



AMERICAN
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2023 Bankruptcy Battleground West

I Got J-Crewed: Lender-on-Lender Violence

Tristan Axelrod

Brown Rudnick LLP | Boston

Jennifer A. Christian

ASK LLP | New York

Gary E. Klausner

Levene, Neale, Bender, Yoo & Golubchik L.L.P. | Los Angeles

Rachel Jaffe Mauceri

Robinson & Cole LLP | Philadelphia

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Tristan Axelrod, Brown Rudnick LLP
Jennifer Christian, ASK LLP
Gary E. Klausner, LNBY&G LLP
Rachel Jaffe Mauceri, Robinson & Cole LLP

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What Is an Uptier Transaction?

An “uptier” transaction is a transaction in which:

- A distressed borrower agrees with some (not all) first lien lenders to amend secured credit documents to allow issuance of a new super-priority debt; and
- Rolls up and promotes participating lenders to the super-priority debt tier; thereby
- Obtaining new liquidity while effectively subordinating non-participating former first lien lenders.

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Why All the Litigation?

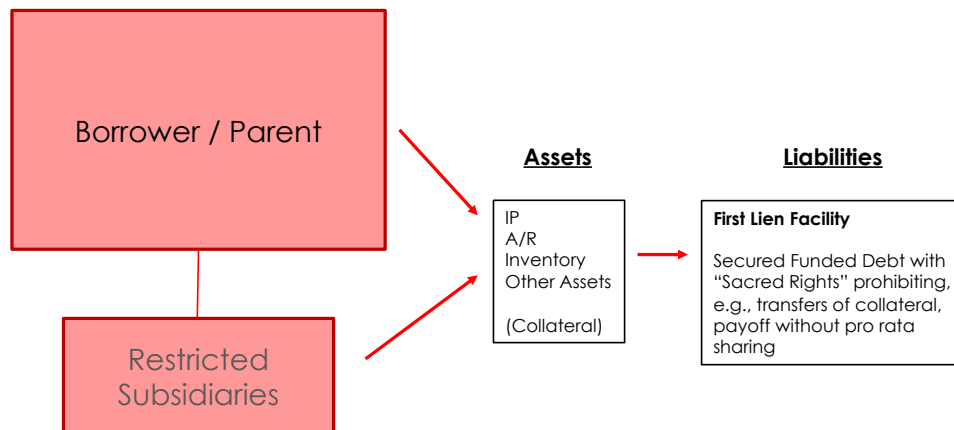
Recent uptier transactions with borrowers including J. Crew, Revlon, and Serta have resulted in significant state court and bankruptcy litigation.

- Non-participating former first lien lenders typically view an uptier transaction as a breach of their “sacred rights” to maintain first priority against the borrower’s most valuable collateral assets.
- Typically, a borrower cannot obtain substantial new liquidity senior to the first lien lenders without supermajority or unanimous consent, and cannot roll up or buy out any first lien lenders without offering the same opportunity to all first lien lenders. (These are the among the “sacred rights”).
- Uptier transactions typically use a combination of amendments to non-sacred provisions of a loan agreement to circumvent the sacred rights.
- In some cases, it has been alleged that the borrower improperly manufactured simple majority lender consent for the transaction. In all cases, it has been alleged that the borrower and favored lenders breached the loan agreement itself and the implied duty of good faith and fair dealing.

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Uptier Transaction: The Borrower “Before”

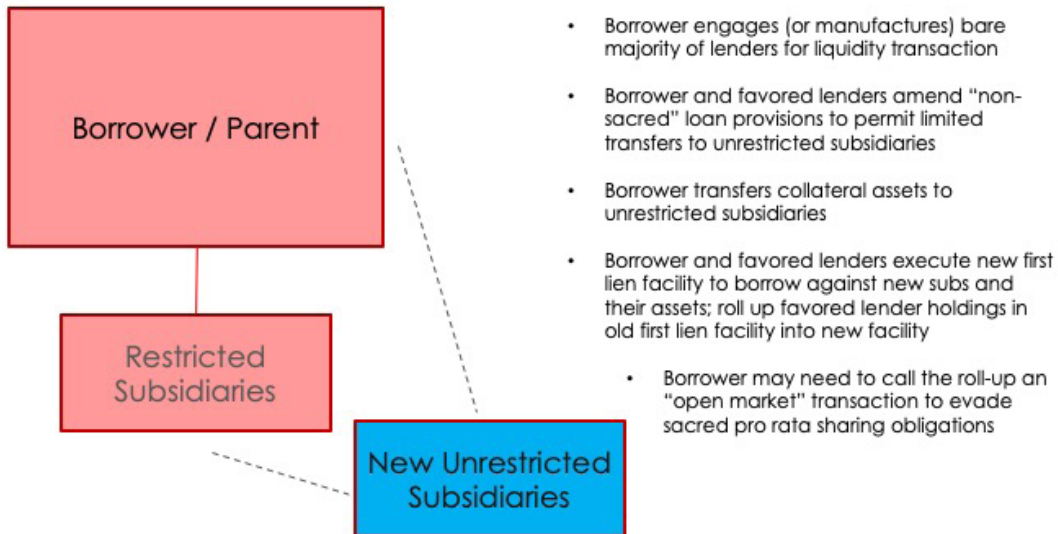


Restricted subsidiaries: entities required to comply with loan covenants, guaranty the loan and pledge collateral, and together with the parent borrower, restricted from certain investments and debt transactions. A borrower may also have unrestricted subsidiaries (e.g., foreign subsidiaries or defunct entities).

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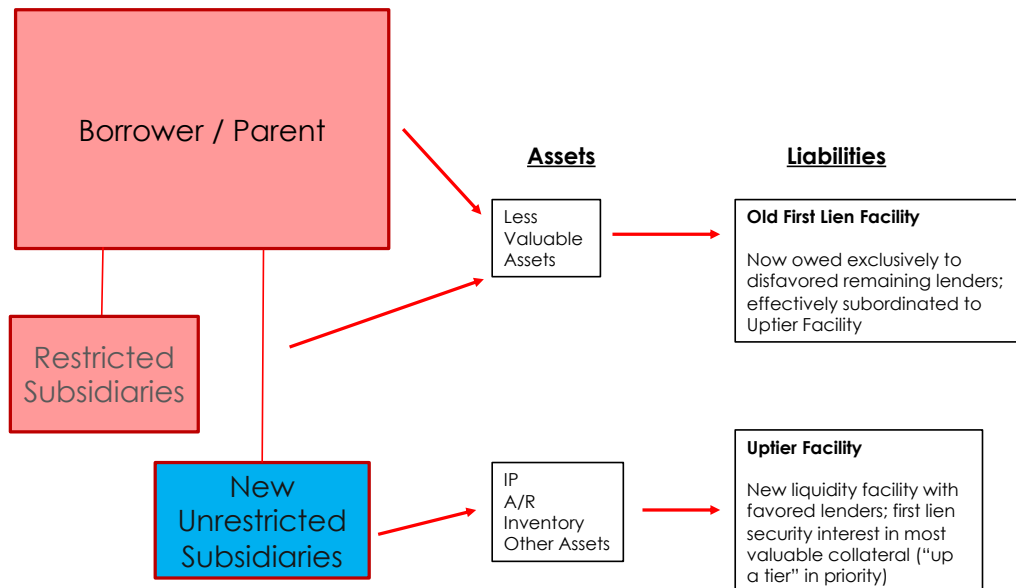
Uptier Transaction: The Transaction



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Uptier Transaction: The Borrower "After"



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Why an Uptier Transaction? Why Now?

1. Liquidity!

- Secured credit facilities generally limit incurrence of additional indebtedness, with additional limitations springing when the borrower reports conditions approaching insolvency or calling into question going concern viability.
- A struggling company and its lenders have a choice: more borrowing, or foreclosure/restructuring. Hypothetically, the "sacred rights" should prevent more borrowing unless the lenders are united in their willingness to lend, and give all lenders the opportunities to profit from further lending opportunities
- An uptier transaction allows lenders who wish to offer additional liquidity to do so while subordinating other lenders.

2. Cheap Capital Incentivized Contract Conditions for Uptiers

- For much of the 2010s, capital was cheap and lenders competed for deal opportunities. The result: a spate of debt-funded M&A transactions, some with loose covenants allowing for substantial credit facility amendments by majority vote.
- When borrowers hit hard times – notably during the pandemic – capital was still cheap due to stimulus measures. Lenders appeared willing to take risks on litigation to gain a superior position in the capital structure (including by positioning themselves as eventual DIP lenders in foreseeable chapter 11 proceedings).

3. Legal Rulings Absolved Management

- A spate of legal rulings preceding this period absolved management and lenders of liability to creditors for "deepening insolvency" and similar claims.*
- As a result, officers and directors of borrowers in liquidity crisis, wishing to prolong the runway for their own control and seeking an opportunity to rebuild equity value, had an incentive to engage in ever-riskier borrowing behavior.

*See, e.g., *Trenwick Am. Litig. Tr. v. Ernst & Young*, 906 A.2d 168 (Del. Ch. 2006); *N. Am. Catholic Educ. Programming Found. v. Gheewalla*, 930 A.2d 92 (Del. 2007); *Quadrant Structured Prod. Co. v. Vertin*, 102 A.3d 155 (Del. Ch. 2014).

Significant Uptier Litigation

BORROWER	STATUS (Mar. 2023)
J Crew	Some state court challenge claims dismissed in 2019; appeal and related challenges settled in chapter 11 plan in September 2020.
Trimark	Most state court claims survived dismissal. In January 2023, settled with plaintiff lenders by exchanging old first lien debt dollar-for-dollar for Tranche B (subordinated) loans under the uptier facility.
Serta	Minority lenders attempted to enjoin transaction before closing; state court denied. After closing, parallel actions commenced in state and federal court. Serta commenced chapter 11 proceedings in January 2023 and filed an adversary proceeding seeking summary judgment approving the transaction.
Revlon	Minority lenders sued in 2020, but Citibank accidentally repaid their outstanding balances with its own money, temporarily mooted claims. Revlon commenced chapter 11 proceedings in June 2022. Resolution of uptier-related challenges is part of pending plan settlement.
Boardriders	State court denied motions to dismiss; appeal pending.
Incora	State court motions to dismiss pending.

Uptier Litigation: Common Issues

1. Breach of Contract
 - Breach of “Sacred Rights” including pro rata sharing
 - “Open Market Purchase” provisions
 - Valuation
 - No Action Clauses
2. Implied Covenant of Good Faith and Fair Dealing
 - A separate, viable claim?

Uptier Litigation in Bankruptcy

1. Favored Lender as DIP Lender
 - Unless challenged, favored lenders and borrower may ratify the uptier transaction through a rollup into DIP loan.
2. Standing Litigation
 - Minority lenders or the UCC may seek standing to pursue additional challenges:
 - Fraudulent Transfer Claims
 - Claims Against Management

Are Creditors Protected?

- Creditors are “afforded protection through contractual agreements, fraud and fraudulent conveyance law, implied covenants of good faith and fair dealing, [and] bankruptcy law...”

■ *N. Am. Catholic Educ. Programming Found. v. Gheewalla*, 930 A.2d 92, 99 (Del. 2007)

Faculty

Tristan Axelrod is a partner in Brown Rudnick LLP's Bankruptcy & Corporate Restructuring Practice Group in Boston, where he concentrates his practice in bankruptcy and insolvency proceedings and related litigation. His experience extends to a wide variety of consumer and commercial sectors, including cryptocurrency, mass torts, freight logistics, energy and manufacturing. Mr. Axelrod has represented chapter 11 debtors, equity securityholders and official committees in connection with bankruptcy cases. His practice includes all aspects of the insolvency and bankruptcy process, including commencement of proceedings, value-maximizing sale transactions, DIP-financing arrangements, avoidance litigation, debt-validity litigation, modification of collective-bargaining agreements, and ERISA withdrawal-liability disputes. He also assists creditors, trustees and beneficiaries in facilitating the claims resolution and allowance process in chapter 11 cases. Mr. Axelrod received his B.A. *magna cum laude* in 2008 from Middlebury College, his M.M. in 2011 from Boston University and his J.D. *cum laude* in 2014 from Boston College Law School.

Jennifer A. Christian is a partner at ASK LLP in New York, and her practice focuses on representing indenture trustees, secured and unsecured creditors (including trade creditors), asset-purchasers, liquidating trustees, and other major constituencies in chapter 11 and chapter 7 bankruptcy cases and other proceedings. She has more than 15 years of bankruptcy and creditors' rights experience. Prior to joining ASK LLP, Ms. Christian was counsel at Thompson & Knight LLP and an associate at Kelley, Drye & Warren LLP and Bryan Cave LLP. Prior to entering private practice, she clerked for two years for the Chief Judge of the U.S. Bankruptcy Court for the Western District of New York in Rochester. Ms. Christian is admitted to practice law in New York and Connecticut, and before the U.S. District Courts for the Southern, Eastern and Western Districts of New York. She received her B.A. in political science from the State University of New York – College at Geneseo and interned at both the Monroe County District Attorneys' Office and the White House, where she worked in the Office of the Legal Counsel to the Vice President of the United States. She received her J.D. from St. John's University School of Law in 2000 with honors and participated in its first-ever Bankruptcy LL.M. program, and she won the Springer Legislative Award for Excellence in Legislative Advocacy and the CALI Excellence for the Future Scholastic Awards in Trusts & Estates and Legislative Advocacy. She interned for Hon. James L. Garrity, Jr. of the U.S. Bankruptcy Court for the Southern District of New York.

Gary E. Klausner is a senior partner with Levene, Neale, Bender, Yoo & Brill L.L.P. in Los Angeles, where he represents chapter 11 debtors, secured and unsecured creditors, creditors' committees, trustees and receivers, licensors and franchisors, purchasers of assets out of bankruptcy cases, and parties involved in litigation and appeals in connection with bankruptcy cases. He has handled cases involving a broad range of businesses and industries including manufacturing, retail, real estate development, hospitality and restaurants, aerospace, entertainment, health care, financial institutions and transportation. Previously, he was a senior shareholder at Stutman, Treister & Glatt P.C. Mr. Klausner has expertise in chapter 9 of the Bankruptcy Code and was the lead lawyer in the chapter 9 case of Valley Health System, in which he successfully confirmed a chapter 9 plan of adjustment. Mr. Klausner has been actively involved and has held prominent positions in local and national professional organizations and bar associations. He is a member of the Board of Governors of the Financial

Lawyers Conference and served as its president from 1993-94. He also is a board member of the Los Angeles Bankruptcy Forum (serving as its president from 2003-04), and he is a member of the American Bar Association's Section on Business Law, for which he chaired its task force on The Economics of Chapter 11 Practice, chaired its Subcommittee on Bankruptcy Fraud, Crimes and Abuse of the Bankruptcy Process, and chaired its Chapter 9 and Chapter 11 Subcommittees. In addition, he is a member of the Los Angeles County Bar Association, for which he has served as a member of the Executive Committee of its Commercial Law and Bankruptcy Section and as vice chair of the Section's Bankruptcy Committee. In 2010, Mr. Klausner was elected as a Fellow of the American College of Bankruptcy, and in 2012, he was recognized as "Bankruptcy Lawyer of the Year" by the Century City Bar Association. He also has served as a Lawyer Representative to The Ninth Circuit Judicial Conference and chaired the U.S. District Court Standing Committee on Attorney Discipline. Mr. Klausner speaks frequently on subjects involving bankruptcy and commercial law and has published numerous articles on bankruptcy-related topics. He is a member of the California and Maryland Bar Associations and is admitted to practice before the U.S. Supreme Court, the U.S. Court of Appeals for the Ninth Circuit, and the U.S. District and Bankruptcy Courts for the Central District of California. Mr. Klausner received his B.A. from the University of Maryland in 1971 and his J.D. with honors from the University of Maryland School of Law in 1974, where he served on the editorial staff of the *University of Maryland Law Review* from 1972-73.

Rachel Jaffe Mauceri is a partner with Robinson & Cole LLP in Philadelphia in the firm's Bankruptcy + Reorganizations Group and has more than 20 years of experience counseling clients in complex corporate bankruptcy and restructuring matters. She participates in all aspects of in- and out-of-court restructurings in such industries as health care, retail, energy, automotive, oil and gas, mortgage-servicing, real estate and telecommunications. Ms. Mauceri regularly represents official committees in chapter 11 cases and has experience counseling companies in pre-negotiated and traditional bankruptcy proceedings as well as out-of-court workouts, advising stalking-horse and other bidders in distressed and bankruptcy-related transactions, representing borrowers and financial institutions in the negotiation and documentation of secured lending facilities, advising indenture trustees and second-lien lenders, representing pension and health plans in connection with collective bargaining issues and proceedings under §§ 1113 and 1114 of the Bankruptcy Code, and counseling vendors, contract parties and other significant creditors and parties in interest on a variety of bankruptcy-related litigation and other issues. She is listed in *Chambers USA: America's Leading Lawyers for Business, Pennsylvania & Surrounds*, and she was named to the *IFLR 1000 United States* as a Notable Practitioner in 2022 and as a Rising Star in 2021, 2020 and 2019 in the area of Restructuring. In addition, she was named a Rising Star, Restructuring (including Bankruptcy): Corporate in *The Legal 500 US* in 2019, and she represented Tribe 9 Foods in its 2021 purchase of Carla's Pasta, which won the Food & Beverage Restructuring of the Year at the 14th Annual Turnaround Atlas Awards. She also represented The Bank of New York Mellon as indenture trustee in connection with the sale of North Philadelphia Health System, a transaction that won the 17th Annual M&A Advisor Sector Deal of the Year, in the category of "Healthcare and Life Sciences (Under \$100MM)." Ms. Mauceri regularly speaks and writes on current issues and topics in bankruptcy. She currently serves as vice chair of the Chapter Presidents Counsel of the Turnaround Management Association and as a member of TMA Global's Executive Board and board of directors, and she is chair of TMA's Philadelphia/Wilmington chapter. She also is a member of ABI and IWIRC, is co-chair of ABI's 2023 VALCON conference, and is secretary of the Consumer Bankruptcy Assistance Project. Prior to joining Robinson & Cole, Ms. Mauceri worked for two global law firms in New York and Philadelphia, respectively, focusing

on bankruptcy and restructuring matters. While in law school, she interned for Hon. Prudence Beatty Abram (ret.) of the U.S. Bankruptcy Court for the Southern District of New York. Ms. Mauceri received her B.A. in journalism from Ithaca College in 1995 and her J.D. *cum laude* in 2001 from Benjamin N. Cardozo School of Law, where she was elected to the Order of the Coif and was supervising editor of its law review.