to non-guarantor restricted subsidiaries; (2) up to $100 million of general investments; and (3) an unlimited amount of investments *made* by non-guarantor restricted subsidiaries, provided the investment was financed with the proceeds of previous investments permitted under the credit agreement.

In a two-step process, the company — relying on the $150 million and $100 million baskets — first transferred intellectual property (IP) valued at $250 million to a non-guarantor restricted subsid-

1 The details of the J. Crew transaction were extensively reported at the time, and the debt documents are available on the Securities and Exchange Commission's Edgar database under "J. Crew Group Inc." *See also* Complaint, *J. Crew Grp. Inc. v. Wilmington Savings Fund Society FSB*, Case No. 650574/2017 (N.Y. Sup. Ct. Feb. 1, 2017), ECF No. 1.

iary. Subsequently, that subsidiary "invested" the IP in an unrestricted subsidiary, resulting in the assets not only being removed from the collateral but also being held by an entity not subject to any of the restrictions of the credit agreement. The second transfer prompted the maneuver that became known as the "J. Crew trap door," because the collateral essentially was released from the lenders' reach through a trap door that permitted unlimited investments in unrestricted subsidiaries if financed with the proceeds of other investments permitted under the credit agreement.

Neiman Marcus's Use of Restricted Payments Basket

In September 2018, Neiman Marcus transferred its valuable myTheresa[2] business up the corporate organizational chart and beyond the reach of the lenders' security interests. When Neiman Marcus initially acquired myTheresa, the entities owning the myTheresa business were "restricted subsidiaries" but were not guarantors of the credit facility. In 2014 and 2017, Neiman Marcus designated them as "unrestricted subsidiaries" by using investment capacity under its credit agreement. Neiman Marcus then moved myTheresa outside the reach of its lenders by utilizing the restricted payments basket.

Typically, credit agreements contain negative covenants around "restricted payments" that limit, among other things, the payments the borrower can make to its shareholders. In this case, Neiman Marcus's credit agreement allowed the distribution of equity interests of any unrestricted subsidiary to the parent company. Because the entities that owned myTheresa had been designated as unrestricted subsidiaries, Neiman Marcus could distribute the equity interests to its parent company — an entity that was not subject to any of the restrictions of, or liens in favor of, the loan facility. This put the myTheresa business outside the scope of the lenders' security interests and preserved its value for the sponsors.

PetSmart's Use of Multiple Baskets

In June 2018, PetSmart[3] transferred a valuable asset — its equity interests in the online pet retailer Chewy.com — out of lenders' reach through a transaction that used permitted investments and restricted payments baskets. First, PetSmart transferred 16.5 percent of its equity interests in Chewy to a newly formed unrestricted subsidiary using capacity available under its permitted investments basket.

Second, PetSmart distributed 20 percent of Chewy's equity to its sponsor using capacity available under its restricted payments basket. As a result of these transactions, PetSmart transferred 36.5 percent of Chewy's equity to entities that were not subject to its credit agreement, resulting in Chewy no longer being a wholly owned subsidiary of PetSmart. Because the credit agreement required the release of subsidiaries not wholly owned by PetSmart, the company requested a release of Chewy's guaranty and pledged collateral, thereby limiting the collateral available to lenders.

Uptiering Transactions Usher in a New Wave

The next chapter in LMTs involved "uptiering" transactions that were part of what the loan market coined a wave of "lender-on-lender violence." Unlike drop-down transactions, in uptiering transactions the objectives of the borrower and a majority of its existing lenders were aligned, with both groups cooperating to effectuate a transaction that benefited the borrower and cooperating lender group at the expense of other lenders. In these situations, the borrower sought additional financing, and the cooperating (majority) lenders agreed to provide it, subject to an uptiering transaction pursuant to which they exchanged their existing loans for new loans with a higher collateral priority than the other (minority group of) lenders.

Made infamous by Serta Simmons, Trimark and Boardriders, these transactions and the resulting litigation brought by the nonparticipating lenders destabilized the loan market in 2020 and 2021. Unlike the drop-down transactions that were often company-specific in terms of their various permutations, uptiering transactions typically follow a formulaic series of sequential steps.

First, the borrower and a majority group of consenting lenders amend the credit agreement to permit the incurrence of a tranche of debt senior to the outstanding debt under the existing credit agreement. After adopting the amendment, the borrower incurs the newly permitted senior debt and enters into open-market purchase transactions, whereby the borrower purchases the consenting lenders' existing debt with the proceeds of the senior debt. Finally, the debt purchased by the borrower is retired and deemed satisfied.

The result is an exchange of the consenting lenders' loans that were previously secured on a *pari passu* basis, with all loans for new debt secured on a senior basis to the original loans. Therefore, the consenting lenders have effectively primed the other syndicate members and obtained a senior position. On its face, these exchanges would seem to violate *pro rata* sharing provisions, which are a hallmark of multi-lender financings. Credit agreements typically treat the *pro rata* allocation of principal and interest payments among all lenders as a "sacred right" that may not be amended without the consent of each affected lender.

Litigation has focused on the *pro rata* sharing requirement and any built-in exceptions to it.[4] In a number of these transactions, borrowers, lenders and other participants have argued that they were acting within the parameters of the credit agreement's "open-market purchase" provisions, which permit a borrower to purchase a portion of outstanding loans on a non-*pro rata* basis.

In addition, litigants have argued that a debt exchange offered privately to a select group of lenders is permitted. Whether uptiering transactions constitute permissible "open-market purchases" or violate a core tenet of credit agreements remains a hotly contested issue in ongoing litigation, and the issue is currently on appeal

2 The transfer of the MyTheresa business was initially report by Nieman Marcus in a Form 10-K filed on Sept. 18, 2018, *available at* sec.gov/Archives/edgar/data/1358651/000135865118000013/a2018072810-k.htm (unless otherwise specified, all links in this article were last visited on Dec. 5, 2023).

3 Complaint, *Argos Holdings Inc. v. Citibank NA*, Case No. 18-cv-5773 (S.D.N.Y. June 26, 2018), ECF No. 1.

4 *LCM XXII Ltd. v. Serta Simmons Bedding LLC*, Case No. 21-cv-3987, 2022 WL 953109 (S.D.N.Y. March 29, 2022).

continued on page 93

Turnaround Topics: The Dizzying Impact of LMTs: Where We Are Now

from page 61

to the Fifth Circuit Court of Appeals following a ruling in *Serta*'s chapter 11 case that the uptiering transaction was permitted.[5]

The New Frontier: The Emergence of Double-Dip Transactions

More recently, "double-dip" transactions have grabbed lenders' attention. Double-dip transactions, like drop-down transactions, take advantage of existing flexibility regarding permitted liens, investments and unrestricted subsidiaries, meaning that they can be carried out by borrowers without the consent of existing lenders. However, the hallmark feature of double-dip transactions is not stripping existing lenders of collateral; instead, it is providing new lenders with two means of potential recourse (a.k.a. "dips") against the borrower and collateral.

In a double-dip transaction, an existing or newly created subsidiary with few assets issues new debt to the lenders that participate in the transaction. The proceeds of the new debt are loaned to the borrower in exchange for an intercompany note, which is then pledged as security for the lenders of the new debt. This intercompany note (and pledge to the lenders) creates the first "dip" against the borrower and the existing loans' security.

The new debt is then guaranteed by the borrower, another member of the restricted credit group or a subsidiary outside the restricted credit group. This guaranty creates the second "dip" against the borrower and creates additional credit support for the new debt. If the guaranty comes from an existing credit party, the existing lenders' collateral may be further diluted. If not, the new lenders receive a credit enhancement not otherwise available to the existing lender group.

In September 2023, Trinseo executed a $1 billion refinancing of existing term loans and unsecured notes with pending maturities through a double-dip structure that also featured an asset drop-down.[6] The new money lenders loaned to a newly created, unrestricted subsidiary that then loaned most of the proceeds via an intercompany note to the restricted credit group. The remainder was used as an indirect equity contribution. The intercompany note (*i.e.*, the "first dip") was structured as an incremental and refinancing loan under the existing credit agreement, making it *pari passu* with the existing debt.

The "second dip" came via various guarantees, including guarantees from the new money borrowers' parents and limited guarantees from members of the restricted credit group. It is likely the guarantees were limited so as to not violate the credit agreement's permitted debt and lien baskets. The drop-down portion involved transferring a subsidiary, American Styrenics, to an unrestricted subsidiary that was also a co-borrower for the new money loans. This drop-down may have been affected using both pre-existing investments capacity and additional capacity created by the equity investment made with the new money loans' proceeds.

Trinseo and other double-dip transactions create a way for lenders to have two different claims against a borrower and its assets. Although double claims *do not* create double recoveries, they create the potential for greater recovery in a downside scenario, such as a bankruptcy proceeding, in which lenders' direct claims against specific obligors are not entitled to full repayment. Although the transactions might not be viewed as "violent," *vis-à-vis* existing lenders, as the drop-down or uptiering transactions, they have the potential to dilute existing lenders' collateral.

For borrowers, they are a valuable liability-management tool. By offering greater downside protection, borrowers can obtain new financing or a refinancing in a challenging credit environment.

Market Response: How Lenders Can Mitigate the Risks of LMTs

Initially, many LMTs surprised market participants because they were inconsistent with expectations and market norms. Several of these transactions have been challenged by the impacted lenders to varying degrees of success. As a result, certain lenders have responded by attempting to insert certain new provisions into credit agreements to prevent each of these types of transactions.

For example, in 2021, the syndicated loan market prioritized seeking "Serta blocker" language in credit agreements to mitigate the risk of uptiering transactions.[7] These provisions explicitly state that the *pari passu* status of lenders is a sacred right, and that the subordination of any or all of the loans requires the consent of each affected lender.

Although this type of provision is straightforward and effective, it has not been uniformly adopted throughout the loan market. Some versions of this provision do not require an affected lender's consent if that lender has been offered (and declined) an opportunity to participate in the uptiered tranche. Under the shadow of litigation in recent years, borrowers and lenders interested in uptiering transactions have weighed the likelihood of facing a lawsuit by nonconsenting lenders and are considering using strategies to minimize this risk, such as opening the exchange to all lenders.

The market response to drop-down transactions (and likely to double-dips as well) has been more nuanced. The provisions at play — permitted debt and lien baskets, permitted investments, restricted payments, etc. — are key

5 *See* Notice of Appeal, *Excluded Lenders v. Serta Simmons Bedding LLC (In re Serta Simmons Bedding LLC)*, Case No. 23-cv-20181 (5th Cir. April 26, 2023), ECF No. 1.

6 Trinseo announced the transaction via a public filing on Form 8-K on Sept. 8, 2023, *available at* sec.gov/ix?doc=/Archives/edgar/data/1519061/000110465923099167/tm2325668d1_8k.htm.

7 *See, e.g.*, Julian Bulaon, "Covenant Trends: Expanded Sacred Rights Provisions in Recent Credit Agreements Provide Varying, Sometimes Circumventable Protections Against Lien Subordination Amendments," Reorg Research (Feb. 25, 2022), *available at* reorg.com/covenant-trends-expanded-sacred-rights-provisions.

continued on page 94

Turnaround Topics: The Dizzying Impact of LMTs: Where We Are Now

from page 93

provisions that enable borrowers to pursue their business objectives. For lenders, it can be difficult to justify restrictive covenants at deal origination when the company (and financing) look promising.

Although certain blockers (such as prohibiting transfers of the company's material IP to unrestricted subsidiaries) may prevent more egregious LMTs, there is no easy fix to avoid the potential for these transactions entirely. A prohibition on the transfer of IP would not help if a company has another valuable asset that it transfers to an unrestricted subsidiary.

Key Takeaways for Lenders

Taking center stage in just a few years, LMTs have sparked various reactions in the loan market, from surprise to fearful skepticism to proactive risk-mitigation. While the loan market is far from settled, borrowers and lenders should focus on the permitted investments, restricted payments, unrestricted subsidiary and sacred rights provisions in their credit agreements. After all, the specificity, clarity and scope of these provisions can make or break whether participants realize the benefit of their bargain, or face unintended and adverse consequences. abi

APRIL 17, 2025

Nondebtor Releases Are Still Permissible in Chapter 15, Delaware Judge Says

> Foreign reorganizations with nondebtor releases are not 'manifestly contrary' to public policy after Purdue, according to Delaware's Bankruptcy Judge Thomas Horan.

The *Purdue* decision from the Supreme Court banning nonconsensual releases of nondebtors does not preclude a U.S. bankruptcy court in chapter 15 from enforcing foreign plans with nondebtor releases, for reasons explained by Bankruptcy Judge Thomas M. Horan of Delaware.

In his April 1 opinion, Judge Horan described how the "*Purdue* Court held that [Section 1123(b)(6)] does not allow a chapter 11 plan to include nonconsensual third-party releases." Distinguishing the language in Section 1123(b)(6) from the relevant provisions in chapter 15, he held that "the plain language of both section 1521(a)(7) and section 1507(a) permit a U.S. court to enforce a foreign order for nonconsensual third-party releases."

The Mexican Plan

The debtor was one of Mexico's largest nonbank lenders. Financial problems began in 2021 and led to a liquidation proceeding in a Mexican court in 2022. Discussions culminated when the debtor, the

Mexican liquidators and an *ad hoc* group of creditors developed a restructuring support agreement. The Mexican liquidator then commenced a proceeding in Mexico to implement the prepackaged plan.

When the plan received support from almost 57% of creditors, the Mexican court overruled objections and approved the prepackaged plan.

The plan contained releases for the *ad hoc* committee members, the Mexican liquidator, the indenture trustee and related parties. The releases barred claims for actions taken during the restructuring. Judge Horan said the releases were “customary in Mexican settlement agreements and . . . permitted under Mexican Bankruptcy Law.”

An agency of the U.S. government, the U.S. International Development Finance Corporation, or DFC, had objected unsuccessfully to the Mexican court’s approval of the plan. Until appealing in Mexico, the DFC had not objected to the nondebtor releases. The DFC’s appeal remains pending in Mexico.

The debtor’s foreign representative commenced the chapter 15 case in early February, seeking foreign main recognition and enforcement of the Mexican plan and its releases in the U.S. The DFC lodged the only objection to recognition.

Judge Horan characterized the DFC as contending that the releases are “not authorized under Bankruptcy Code sections 1507 and 1521” and that “appropriate relief” available to a foreign debtor “refers to relief available under the Bankruptcy Code.”

Sections 1501, 1506, 1507 and 1521(a)

The outcome turned primarily on four sections in chapter 15. Section 1507(a) provides that the bankruptcy court “may provide additional assistance to a foreign representative . . . .” Upon recognition, Section 1521(a) similarly provides that the court “may . . . grant any appropriate relief, including” seven specific types of relief.

“In determining whether to provide additional assistance,” Section 1507(b) directs the U.S. court to “consider whether such additional assistance [is] consistent with the principles of comity.”

In addition, Section 1501 states that one of the purposes of chapter 15 is to promote “cooperation” with courts abroad. On the other hand, Section 1506 allows the court to refuse “to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States.”

In deciding how to rule, Judge Horan said he would “consider[] the centrality of cooperation and comity in reaching [his] decision” and “maximize assistance to the foreign court conducting the foreign main proceeding.”

Regarding Section 1506, Judge Horan said that the foreign proceeding must “afford litigants the same fundamental protections that they would have received in a U.S. court,” but that the relief need not “be identical to relief that might be available in a U.S. proceeding.”

The Differences Between Chapters 11 and 15

For Judge Horan, the question was whether "*Purdue* changes the way courts should interpret sections 1521(a) and 1507," given the Supreme Court's conclusion that Section 1123(b)(6) "does not allow a chapter 11 plan to include nonconsensual third-party releases." The DFC wanted him to apply the same analysis to chapter 15, because Sections 1521(a)(7) and 1507(a) are "catchalls," just like Section 1123(b)(6).

Judge Horan answered the argument by stressing the linguistic differences between the sections in chapter 11 and those in chapter 15.

Unlike Section 1123(b)(6), Section 1521(a) uses the word "including" to show that "appropriate relief" is not limited to the seven specifically listed types of relief. Judge Horan went on to say that "section 1521(a)(7) qualifies its 'any . . . including' language by listing specific relief that a court is not permitted to grant under that section" and that the "list of prohibited relief does not include nonconsensual third-party releases."

Employing the canon "*expressio unius est exclusio alterius,*" Judge Horan concluded that the "list of relief that courts should not grant under section 1521(a)(7) . . . implies that other forms of relief not expressly prohibited are permitted." He therefore deduced that "enforcing foreign orders providing for nonconsensual third-party releases is within the scope of authority that section 1521(a) provides." Because "comity is central to chapter 15, the relief granted in the foreign court does not have to be available in U.S. courts under chapter 11."

Judge Horan held that "the plain language of both section 1521(a)(7) and section 1507(a) permit[s] a U.S. court to enforce a foreign order for nonconsensual third-party releases." Even if chapter 15 were ambiguous, he concluded that "the legislative history and canons of statutory construction confirm this interpretation and corresponding Congressional intent."

Judge Horan noted that "nonconsensual third-party releases are widely accepted by foreign courts." Therefore, "granting bankruptcy courts the authority to enforce nonconsensual third-party releases originating in foreign courts would promote chapter 15's goals of comity and providing assistance to foreign courts."

'Manifestly Contrary'

The DFC argued that enforcing nondebtor releases would be "manifestly contrary" to public policy under Section 1506 as a result of *Purdue*.

Judge Horan retorted by saying that "the Mexican proceeding comported with U.S. standards of procedural fairness[;] . . . the Concurso Plan does not violate any constitutional or statutory rights," and the releases were "customary and permitted under Mexican law."

Far from being "manifestly contrary," Judge Horan said that nondebtor releases are permitted in "asbestos" cases by Section 524(g). Furthermore, he noted how the Supreme Court in *Purdue* said that Congress could have permitted nondebtor releases. "Lack of specific availability in U.S. courts does not equate to manifest contrariness to U.S. public policy," he said.

Judge Horan noted possibly contrary authority from the Fifth Circuit in *Ad Hoc Group of Vitro Noteholders v. Vitro S.A.B. de C.V. (In re Vitro S.A.B. de C.V.)*, 701 F.3d 1031 (5th Cir. 2012). He said the Fifth Circuit "could not deny the relief simply on the basis that third-party releases were not available in its jurisdiction." Rather, he said that the *Vitro* "court only declined to enforce the plan in that case because of the role in the approval process of the votes of insiders holding intercompany claims."

Judge Horan granted foreign main recognition and enforced the Mexican plan in the U.S., since the "plain language of Bankruptcy Code sections 1521(a) and 1507 giv[es] this Court a broad grant of discretion to aid foreign courts in accordance with principles of comity." He added, "The simple fact that a U.S. court could not grant such releases in a typical chapter 11 plan does not make them manifestly contrary to U.S. public policy."

The DFC is appealing.

Observations

Would Judge Horan's decision give Johnson & Johnson a fourth shot at nondebtor releases?

Assume J&J incorporates a subsidiary abroad, and the subsidiary assumes all of J&J's mass tort liability. Further assume that the foreign court approves a reorganization with discharges for the debtor-subsidiary and for the parent and all affiliates. Assuming the requisites for foreign main recognition were shown, would a U.S. bankruptcy court enforce the nondebtor releases in the U.S.?

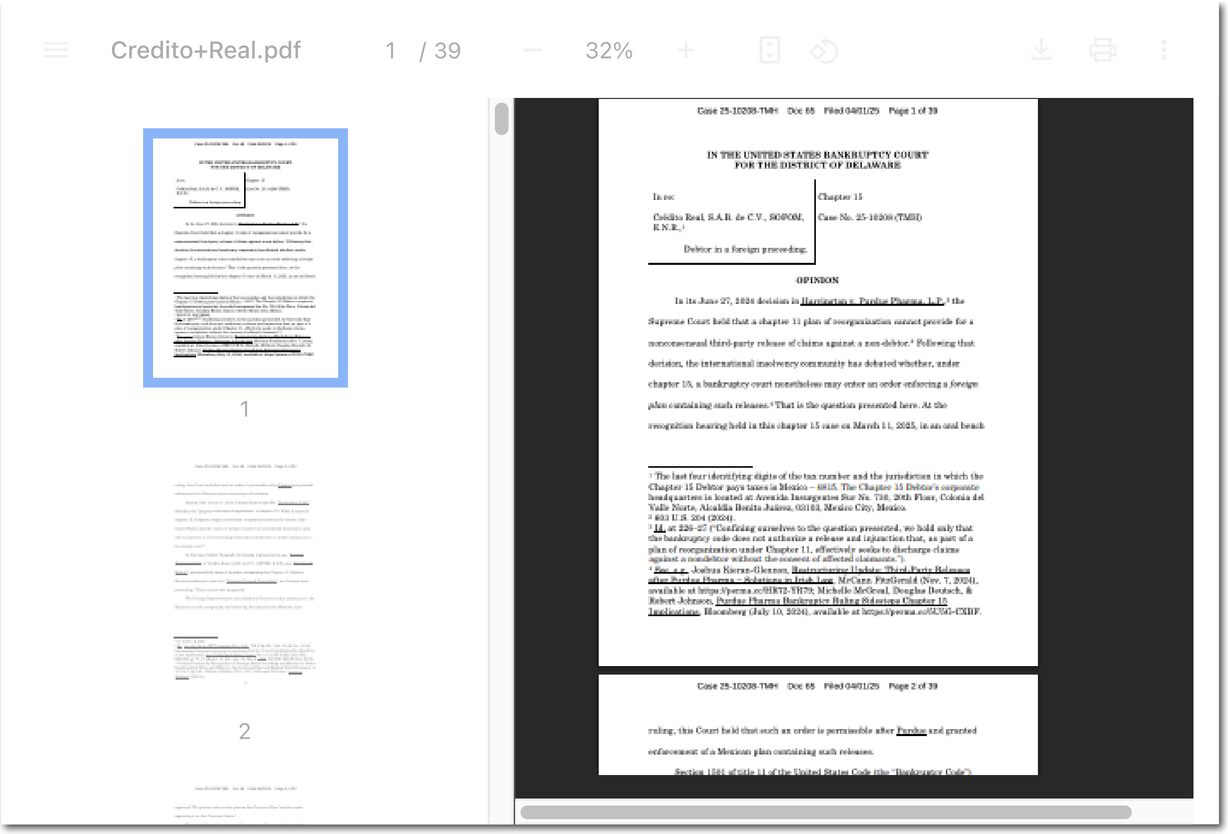
Answer: Probably not, but why not?

What about this: A foreign parent has guaranteed a loan from a U.S. bank to one of its subsidiaries. The subsidiary reorganizes abroad with a plan giving a release to the nondebtor parent. Again assuming foreign main recognition, would a U.S. bankruptcy court enforce the release in favor of the nondebtor parent, barring the U.S. bank from collecting from the parent's assets in the U.S.?

In the comment box below, we invite our readers to say how a U.S. bankruptcy court would or should rule.

Opinion Link

PREVIEW



Case 25-10208-TMH Doc 65 Filed 04/01/25 Page 1 of 39

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	Chapter 15
Crédito Real, S.A.B. de C.V., SOFOM, E.N.R.,[1]	Case No. 25-10208 (TMH)
Debtor in a foreign proceeding.	

OPINION

In its June 27, 2024 decision in Harrington v. Purdue Pharma, L.P.,[2] the Supreme Court held that a chapter 11 plan of reorganization cannot provide for a nonconsensual third-party release of claims against a non-debtor.[3] Following that decision, the international insolvency community has debated whether, under chapter 15, a bankruptcy court nonetheless may enter an order enforcing a *foreign* plan containing such releases.[4] That is the question presented here. At the recognition hearing held in this chapter 15 case on March 11, 2025, in an oral bench

[1] The last four identifying digits of the tax number and the jurisdiction in which the Chapter 15 Debtor pays taxes in Mexico – 6815. The Chapter 15 Debtor's corporate headquarters is located at Avenida Insurgentes Sur No. 730, 20th Floor, Colonia del Valle Norte, Alcaldía Benito Juárez, 03103, Mexico City, Mexico.
[2] 603 U.S. 204 (2024).
[3] Id. at 226–27 ("Confining ourselves to the question presented, we hold only that the bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a nondebtor without the consent of affected claimants.").
[4] See, e.g., Joshua Kieran-Glennon, Restructuring Update: Third-Party Releases after Purdue Pharma – Solutions in Irish Law, McCann FitzGerald (Nov. 7, 2024), available at https://perma.cc/HR72-YR79; Michelle McGreal, Douglas Deutsch, & Robert Johnson, Purdue Pharma Bankruptcy Ruling Sidesteps Chapter 15 Implications, Bloomberg (July 10, 2024), available at https://perma.cc/5USG-CXBF.

Case 25-10208-TMH Doc 65 Filed 04/01/25 Page 2 of 39

ruling, this Court held that such an order is permissible after Purdue and granted enforcement of a Mexican plan containing such releases.

Section 1501 of title 11 of the United States Code (the "Bankruptcy Code")

https://abi-opinions.s3.us-east-1.amazonaws.com/Credito+Real.pdf

Case Details

Case Citation	In re Crédito Real SAB de CV, 25-10208 (Bankr. D. Del. April 1, 2025)
Case Name	In re Crédito Real SAB de CV
Case Type	Business
Court	3rd Circuit Delaware
Bankruptcy Tags	Business Reorganization International Insolvency

Add new comment

Your name

ckanon@abi.org

Comment*

Faculty

Hon. Lisa G. Beckerman is a U.S. Bankruptcy Judge for the Southern District of New York in New York, sworn in on Feb. 26, 2021. From May 1999 until she was appointed to the bench, she was a partner in the financial restructuring group at Akin Gump Strauss Hauer & Feld LLP. From September 1989 until May 1999, she was an associate and then a partner in the bankruptcy group at Stroock & Stroock & Lavan LLP. Prior to her appointment, Judge Beckerman served as a co-chair of the Executive Committee of UJA-Federation of New York's Bankruptcy and Reorganization Group, as co-chair and as a member of the Advisory Board of ABI's New York City Bankruptcy Conference, and as a member of ABI's Board of Directors of from 2013-19. She is a Fellow and a member of the board of directors of the American College of Bankruptcy, as well as a member of the National Conference of Bankruptcy Judges (NCBJ) and the 2021 NCBJ Education Committee. She also is a member of the Dean's Advisory Board for Boston University School of Law. Judge Beckerman received her A.B. from University of Chicago in 1984, her M.B.A. from the University of Texas in 1986 and her J.D. from Boston University in 1989.

Hon. Marvin P. Isgur is a U.S. Bankruptcy Judge for the Southern District of Texas in Houston, appointed on Feb. 1, 2004, and reappointed on Feb. 1, 2018. He also served as Chief Judge from 2009-2012. Judge Isgur serves as adjunct faculty at the University of Houston Law Center. Between 1978 and 1990, he was an executive with a large real estate development company in Houston. From 1990 until 2004, he represented trustees and debtors in chapter 11 and chapter 7 cases, as well as various parties in 14 separate chapter 9 bankruptcy cases. Judge Isgur has written over 500 memorandum opinions. He was one of the first judges to issue opinions interpreting the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act. Judge Isgur is a volunteer with the Houston Urban Debate League, a nonprofit organization that works in partnership with the Houston Independent School District to bring policy debate to high school students. He is one of the principal organizers of the annual University of Texas Consumer Bankruptcy Conference and is a frequent speaker at continuing education programs. Judge Isgur received his bachelor's degree from the University of Houston in 1974, his M.B.A. with honors from Stanford University in 1978, and his J.D. with high honors from the University of Houston in 1990.

Brad M. Kahn is a partner with Akin Gump Strauss Hauer & Feld LLP in New York and a financial restructuring practitioner focused on large, complex in-court and out-of-court corporate restructurings. His experience includes representing ad hoc and official creditors' committees, as well as debtors, in high-profile chapter 11 cases. He also advises clients in multijurisdictional and cross-border insolvency proceedings. Mr. Kahn's restructuring matters encompass a variety of industries, including financial services, energy, telecommunications, shipping, technology and printing. He was listed as a *Turnarounds & Workouts* "Outstanding Young Bankruptcy Lawyer" in 2019 and as a *New York Super Lawyers* Rising Star from 2016-18. Mr. Kahn received his B.A. in 2004 from Yale University and his J.D. in 2007 from New York University School of Law.