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New York City Bankruptcy Conference

LMEs After *Serta*

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CONCURRENT SESSION

2025

American Bankruptcy Institute
New York City 2025 Conference
Recent Trends in Liability Management

Introduction

Why are we here?	• Companies are becoming more and more sophisticated in the ways they implement capital structure and liquidity solutions by taking advantage of the "looseness" that exists from a covenant and amendment perspective in most credit agreements and indentures. • These "liability management" transactions can be both utilized by, and harmful to, existing debtholders. • This presentation will highlight recent and historic trends in liability management transactions, along with explanations for how these transactions came about.
Why does it matter?	• Companies are implementing liability management transactions at earlier and earlier stages, oftentimes prior to an inflection point, and so it is important to understand what transactions are possible under credit agreements and indentures. • By understanding how companies have historically implemented liability management transactions, investors can mitigate their exposure by proactively taking steps to protect their investments, including by proposing their own liability management transactions or finding likeminded institutions to block them. In the same vein, companies can proactively manage their capital structures and liquidity positions, including by considering liability management transactions that may be permitted under their credit agreements and indentures.

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Applicable Agreements and Terms

Documents	• Credit agreements and indentures are at their most basic level contracts. • As a condition to loaning money to a company, investors will look to employ safeguards, which serve to limit a company's ability to take certain actions and help protect their investment. • The extent to which these safeguards restrict a company depends on the nature of the credit agreement or indenture (*i.e.*, high yield vs. investment grade; secured vs. unsecured) and the economics (*i.e.*, floating rate bank debt vs. high yield bonds).
Covenants	• Affirmative and negative covenants in credit agreements and indentures govern a company's actions. • As a general matter, the closer a company is to becoming stressed or distressed, the more onerous the company's covenant package. • Alternatively, many indentures and credit agreements are considered "covenant-lite," meaning that they give companies a relatively meaningful amount of freedom to take actions. • While this freedom can be positive in a good economic environment by allowing companies to grow, it can also be manipulated to dilute the interests of existing debtholders and to extract value in favor of equityholders, at the debtholders' expense.

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Applicable Agreement and Terms *(Cont'd)*

Key Parties

Borrower / Issuer

Non-Guarantor Restricted Subsidiaries

- *Not guarantors, but still subject to covenants*
- *Assets do not directly support repayment of the indebtedness*
- *Debt raised at such entities is "structurally senior"*

Guarantor Restricted Subsidiaries

- *Direct guarantors and subject to covenants*
- *Assets directly support repayment of the indebtedness*

Unrestricted Subsidiaries

- *Not subject to covenants*
- *Assets do not directly support repayment of the indebtedness*
- *Debt raised at such entities is "structurally senior"*

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Negative Covenants

Liability management transactions are implemented by taking advantage of existing provisions in credit agreements and indentures, largely through the use (or amendment) of capacity contained in negative covenants ("basket capacity").

Sample Language:

*Each Borrower covenants and agrees with each Lender that, until the Termination Date, unless the Required Lenders shall otherwise consent in writing, **the Borrowers will not, nor will they permit any of the Restricted Subsidiaries, to** . . . "incur, create, or assume any Indebtedness" . . . "create, incur, or assume any Lien" . . . "make any Investment" . . . "declare or pay any dividend or make any other distribution " . . . **EXCEPT**:*

The default position is that a company is prohibited from incurring debt and liens or making investments or restricted payments, unless expressly authorized to do so.

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Negative Covenants (Cont'd)

Investment, Restricted Payment, Debt, and Lien Baskets	• Liability management transactions are generally implemented through the use of permitted actions (which may be subject to limitations), typically referred to as "baskets" under the negative covenants (whether already existing or added via amendment). • These baskets allow companies to move assets (using investment and restricted payment capacity) or incur debt (using debt and lien capacity), up to a stated amount (i.e., the total capacity available under a basket). • Credit agreements and indentures may not provide the capacity necessary to implement a particular transaction, but companies will work with a group of debtholders to amend their credit agreements and indentures (which typically require a majority or supermajority vote, depending on the document) to open up flexibility (or "basket capacity") to implement transactions.
Sacred Rights	• While most credit agreements and indentures can be amended with a majority or supermajority vote, there are certain provisions that require either all lender consent or affected lender consent. • These provisions – which are usually found in the amendment sections of credit agreements and indentures – are called "sacred rights" provisions. • The scope and protection of "sacred rights" vary, but certain protections (e.g., against extending maturities, increasing commitments, releasing all or substantially all collateral) are relatively uniform. Others, like prohibitions on amending a document's waterfall or pro rata sharing requirements, appear in the majority of amendments sections of credit agreements, but are sometimes left out. • One protection that has historically been omitted from sacred right protections is anti-subordination protection, which has the effect of allowing companies to amend a credit agreement or indenture with a simple majority to allow for the incurrence of incremental priming indebtedness.

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Transaction Types

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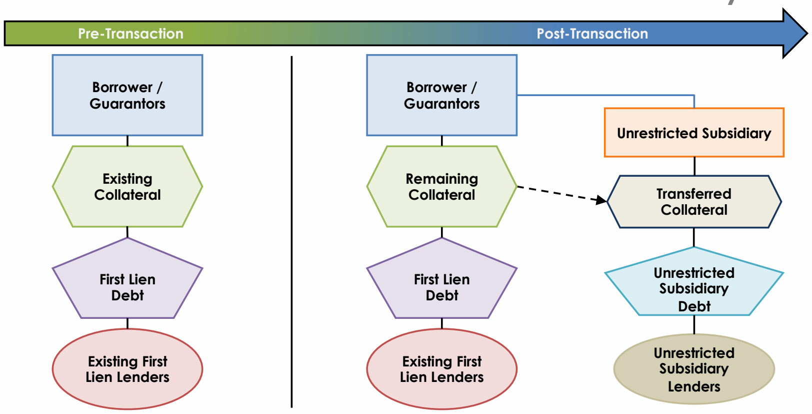
Unrestricted Subsidiary Transactions



Considerations

- In an unrestricted subsidiary transaction, a company transfers (or "drops down") assets into an unrestricted subsidiary using existing investment and restricted payment capacity.
- Once the assets are owned by the unrestricted subsidiary, the assets are no longer subject to any of the covenants under a credit agreement or indenture and thus there is no limitation on what can be done with such assets.
- More recent credit agreements and indentures have implemented various forms of "drop down" protection.
- Even if drafted well, however, "drop down" protection is typically limited to the movement of material intellectual property – a protection created in direct response to the J. Crew Transaction (which is described further on the next slide) – which may not protect against transfers of the most valuable assets of most companies.

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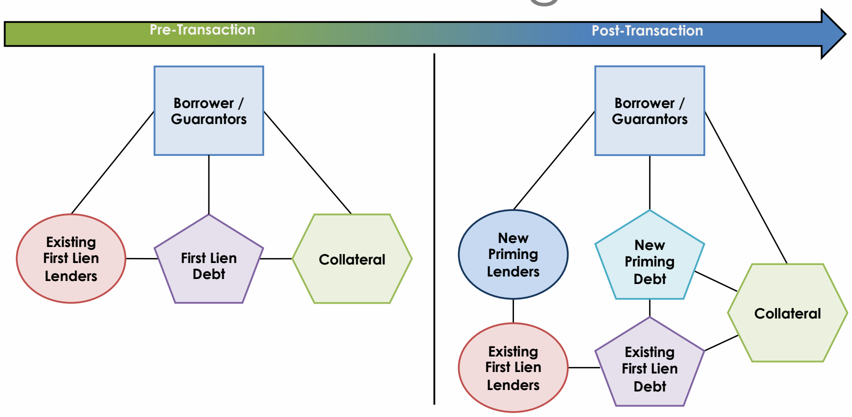
Priming Transactions



Considerations

- In the absence of subordination protections, a company and a majority of lenders under a credit agreement (or two thirds under most indentures) agree to consent to a priming facility.
- Given the priming position enjoyed by the lenders under a priming facility, a priming facility increases a company's chances of incurring the priming debt on beneficial economic terms.
- At its core, a priming transaction is a liquidity enhancing transaction, but if structured differently (namely on a non-pro rata basis), it can also be used to exchange debt at a discount and effectuate a deleveraging.
- Various lawsuits are currently pending that challenge non-pro rata priming exchanges.

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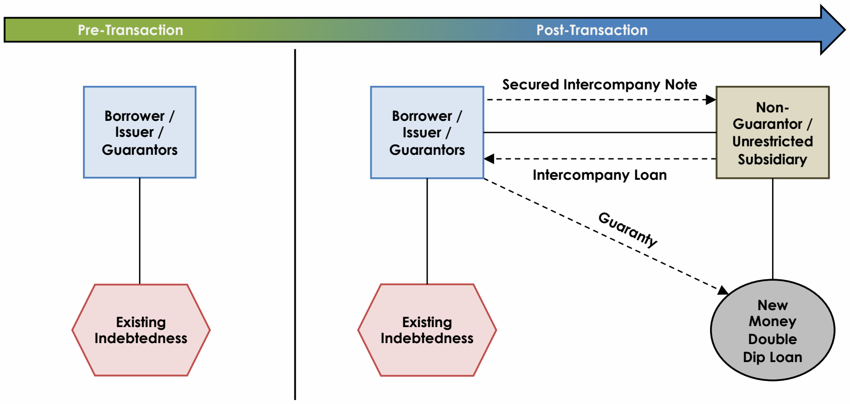
"Double Dip" and Credit Enhancement Transactions



Considerations

- In a "double dip" transaction, a company forms or utilizes an existing non-guarantor subsidiary to incur new money indebtedness.
- This non-guarantor then moves the proceeds of this new money back to the borrower / issuer / guarantors through an intercompany loan.
- The borrower / issuer / guarantors then issues (on a dollar-for-dollar basis) (i) a secured intercompany note to the non-guarantor and (ii) a guaranty on the new money financing, both of which serve as security for the new money financing.
- The end result is that those providing the new money financing effectively have two separate secured claims against the borrower / issuer / guarantors (one direct, and one indirectly through the intercompany loan), which increases their prospects of recovery (relative to existing debtholders that have only a single claim).

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LME Timeline: Increasing Frequency

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Discussion: LME Transactions Involved Litigation

Transaction Type	LMEs that Resulted in Litigation
Non-Pro Rata Uptier	incora, Mitel, McClatchy, Serta, LIONSGATE, NYDJ, Robertshaw, BOARDRIDERS, TriMark
Drop-Down – Down and Away	chewy, iHeartMEDIA INC, INTELSAT, J.Crew, REVLON, Transocean, TRAVELPORT
Drop-Down – Up and Out	NeimanMarcus, chewy
Drop-Down – Pari+	dish
Drop-Down – Double Dip	amc, Del Monte, STG Logistics

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Subsequent Bankruptcy Filings

Transaction Type	Bankruptcy
Non-Pro Rata Uptier	Envision HEALTHCARE, incora, McClatchy, Robertshaw, Serta
Drop-Down – Down and Away	Envision HEALTHCARE, iHeartMEDIA INC, INTELSAT, PartyCity, J.Crew, REVLON
Drop-Down – Up and Out	NeimanMarcus
Drop-Down – Double Dip	

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LMEs by Category

Pro Rata Uptier	8	Sinclair Broadcast Group, MultiPlan, employbridge, Anthology, Sound Inpatient Physicians, Scripps, ivanti, Cision
Non-Pro Rata Uptier	26	Apex Tool Group, Better Health, Dodge Construction Network, Envision Healthcare, EyeCare Partners, FinThrive, GoTo, incora, Loparex, McClatchy, Mitel, MRP Solutions LLC, NYDJ, Pretium, Robertshaw, Serta, SI Group, The RealReal, U.S. Renal Care, accentCare, iHeartMedia, tropicana brands group
Drop-Down: Down and Away	17	J.Crew, Bausch Health, chewy, altice, iHeartMedia, Intelsat, Neiman Marcus, ivanti, Party City, Pluralsight, rackspace, Revlon, Transocean, U.S. Renal Care, Magenta Buyer, Lionsgate
Drop-Down: Up and Out	2	chewy, Neiman Marcus
Pari+	6	Ardagh Metal, dish, Envision Healthcare, NewFortress energy, Trinseo, Sonrava
Double DIP	16	Alvaria, amc, at home, STG Logistics, Empire Today, Oregon Tool, Pabst, Del Monte, Sabre, SI Group, Ascend, Trinseo II, United Site Services, ivanti

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Case Study – Unrestricted Subsidiary Transactions

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J.CREW

Background	• In 2017, J. Crew (the "***Company***") faced operational and financial headwinds due to decreased demand in the retail market and an inability to address the upcoming maturity for ***$500 million*** of the Company's unsecured payment-in-kind notes (the "***PIK Notes***"). • Lacking any "regular-way" options for raising liquidity, as substantially all of the Company's assets were already pledged as collateral under the Company's ***~ $1.567 billion*** credit facility (the "***Credit Agreement***"), the Company began to look at other ways in which it could create the value necessary to address the PIK Notes. • The Company implemented one of the first instances of an unrestricted subsidiary "drop-down" transaction, which moved a substantial portion of its material intellectual property to an unrestricted subsidiary (the "***J. Crew Transaction***").
Transaction Description	• On December 5, 2016, J. Crew International, Inc. ("***J. Crew International***"), a wholly owned subsidiary of J. Crew Operating Corp. ("***J. Crew OpCo***"), contributed and assigned an undivided 72.04% interest in certain trademarks (valued at ***$250 million***) (the "***IP Assets***") to J. Crew International Cayman Limited ("***J. Crew Cayman***") (a non-loan party restricted subsidiary). • Immediately upon receipt of the IP Assets, J. Crew Cayman contributed the IP Assets to J. Crew Brand Holdings, LLC ("***Brand Holdings***") (an unrestricted subsidiary), which then contributed the IP Assets to a number of intermediary unrestricted subsidiaries (the "***Brand Entities***") until the IP Assets were eventually held by J. Crew Domestic Brand, LLC ("***Domestic Brand***") (also an unrestricted subsidiary). • Domestic Brand, the Brand Entities, and J. Crew Cayman then entered into an exclusive, non-transferable license agreement with J. Crew International that allowed J. Crew International to continue using the IP Assets in exactly the same way as it had prior to the J. Crew Transaction.

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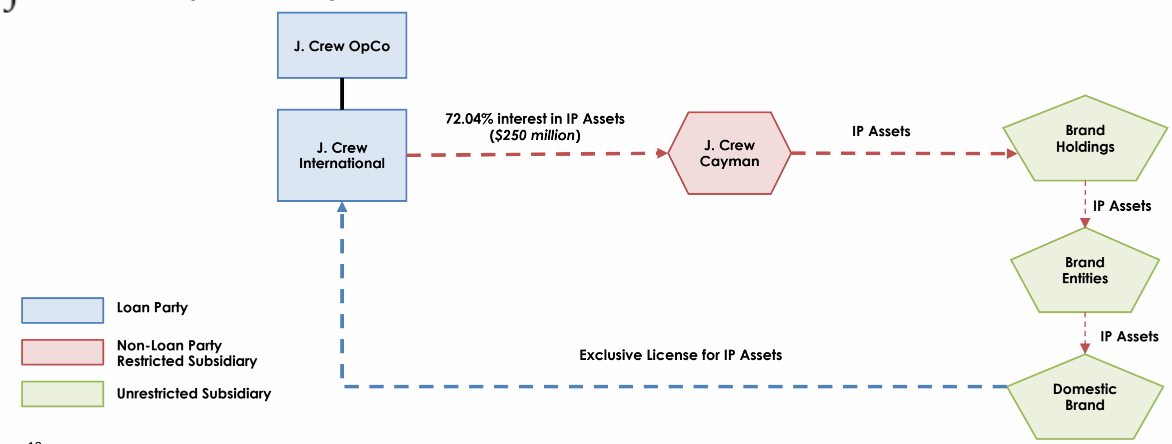
J.CREW*(Cont'd)*



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J.CREW *(Cont'd)*

Implementation

- To implement the J. Crew Transaction, the Company relied on a number of baskets under the Credit Agreement, namely:
  - A general investment basket, which permitted investments up to the greater of ***$100 million or 3.25% of total assets*** (the ***"General Investment Basket"***);
  - A non-loan party investment basket, which permitted investments in non-loan party restricted subsidiaries up to the greater of ***$150 million or 4% of total assets*** (the "***Non-Loan Party Investment Basket***"); and
  - An investment basket, which permitted non-loan party restricted subsidiaries to make investments "to the extent such Investments [were] financed with the proceeds received by such Restricted Subsidiary from an Investment in such Restricted Subsidiary made pursuant to [the Permitted Investments Baskets]" (the "***Trap Door Provision***").

Explanation

- The novel aspect of the J. Crew Transaction was not the use of the General Investment Basket, which could have been used to directly transfer assets to Domestic Brand or one of the other Brand Entities (each of which were Unrestricted Subsidiaries) in any event; instead it was the use of the so-called Trap Door Provision to move assets from J. Crew Cayman (a non-loan party restricted subsidiary) to Domestic Brand, an unrestricted subsidiary, which was not governed by the Credit Agreement's restrictions.
- To use the Trap Door Provision, the Company argued that the IP Assets were the "proceeds" of investments that had been made in J. Crew Cayman in full compliance with the Credit Agreement's investment baskets.
- This essentially allowed the Company to transform a basket that was intended only to allow investments in non-loan party restricted subsidiaries into an investment basket that could transfer assets to unrestricted subsidiaries (i.e., the "Trap Door").

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J.CREW *(Cont'd)*

Legal Challenges and End Result

- Subsequent to the consummation of the J. Crew Transaction, an ad hoc group of term lenders organized and pressured the then existing administrative agent (Bank of America) to resign, and replaced Bank of America with an agent (WSFS) that would challenge the movement of the IP Assets and/or declare an event of default as a result of the J. Crew Transaction.
- The Company then instituted a suit for declaratory judgment in the Supreme Court of New York seeking an order declaring the J. Crew Transaction valid (with WSFS filing various counterclaims in response).
- At the same time, the Company began negotiations with holders of the PIK Notes (the "***PIK Noteholders***"), eventually settling on a transaction through which the PIK Noteholders would exchange the PIK Notes into a combination of: (a) up to ***$250 million*** of senior secured notes issued by certain of the Brand Entities (secured by the IP Assets) (the "***IP Notes***"); (b) up to ***$190 million*** of non-convertible perpetual preferred stock issued by the Company's ultimate parent ("***J. Crew Parent***"); and (c) up to ***15%*** of common equity issued by J. Crew Parent (the "***PIK Exchange Offer***").
- As part of the PIK Notes negotiations, the Company also negotiated the parameters of a potential amendment to the Credit Agreement, which would: (a) see the remainder of the IP Assets held by J. Crew International (***27.96%***) transferred to an unrestricted subsidiary; (b) raise ***$30 million*** of debt under the Credit Agreement (the "***New Term Loans***"); (c) raise ***$97 million*** of new money in the form of additional notes secured by the IP Assets (on the same terms as the IP Notes) (the "***Private Placement IP Notes***"); (d) direct WSFS to dismiss, with prejudice, all litigation related to the J. Crew Transaction; and (e) use a combination of cash on hand, the New Term Loans, and the Private Placement IP Notes to fund a ***$150 million*** paydown of the term loans (collectively, the "***Term Loan Amendment***").
- Eventually, the Company was able to obtain consents from more than ***88%*** of the term lenders for the Term Loan Amendment (ending any majority term lender led litigation) and more than ***99.95%*** of the PIK Notes for the PIK Exchange Offer.
  - While the success of the Term Loan Amendment resolved all majority term lender led litigation, certain minority term lenders continued to pursue claims against the Company (and WSFS), though they were eventually unsuccessful.

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J.CREW *(Cont'd)*

J. Crew Protections

Provision	Examples	Considerations
J. Crew Protections	• **Example 1:** ◦ "[N]o Unrestricted Subsidiary may hold Intellectual Property that is material to the operations of Intermediate Holdings and its Subsidiaries taken as a whole." • **Example 2:** ◦ "The Borrowers shall not, and shall ensure that their Restricted Subsidiaries shall not, sell or otherwise transfer Material Intellectual Property to any Unrestricted Subsidiary or designate as an Unrestricted Subsidiary any Restricted Subsidiary that owns Material Intellectual Property; *provided that* this sentence shall not restrict a sale or transfer in the form of a non-exclusive license or an exclusive license entered into for legitimate business purposes that is entered into to effect a bona fide joint venture with a third party that is not an Affiliate of any Borrower." ▪ "***Material Intellectual Proper***ty" shall mean any Intellectual Property (other than customer lists) owned by the Borrowers and their Subsidiaries that is material to the business of the Borrowers and their Subsidiaries, taken as a whole (whether owned as of the Closing Date or thereafter acquired) ***as determined by the Administrative Borrower in good faith.*** • **Example 3:** ◦ "Notwithstanding anything herein to the contrary, none of the Borrower or any of its Restricted Subsidiaries will make any Investment consisting of Material Intellectual Property in any Unrestricted Subsidiary."	• Of the three examples presented, ***Example 1*** is probably the best form of J. Crew protection because it ensures that unrestricted subsidiaries cannot "hold" material intellectual property. • The other two examples are helpful, but incomplete because while they keep restricted subsidiaries from transferring material intellectual property to unrestricted subsidiaries, they do not have a general prohibition on unrestricted subsidiaries "holding" material intellectual property. • In other words, if you can find a way to get material intellectual property to an unrestricted subsidiary outside of a transfer from a restricted subsidiary, the J. Crew protections in **Example 2** and **Example 3** will be ineffective. • At the end of the day, J. Crew protection will never be complete protection against a "drop down" transaction if it only applies to material intellectual property. • Some market participants have pushed for broader "crown jewel" protection (*i.e.*, a prohibition on transferring material assets to an unrestricted subsidiary).

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Case Study - Priming Transactions

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Serta Simmons Bedding

Background	• In April 2020, facing liquidity constraints brought on by the pandemic, Serta Simmons Bedding, LLC (“***Serta***”) engaged in negotiations with a minority group of term lenders (the “***Minority Group***”) under the Company’s first lien credit agreement (the “***First Lien Credit Agreement***”) and began to explore raising debt secured by Serta’s valuable royalty streams and intellectual property that would be transferred to an unrestricted subsidiary (the “***Drop-Down Transaction***”). • Seeking to eliminate the risk presented by the Drop-Down Transaction, a competing group of term lenders constituting a majority (the “***Majority Group***”) under the First Lien Credit Agreement also organized and submitted their own proposal to Serta premised on the issuance of super senior (*i.e.*, priming) debt (the “***Priming Transaction***”). • Serta eventually terminated its negotiations with the Minority Group and chose to proceed with the Majority Group’s proposal, including the Priming Transaction.

Transaction Description	• On June 8, 2020, Serta announced that it had reached a deal with the Majority Group, which provided for a comprehensive recapitalization of Serta’s balance sheet through the Priming Transaction.
	• The Priming Transaction contemplated two new facilities, each of which ranked senior to Serta’s existing first and second lien debt, including:
	    • A ***$200 million*** first-out, super senior new money term loan (the “***First-Out Tranche***”) provided by certain of Serta’s first and second lien lenders (the “***New Money Lenders***”); and
	    • An ***$875 million*** second-out facility issued in exchange (at a discount) for first and second lien loans held by the New Money Lenders (the “***Second-Out Tranche***”).
	• The Priming Transaction also pre-wired a third-out debt tranche (also ranking ahead of Serta’s existing first and second lien debt), which could be used for similar exchanges in the future (the “***Potential Third-Out Tranche***”).

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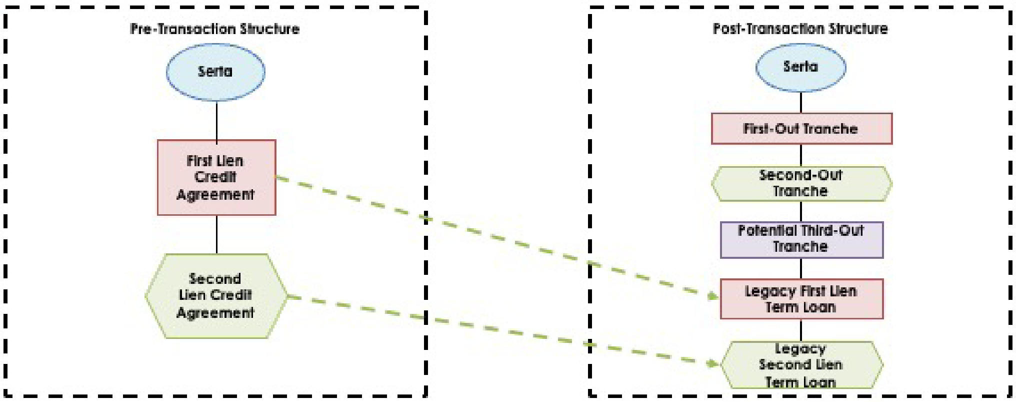
Serta Simmons Bedding (Cont’d)



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Serta Simmons Bedding *(Cont'd)*

How did they do it?

- The key to implementing the Priming Transaction was the lack of "anti-subordination" protection in the sacred rights protections of the credit agreements governing the existing first and second lien debt, meaning that a simple majority of lenders could enter into amendments that would permit the incurrence of priming indebtedness.
- The incurrence of a priming facility was relatively standard practice by June 2020, but the Priming Transaction took it a step further by implementing a non-pro rata up-tier exchange of the first and second lien loans of the Majority Lenders (the "***Up-Tier***").
- What complicated the Up-Tier was that the First Lien Credit Agreement provided that any prepayments of the first lien loans are subject to "pro rata" sharing principles.
  - This "pro rata" requirement was also a "sacred right" and therefore could not be amended without each affected lender's consent.
- To circumvent the pro rata sharing protections, the Up-Tier was effectuated through so-called "open market purchases," which, as is fairly common in looser credit agreements, were expressly carved out of the pro rata sharing requirements (*i.e.*, "open market purchases" were expressly permitted on a non-pro rata basis).

Explanation

- Prior to the Priming Transaction, many investors believed that pro rata sharing requirements would protect them against a transaction like the Up-Tier.
- The key in *Serta* was the fact that the First Lien Credit Agreement not only allowed for "open market purchases," but (a) it did not specify whether the purchase consideration by the company needed to be in the form of cash (versus non-cash consideration in the form of priming debt) and (b) it specifically excluded "open market purchases" from the pro rata sharing requirements.
- In these circumstances, the Company took the position that the First Lien Credit Agreement permitted both the Priming Transaction and the Up-Tier because it was "purchasing" in the "open market" the New Money Lenders' first and second lien loans, using loans under the Second-Out Tranche as purchase consideration.

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Serta Simmons Bedding *(Cont'd)*

Legal Challenges and End Result

- In June 2020, prior to closing, the Minority Group brought an action in New York State Supreme Court (the "***State Court***") seeking to enjoin the Priming Transaction, arguing, among other things, that the Priming Transaction violated the pro rata provisions under the First Lien Credit Agreement (the "***State Court Action***").
  - The State Court denied the injunctive relief, determining, among other things, that the First Lien Credit Agreement permitted the Priming Transaction as an "open market" transaction and that the Priming Transaction did not appear to implicate any of the sacred right protections.
- In May 2021, the Minority Group filed a second lawsuit in the United States District Court for the Southern District of New York (the "***District Court***"), arguing that the Priming Transaction breached the First Lien Credit Agreement, as well as the implied covenant of good faith and fair dealing (the "***Federal Action***").
  - The Federal Action survived a motion to dismiss, with the District Court determining that the term "open market purchase" was ambiguous and so discovery was necessary to determine whether the Up-Tier was permissible and that the Minority Group adequately pled a cause of action for a breach of the implied covenant of good faith and fair dealing.
- On January 23, 2023, the Company commenced bankruptcy cases in the United States Bankruptcy Court for the Southern District of Texas and immediately commenced proceedings to have the court validate the Priming Transaction, and in particular, as an "open market purchase."
- The bankruptcy court determined that (1) the Up-Tier fell within the meaning of "open market purchase" and (2) because the parties were aware of the flexibility under the original debt documents, the Up-Tier also did not violate the implied covenant of good faith and fair dealing. The bankruptcy court's decision is now on appeal.
- The impact of the bankruptcy court's decision remains to be seen, as multiple lawsuits in different jurisdictions have come to competing conclusions.
- In December 2024, the U.S. Court of Appeals for the Fifth Circuit reversed the Bankruptcy Court's ruling and held that the 2020 Up-tier did not qualify as an open market purchase and therefor violated the pro rata distribution covenant in the First Lien Credit Agreement. Most significantly, by reference to the "open markets" for purchases of equity and bonds, the U.S. Court of Appeals for the Fifth Circuit held that the term "open market" did not encompass privately negotiated transactions and therefore that Serta was not able to rely on the open market purchase exception to consummate the Uptier via a private exchange of loans with the Majority Group. In making its determination, the Fifth Circuit explicitly noted that while "every contract should be taken on its own, today's decision suggests that such "[i.e., open market purchase] exceptions will often not justify an uptier."

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Serta Simmons Bedding (Cont'd)

While not entirely new, the Priming Transaction encouraged lenders to implement various forms of "Serta" protections in credit agreements.

Provision	Examples	Considerations
Serta Protections	• No waiver, amendment, or modification shall: • **Example 1:** • "***Subordinate any of the Obligations hereunder to any other Indebtedness or other Obligations*** in any transaction or series of transactions or ***subordinate the Liens on the Collateral securing the Obligations to Liens securing any other Obligation*** in any transaction or series of transactions (including, without limitation, Indebtedness issued under this Agreement) without the written consent of each Lender directly affected thereby." • **Example 2:** • "***Contractually subordinate the Obligations hereunder, or the Liens granted hereunder*** or under the other Loan Documents, ***to any other Indebtedness or Lien on all or substantially all of the Collateral***, as the case may be, except (i) indebtedness that is expressly permitted by this Agreement as in effect as of the Closing Date to be senior to the Obligations and/or be secured by a Lien that is senior to the Lien securing the Obligations, (ii) *any "debtor in-possession" facility* (or similar financing under applicable law) or (iii) ***any other Indebtedness so long the opportunity to participate in such Indebtedness is offered ratably to all adversely affected Lenders, in each case, without the written consent of each Lender directly and adversely affected thereby***." • **Example 3:** • "***Subordinate the Liens*** on the Collateral granted to or held by the Administrative Agent under any Collateral Documents to the Liens on such Collateral securing any other Indebtedness for borrowed money or ***subordinate the right of payment of the Obligations*** to the right of payment of any other Indebtedness for borrowed money, ***except*** (w) any Indebtedness that is expressly permitted under the Loan Documents as in effect on the Closing Date to be secured by a Lien that is senior to the Lien securing the Obligations, (x) *any "debtor-in-possession" facility*, (y) ***any other Indebtedness exchanged for the Obligations so long as such Indebtedness is offered ratably to all Lenders holding the Obligations*** or (z) any Indebtedness incurred pursuant to any customary asset based, factoring, securitization or other similar facility, the incurrence of which is otherwise approved by the Required Lenders."	• **Example 1** is total Serta protection in that it prohibits any type of subordination. • While effective in guarding against a non-pro rata exchange, this type of provision may be too limiting as there may be scenarios when raising priming debt would be beneficial for a distressed company. • **Example 2** is more commercial in that it permits priming to the extent the opportunity is offered ratably to all lenders, but it can leave lenders exposed in that the protection only applies to subordination "to any Indebtedness or Lien on all or substantially all the Collateral." • An argument could be raised, therefore, that as long as a priming facility was secured by less than all or substantially all of the collateral, the Serta protection does not apply. • **Example 3** is a much better example of Serta protection as it does not have a materiality qualifier, and also permits priming debt so long as it is offered up ratably to all lenders.

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Mitel

Background	• In November 2018, Mitel Networks ("**Mitel**")entered into a first lien credit agreement, providing for a first lien revolving credit facility incurring $1.12 billion of first lien term loans ("**1L Term Loans**"), and a second lien credit agreement, incurring $260 million of second lien term loans ("**2L Term Loans**"). • The "sacred rights" voting provisions of Section 9.08(b) of each Credit Agreement required the consent of directly affected lenders for, among other things, amendments to (i) decrease the principal amount of or interest rate payable on, or extend the final maturity date of, the First Lien Debt and the Second Lien Debt, respectively. • By 2022, due to outstanding debt and the lingering effects of the pandemic, the Company was at major risk of liquidity shortfalls.
Transaction Description	• In October 2022, Mitel entered into an agreement with the majority of its first lien and second lien lenders (the "**Consenting Lenders**") to amend the Credit Agreements to (i) issue $156 million of new-money superpriority "first out" term debt to the Consenting Lenders and the creation of a new superpriority revolving credit facility, which would be pari passu in right of payment with the "first out" term debt and (ii) issue new superpriority "second out" term debt ("**Second Out Debt**") and "third out" term debt (the "**Third Out Debt**"; together with the First Out Debt and the Second Out Debt, the "**Uptier Exchange Financing**"). • Non-participating lenders were consequently subordinated to more than $850 million of new debt.

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Mitel (Cont'd)

Legal Challenges and End Result

- In March 2023, certain holders of junior loans that did not participate in the Uptier Exchange Financing commenced litigation against the Company and the lenders that participated in such transaction seeking a judgment invalidating the Uptier Exchange Financing and damages for breach of contract, breach of the implied covenant of good faith and fair dealing, tortious interference, and fraudulent transfer. The junior lenders alleged, among other things, that the non-pro rata exchange violated their "sacred rights" under the credit agreement.
- The trial court dismissed the non-participating lenders' implied covenant and tortious interference claims, along with cross-claims brought by a participating lender—but allowed non-participating lenders' contract claims (asserting that their sacred rights were violated) to survive. On appeal, a five-judge panel of the First Department Appellate Division unanimously reversed the trial court, holding that the contract claims should be dismissed as the uptier did not violate the applicable credit agreement.
- In its reversal, the appellate court determined that the consent of non-participating lenders was not required to conduct the transaction because (i) the language of the agreement required only consent from those "directly adversely affected," while the impact of the transaction was indirect, and (ii) the transaction did not actually amend a provision that would have required consent, even if the transaction did impact its application.

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Case Study - Entry Consents

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Wesco Aircraft

Background	• In 2020, Wesco Aircraft Holdings Inc. (Incora) (the "***Company***") was taken private by Platinum Equity Advisors. The leveraged buyout was financed through ***$650 million*** of secured notes due 2024 (the "***2024 Secured Notes***"), ***$900 million*** of secured notes due 2026 (the "***2026 Secured Notes***"), and ***$525 million*** of unsecured notes due 2027 (together with a separate ***$25 million*** unsecured promissory note issued to an affiliate of Platinum, the "***Unsecured Notes***"). • By 2021, the Company faced headwinds due to the long-term effects of the pandemic. The Company began to explore transactions to address its deteriorating liquidity. With existing liens on substantially all of its assets, however, the Company considered other ways to incentivize lenders. • The Company needed two-thirds supermajority consent of the 2024 Secured Notes and of the 2026 Secured Notes in order to impair or release the security interests in the collateral securing such notes. The ability to obtain such consent was in the hands of a group of noteholders that established a blocking position in the 2026 Secured Notes to protect against lien stripping transactions that the market suggested were under consideration by the Company.
Transaction Description	• Lacking the consent of the requisite supermajority of the 2026 Secured Notes, the Company issued $250 million of fungible add-on notes, which then gave the participating noteholders the two-thirds supermajority position in the 2026 Secured Notes. • The 2024 Secured Notes and the 2026 Secured Notes were amended to effectively release the collateral in order to secure new first-lien notes due 2026 (the "***New 1L Notes***") into which the participating noteholders exchanged their 2024 Secured Notes and 2026 Secured Notes. In addition, participating noteholders (including Platinum) were given the opportunity to exchange their Unsecured Notes into new junior secured notes due 2027 (the "***New 1.25L Notes***"). • As a result, the notes held by the excluded noteholders were either relegated to unsecured status or left behind at the bottom of the capital structure.

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Wesco Aircraft *(Cont'd)*

Implementation	• The transaction was implemented in stages, namely: 1. The Company amended the indentures to allow for the issuance of $250 million in additional 2026 Secured Notes (the "***Additional Notes***"), which only required the consent of a simple majority. 2. The Company issued the Additional Notes to the participating noteholders for $250 million in cash. • By issuing the Additional Notes to the participating noteholders, the Company was able to dilute the holdings of the excluded noteholders and effectively give the participating noteholders the two-thirds supermajority vote necessary to strip the liens that secured the 2026 Secured Notes. That vote occurred on the same day that the Additional Notes were exchanged and cancelled. 3. The indentures for the 2024 Secured Notes and the 2026 Secured Notes (and the Unsecured Notes) were amended to remove numerous protections, including those against lien stripping transactions. 4. The Company offered the participating noteholders the opportunity to exchange (1) 2024 Secured Notes and 2026 Secured Notes (including the Additional Notes) for New 1L Notes and (2) Unsecured Notes for New 1.25L Notes.
Explanation	• The novel aspect of the transaction is the predicate step to amend the debt documents to allow for the dilutive issuances of debt for the purpose of creating the requisite vote. • The new dilutive notes, sometimes called "phantom notes," were simultaneously issued and retired and were intended to dilute the holdings of the excluded noteholders. • This allowed the Company to overcome the excluded noteholders' blocking position and convert the participating noteholders into the supermajority necessary to consent to the ultimate transaction.

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Wesco Aircraft (Cont'd)

Legal Challenges

- Subsequent to the consummation of the transaction, excluded noteholders filed lawsuits in New York state court challenging the validity of the transaction (including the issuance of the Additional Notes to gain the requisite consents), arguing, among other things, that the non-pro rata nature of the exchange breached the pro rata redemption provision under the indentures and that the Company's equity sponsor (Platinum) tortuously interfered with the excluded noteholders' contractual rights. Seeking to nullify the transaction, they argued that the notes issued for the purpose of gerrymandering a vote should be excluded from the vote.
- On June 1, 2023, the Company commenced bankruptcy cases in the United States Bankruptcy Court for the Southern District of Texas and commenced proceedings to ultimately validate the transaction (excluded noteholders filed counterclaims in response). All parties moved for summary judgment.
- The bankruptcy court determined that factual disputes existed as to (1) whether the transaction constitutes a redemption subject to the pro rata principles under the indentures or instead constitutes an "open market or privately negotiated transaction" that is not subject to the pro rata principles under the indentures and (2) whether the series of steps to the transaction, including the issuance of the Additional Notes to create the supermajority consent, should be treated as a "single, integrated transaction," which the court explained "will be based on the parties' intentions." In addition, the court allowed the tortious interference claims to survive because such claims depend on the broader factual analysis that is necessary for the contractual claims.
- The court's decision to allow the breach of contract and the tortious interference claims to proceed to trial represents a departure from Serta.
- The impact of the bankruptcy court's decision remains to be seen. The trial has been closely watched.

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Wesco Aircraft (Cont'd)

Holding & Reasoning

- **2026 Secured Notes**: On July 10, 2024, the bankruptcy court issued an oral ruling holding that all rights, liens, and interests of the 2026 Secured Noteholders remained intact following the Company's March 2022 non-pro-rata secured uptier exchange transaction, thereby restoring the liens securing the entirety of the 2026 Secured Notes. According to the bankruptcy court, the secured uptier exchange breached the 2026 notes indenture and was consequently ineffective as the Company failed to obtain the requisite two-thirds vote required to strip the liens securing the notes at the first step of the transaction – specifically, the issuance of $250 million in New 1L Notes to majority holders Pimco and Silver Point that manufactured a two-thirds supermajority.
- The bankruptcy court further reasoned that the indenture required a two-thirds majority for any amendment that "ha[d] the effect of releasing all or substantially all of the Collateral from the Liens" securing the 2026 Secured Notes. Although the third amendment to the indenture, which authorized the issuance of the new notes, did not directly release the excluded noteholders' liens, the bankruptcy court found that it "had the effect" of releasing the liens because under the closing procedures, the fourth amendment, responsible for actually stripped the liens, became effective simultaneously with the third amendment.

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Case Study – "Double Dip"

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STG Logistics

Background	• In 2016, private equity firm, Wind Point Partners ("**Wind Point**") acquired STG, a leader in the market for containerized logistics, for an undisclosed amount, funded in part by Oaktree Capital Management ("**Oaktree**"). In 2022, STG acquired the intermodal division of XPO Logistics, one of the largest providers of container transportation services in North America. The combined business became North America's leading provider of fully integrated, port-to-door containerized logistics services. • As part of that transaction, STG was recapitalized by Wind Point and Oaktree. In March 2022, STG entered into a credit agreement (the "**Credit Agreement**") whereby STG received term loans in the amount of $725 million, and two trances of revolver loans totaling $150 million from certain syndicating banks, which loans were then sold to a broad group of lenders. • In 2023, STG's financial performance declined as market trends shifted away from goods and towards consumer services and the industry was beset by a range of problems including strikes, labor shortages, and regulatory scrutiny. By 2024, STG was experiencing liquidity constraints, which ultimately led to the transaction at issue.
Transaction Description	• STG amended its existing Credit Agreement to allow additional capacity for investments and to incur additional pari passu first-lien debt to accommodate the guarantees of NewCo's debt and the secured intercompany term loan. Following the amendment, the Company transferred approximately half of its assets, which generate 30% of EBITDA, to newly designated unrestricted subsidiary STG Distribution LLC ("**NewCo**"). The transferred assets and the intercompany loan collateralize the new credit facilities issued at NewCo, comprising: (i) $191 million FL1O term loan, including $137 million new money from ad hoc lenders, who, in exchange, converted their term loan holdings into the remaining FL1O; (ii) a $615 million FL2O term loan; (iii) a $93 million FL3O term loan; and (iv) all of these loans were exchanged from existing term loans at discounts to par at varying rates. • The proceeds from the new and exchanged loans were then lent to Reception Purchaser LLC through a secured intercompany loan guaranteed on a first-lien basis by Reception Mezzanine Holdings LLC (its direct parent) and the subsidiary guarantors of the existing term loan (together with Reception Purchaser LLC and Reception Mezzanine Holdings LLC; collectively "**RemainCo**"). In addition to the intercompany loan being pledged to them as collateral, lenders of new term loans at NewCo also receive a secured first-lien guarantee from RemainCo, effectively creating two claims against the legacy obligors. • Existing Lenders were given the opportunity to exchange their current term loan holdings for a mix of NewCo loans, with those contributing additional funds (ad hoc lenders) exchanging into a first-lien, first-out term loan. All non-ad-hoc lenders (i.e., those who did not contribute new money) were offered the chance to participate in the exchange but only into a mix of junior loans, like first-lien, second-out and first-lien, third-out term loans.

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STG Logistics *(Cont'd)*

Litigation

- In January 2025, Axos Financial and Siemens Financial Services (the "**Excluded Lenders**") filed an amended complaint against STG and certain of STG's lenders (the "**Majority Lenders**") in New York state court related to the "double-dip" liability management transaction. According to the excluded lenders, STG transferred "critical collateral assets and guarantors" to unrestricted subsidiaries STG Distribution LLC and STG Distribution Holdings LLC, prepaid the participating lenders' loans, took out new loans secured by the transferred assets and the assets remaining in the restricted group, and stripped "critical lender protections," including payment and default provisions, from the original first lien credit agreement.
- The Excluded Lenders maintain that the drop-down "ran afoul of several lender protections in the existing credit agreement," including protections added in May 2024 through the Fifth Amendment, which states that "it is understood and agreed that any opportunity to participate and/or receive[] such most favorable treatment must be held open to all Lenders for at least five Business Days." The Excluded Lenders argue that this provision combined with the sacred rights already included in the credit agreement "closed potential avenues" for liability management transactions involving "drop downs to unrestricted subsidiaries or non pro-rata treatment of Loans."
- On March 31, 2025, STG, Wind Point, Oaktree, and the Majority Lenders moved to dismiss the New York state court suit arguing that the transaction was "negotiated, agreed-to, and implemented in strict compliance" with the credit agreement. Further, STG asserts that the Excluded Lenders "ignore STG's right to amend nearly every provision in the credit agreement with the consent of a simple majority of lenders," including provisions restricting non-pro-rata loan redemptions and the new anti-drop-down language cited by the Excluded Lenders. STG argues that none of the transaction amendments directly affected the Excluded Lenders' sacred rights and, under the Mitel decision, amendments that do not directly modify sacred rights "cannot support a 'sacred rights' claim even if these amendments are alleged to 'effectively' impact Plaintiffs.
  - STG also points out that it offered the minority lenders the opportunity to exchange their existing loans for second- and third-out unrestricted subsidiary loans at a discount and that only the Excluded Lenders refused.
- The New York State court has yet to rule on this transaction or the motions to dismiss.

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Certain Open Questions

- Can you amend the definition of open market purchase?
- What is the impact of the non-pro rata sharing provision as a sacred right?
- Does the "market" for private credit loans (as opposed to broadly syndicated loans) differ for purposes of open market purchases?
- Except as otherwise permitted herein, all other recoveries will be on a pro rata basis
- Is there an ability to create different tranches of loans, such that you can selectively pay off or refinance only certain tranches?
- Will the Serta decision lead to more third-party financing deals going forward?
- Given that the decision is only binding in the Fifth Circuit, could courts in other jurisdictions come out a different way on the definition of open market purchases?
- Does the Court's ruling on 1123(a)(4) have broader implications for backstop and other similar fees in bankruptcy?

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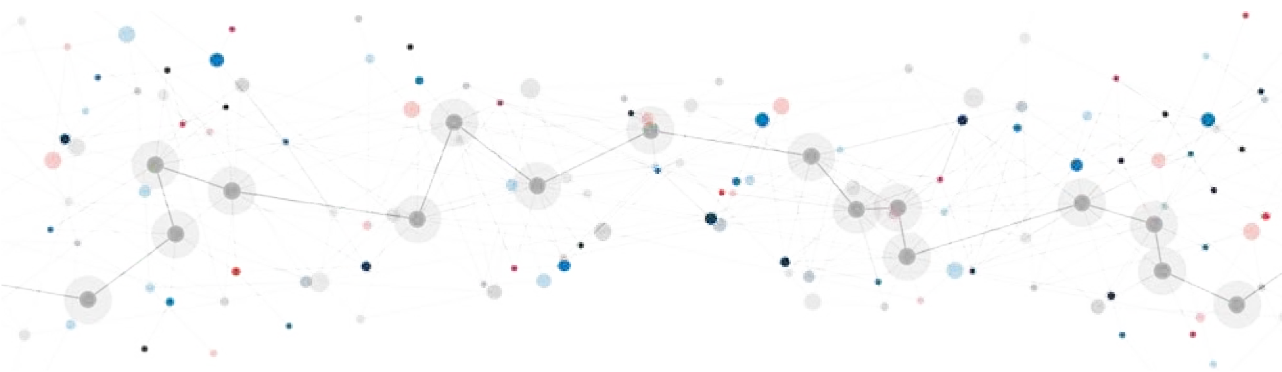


AN ECONOMIC VIEW ON LIABILITY MANAGEMENT EXERCISES (LMEs)

American Bankruptcy Institute: NYC 2025 Conference

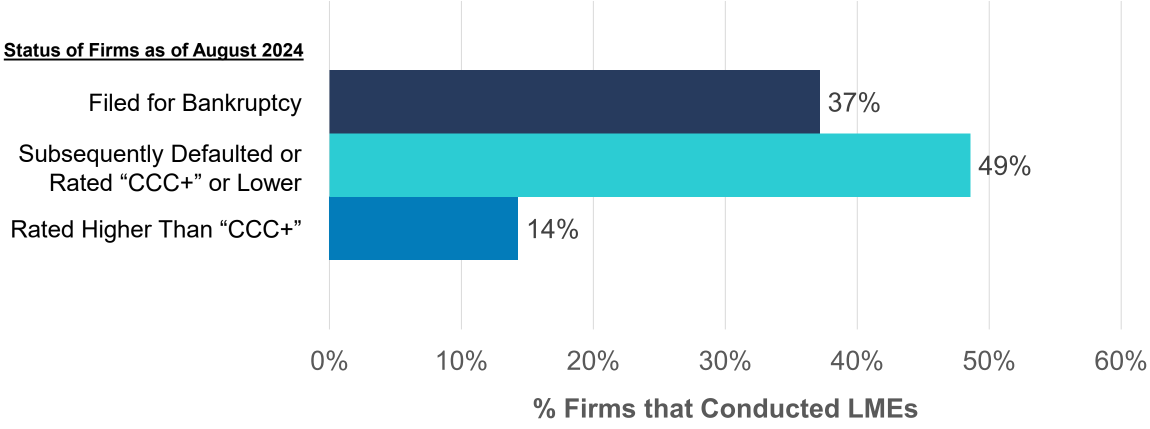
Faten Sabry, Senior Managing Director
June 17, 2025

Questions

- What is the Economic Impact of LMEs on Issuers Based on the Literature?
- Is There Empirical Evidence of Differences Between Uptier Transactions and Drop-Down Transactions?

Have LMEs Resolved Firms' Pre-Existing Capital Structure Challenges?

S&P Studied 35 Firms that Conducted LMEs Between 2017 and Mid-2024



Source: Standard & Poor's, "Loan Liability Management Transactions And Their Impact On First-Lien Lenders Are Demystified, Report Says," October 30, 2024.

Why did Average First Lien Recovery Rates Decline in 2024?

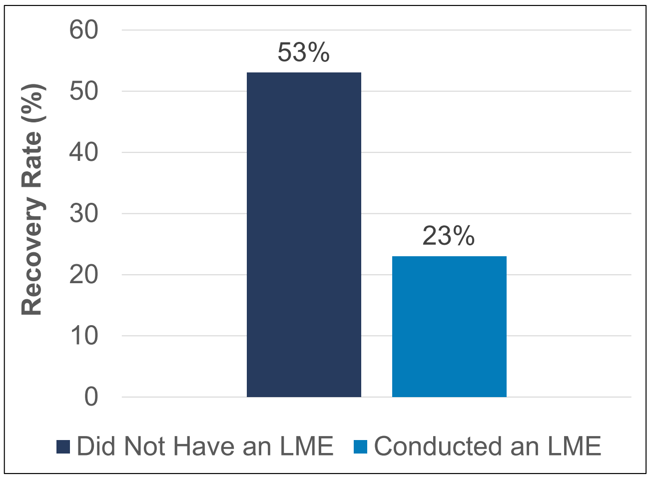
Fitch Examined Data on U.S. Issuers Emerging From Bankruptcy

- Fitch identified several factors:

1. Capital structure, including LMEs

2. Market conditions

3. Firms from low recovery sectors, such as:
   - Broadcasting & Media (17%)
   - Telecommunications (27%)



Source: Fitch Ratings, "Liability Management Transactions Drive Down U.S. Recoveries in 2024," December 9, 2024.

"Uptier" and "Drop Down" Transactions

Subordination of Pre-Existing Loans

Uptier Transactions

- The company issues new debt in exchange for new money from a subset of existing lenders
- Participating lenders can also exchange pre-existing debt for new, higher priority debt, often at a discount to par
- Pre-existing debt is effectively subordinated to new "superpriority" debt

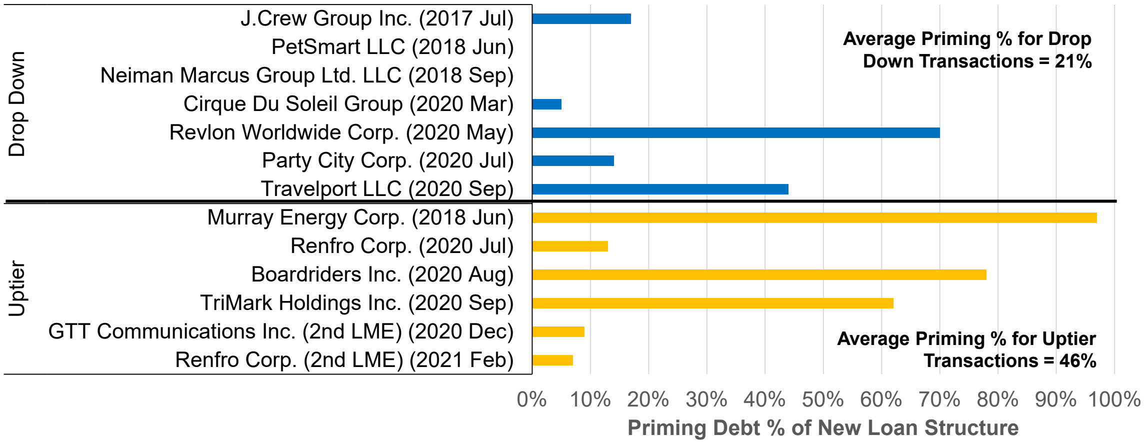
Drop Down Transactions

- The company creates a new entity which is free from restrictive covenants of existing debt
- The company then sells assets to the new entity, which issues new debt
- Participating lenders can often roll up pre-existing debt for the new debt
- Pre-existing debt is effectively subordinated to new debt with collateral

Source: LSTA (Loan Syndications and Trading Association).

Priming Debt As Percentage of New Loan Structure

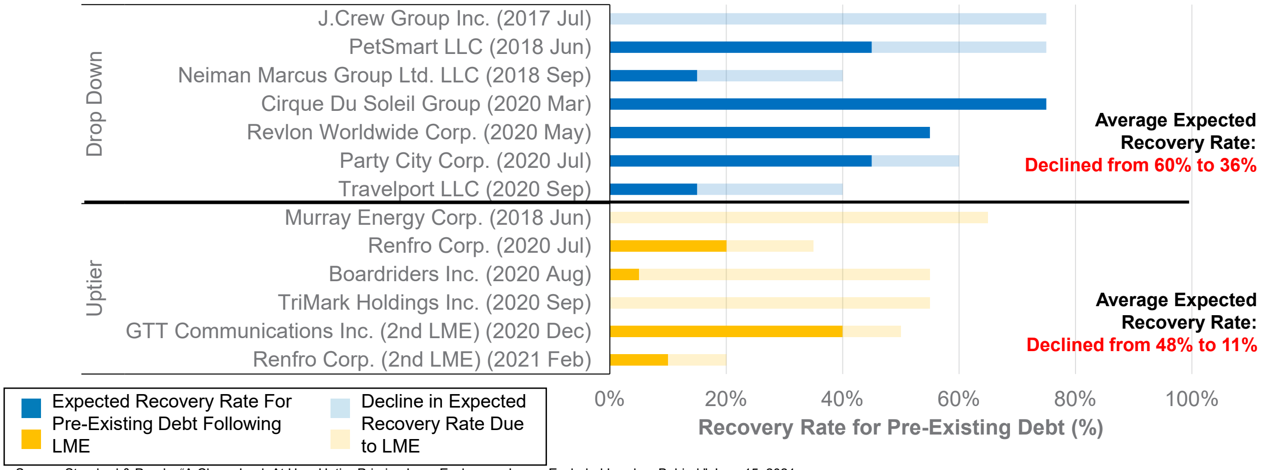
Sample of LMEs from July 2017 to February 2021



Source: Standard & Poor's, "A Closer Look At How Uptier Priming Loan Exchanges Leave Excluded Lenders Behind," June 15, 2021.

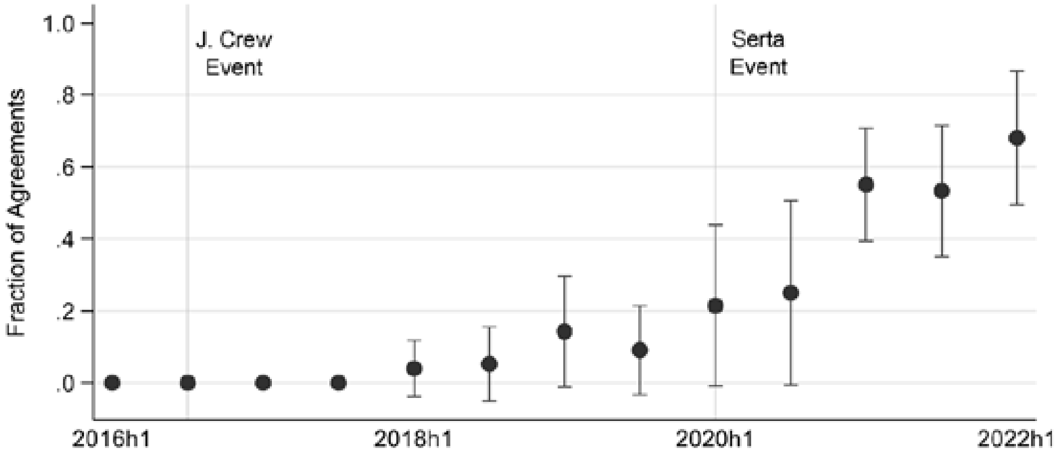
Average Expected Recovery Rates for Pre-Existing Debt Around LMEs

Sample of LMEs from July 2017 to February 2021



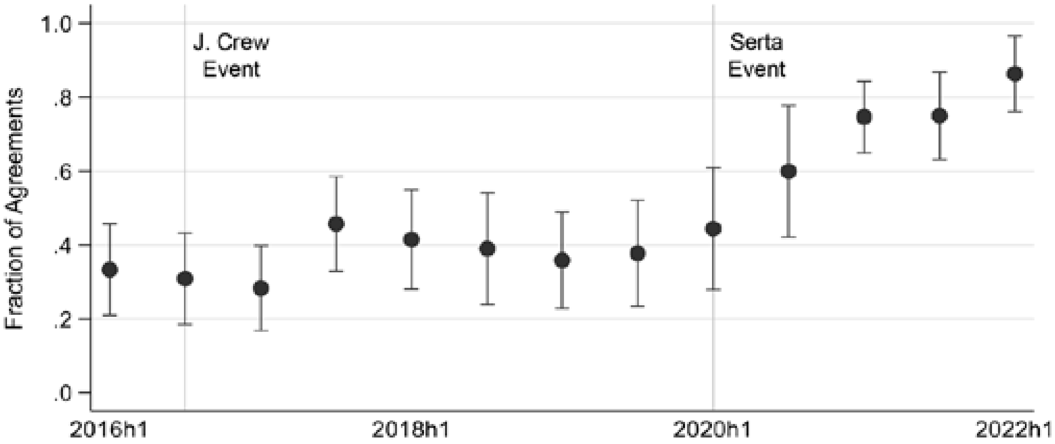
Source: Standard & Poor's, "A Closer Look At How Uptier Priming Loan Exchanges Leave Excluded Lenders Behind," June 15, 2021.

Buccola and Nini (2024) Show the Emergence of and Steady Increase in IP Blockers in Loan Contracts Following the J. Crew Drop Down LME



Source: Buccola, Vincent S.J. and Nini, Gregory, The Loan Market Response to Dropdown and Uptier Transactions (June 2024). *Journal of Legal Studies*, Volume 53, No. 2., pp. 489-526.

Buccola and Nini (2024) Show the Sharp Increase in Uptier Blockers in Loan Contracts Following the Serta Uptier LME



Source: Buccola, Vincent S.J. and Nini, Gregory, The Loan Market Response to Dropdown and Uptier Transactions (June 2024). *Journal of Legal Studies*, Volume 53, No. 2., pp. 489-526.

Notes on the Sample of Loan Contracts Used by Buccola and Nini (2024)

Data:

- Sample of loan contracts from Thomson Reuters' Practical Law (PL) service, compiled from SEC filings
- Started with 4,318 contracts from January 1, 2016, through June 30, 2022, that have non-missing data on the amount of the loan. The final sample examined included 664 contracts (2016-2022).
  - excluded amendments (670)
  - excluded DIP loans, second-lien loans, and asset-based loans because; loans to firms in financial services; loans with a maturity of less than 1 year; and loans granted in a currency other than US dollars
  - removed loans that PL labels unsecured; excluded secured loans granted to investment-grade borrowers
  - excluded loans with initial principal less than $50 million
  - excluded contracts that contemplate only a line of credit (i.e., revolving-lender loans)
  - excluded any loan that was not broadly syndicated (i.e., single-lender loans)

Source: Buccola, Vincent S.J. and Nini, Gregory, The Loan Market Response to Dropdown and Uptier Transactions (June 2024). *Journal of Legal Studies*, Volume 53, No. 2., pp. 489-526.

Faculty

Hon. Philip Bentley is a U.S. Bankruptcy Judge for the Southern District of New York in New York, sworn in on Sept. 7, 2022. Prior to joining the court, he has been a partner in the bankruptcy and restructuring department of Kramer Levin Naftalis & Frankel LLP, where his practice focused on complex litigation in bankruptcy courts, as well as other federal and state courts. In addition to occasionally representing debtors, trustees and examiners, Judge Bentley frequently litigated on behalf of official committees and creditor groups in large bankruptcies, including Purdue Pharma, Puerto Rico, Residential Capital, Madoff Investment Securities, General Motors, W.R. Grace, Adelphia Communications, WorldCom, Dow Corning and SGL Carbon. A regular speaker on bankruptcy issues, he is a member of the Federal Bar Council's Bankruptcy Litigation Committee and of the National Conference of Bankruptcy Judges, and he has served as a court-appointed mediator in several chapter 11 cases, including Celsius Network. Prior to his appointment, Judge Bentley was a member of the advisory board for ABI's annual New York City Bankruptcy Conference, as well as a longstanding member of the Policy Committee of Human Rights Watch. He received his B.A. *cum laude* from Yale University and his J.D. *cum laude* from Columbia Law School, where he was a Harlan Fiske Stone Scholar.

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Brett H. Miller is a partner in the Business Reorganization & Restructuring Department of Willkie Farr & Gallagher LLP in New York and co-chairs the firm's Restructuring Department. His clients include official and ad hoc creditors' committees, bank groups, individual lenders, court-appointed fiduciaries, debtors, and investors that focus on distressed situations. Mr. Miller advises on chapter 11 cases, out-of-court restructurings, bankruptcy-related acquisitions, cross-border insolvency matters, bankruptcy-related litigation and insolvency-sensitive transactions. Mr. Miller has represented parties in restructurings in such industries as real estate, transportation, retail, manufacturing, food service, oil and gas, and media. He is a Fellow of the American College of Bankruptcy and is listed as a leading lawyer for Bankruptcy & Restructuring in *Chambers Global*, *Chambers USA* and *Legal 500 US*. He has been recognized by *Law360* as an "MVP" of the bankruptcy bar, and *Turnarounds & Workouts* named him an "Outstanding Restructuring Lawyer." Mr. Miller received his B.A. from Columbia University in 1988 and his J.D. from Georgetown University Law Center in 1991.

Dr. Faten Sabry, APS is a senior managing director of Compass Lexecon in New York and provides economic consulting and expert testimony in securities, bankruptcy and complex damages. She has testified as an expert at trial in state and federal courts, the UK High Court, Canadian courts and FINRA proceedings. Dr. Sabry has performed analyses involving issues of class certification, econometric modeling, liability, fraudulent conveyance, and damages in cases ranging from contract disputes to valuing a portfolio of mortgages. She also has assessed risk-management models and examined the prudence of investments including hedging strategies. Dr. Sabry has also consulted on the valuation of fixed-income securities, crypto assets, derivatives, businesses and litigation settlements. She also has consulted on complex securities, including cash and synthetic CDOs, as well as asset- and mortgage-backed securities. In addition, she has evaluated rating agencies' models, loan loss prediction models, and cash-flow models. Dr. Sabry's product-liability work includes estimating the future liabilities in cases involving opioids, asbestos, silica, pharmaceutical products, medical devices, automobiles and construction products; analyzing liabilities related to environmental contamination in cases including the Met-Coil bankruptcy trust and the future silica and asbestos liabilities for the Tyler Pipe/Swan Transportation bankruptcy trust; assessing recall costs and diminution of value for automobile and construction products; analyzing insurance allocation; applying statistical and content analyses to examine product identification; and analyzing class certification in consumer class actions, including actions related to servicing loans, consumer finance, and credit as well as automobile recalls. She is the author of various articles on the economics of subprime lending, the credit crisis, the impact of securitization on the cost of credit and liquidity, econometric analysis of mutual funds' advisory fees, claiming behavior, and determinants of anti-dumping protection. Her research has been published in the *Journal of Structured Finance*, *Journal of Fixed Income*, *Journal of Investment Compliance*, *Journal of Alternative Investments*, *Business Economics*, *International Trade Journal* and others. Dr. Sabry is the lead author of "Residential Mortgage Defaults, Foreclosures, and Modifications" in *The Handbook of Mortgage-Backed Securities* (Frank J. Fabozzi, ed. 2016), as well as an econometric study on the impact of securitization before and after the credit crisis for the American Securitization Forum. She is a member of the American Finance Association and ABI. Before joining Compass Lexecon, Dr. Sabry was a managing director and chair of the Global Securities and Finance Practice at NERA Economic Consulting, a Post-Doctoral Fellow at the International Food Policy Research Institute, and an assistant professor of economics at the American University in Cairo, where she taught graduate and undergraduate economic courses. She received her B.A. *magna cum laude* and her M.A. from American University in Cairo, and her Ph.D. from Stanford Business School, where she was awarded the J.M. Olin Graduate Fellowship, the Graduate School of Business Fellowship and a Ford Foundation Fellowship.

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Jane A. VanLare is a partner with Cleary, Gottlieb, Steen & Hamilton LLP in New York, where her practice focuses on restructuring, insolvency and bankruptcy litigation. She represents investors in distressed assets, large financial institutions and corporations in all matters relating to in- and out-of-court restructurings, bankruptcy, insolvency and related litigation. She has a wide range of industry experience, including auto, energy, consumer, airlines, retail, restaurants and hospitality, shipping and digital assets. In 2017, Ms. VanLare was honored on *Benchmark Litigation*'s "Under 40 Hot List." She also was selected as an ABI "40 Under 40" honoree. Ms. VanLare received her A.B. *magna cum laude* and Phi Beta Kappa from Harvard College in 2004 and her J.D. from Harvard Law School in 2007, where she was editor-in-chief of the *Harvard Negotiation Law Review*.