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# **Liability-Management Exercises: Sustainable Solutions, or Temporary Fixes?**

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## **Liability-Management Exercises: A Force for Good?**



### Objective:

Consider how liability management exercises (LMEs) may be structured to optimize benefit and improve enterprise value for stakeholders, minimize friction, and ensure long-term success.

### Key Themes:

- Evaluate evolving market practices post-*Serta* and *Mitel* court decisions
- Practical Lessons: What makes for a successful LME
- Continued development of LME approaches: balancing desire for improved economics for “in” group while mitigating risk of added costs from litigation and further restructuring
- Consider new tools that support restructuring efforts outside of chapter 11 bankruptcy



### What Is an LME?

Amorphous phrase describing various transactions creatively utilizing terms of existing credit documentation for non-traditional refinancing and facility upsizing efforts

LMEs are often done on a non-*pro rata* basis, without being offered to all lenders within the affected facility

### Common Types of LMEs:

- Uptier
- Drop-Down
- Double-Dip
- Non-*Pro Rata* Exchanges
- Next Step in the Evolution?

*\*Examples of transaction structures for multi-part LMEs is contained in the Appendix*



### Common Criticisms of LMEs:

- Exacerbate borrower's pre-existing leverage issues
- Simply delay broader in-court and out-of-court restructuring
- Non-*pro rata* nature of most LMEs leads to costly litigation

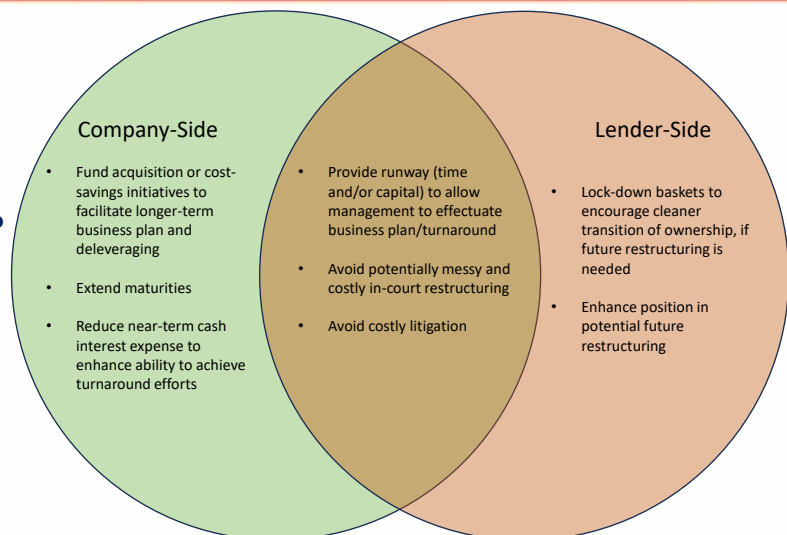
### Responses to Criticism:

- Provide management with opportunity to effectuate turnaround
- LMEs are in their infancy; evolving structuring has improved effectiveness over the years
  - *E.g.*, according to 9fin, although 70% of 20 LMEs tracked through 2021 resulted in repeat restructurings, nearly 70% undertaken since then have staved off further restructuring thus far (although some may be on the precipice)
- Techniques continue to be refined to minimize litigation risk, potentially avoiding both costly litigation and a costly in-court restructuring



### What Makes an LME Successful?

As with most things, the definition of success depends upon a party's perspective





### Developments in LME Litigation Risk:

- Where have we been; litigation risk for LMEs
- *Serta* and *Incora* demonstrate litigation risk for transaction participants
  - Judges may order companies to “unscramble” the egg
  - Participating lenders may lose indemnification for attorneys’ fees and judgments in litigation challenging the LME

### *In re Serta Simmons Bedding, L.L.C. (“Serta”), 125 F.4th 555 (5th Cir. 2024)*

- Fifth Circuit rejected company’s and participating lenders’ reliance on indenture’s “open market purchase” provision to justify uptier transaction
- Court also recognized that non-*pro rata* treatment at the heart of LMEs is at odds with central norm of ratable treatment in syndicated loan agreements

### *In re Wesco (aka “Incora”), 2025 WL 354816 (Bankr. S.D. Tex.)*

- In early 2025, Judge Isgur of the Southern District of Texas Bankruptcy Court issued written decision memorializing July 2024 oral ruling that uptier transaction violated agreements and must be unwound



Company	Date	Transaction Benefit			Transaction Structure		Transaction Summary
		Maturity Extension	Discount Capture	Liquidity	Amended Docs	Non Pro Rata	
iHeart MEDIA	Dec-24	✓	✓		✓		<ul style="list-style-type: none"> <li>• <b>Discounted exchange</b> that <b>extended maturities</b> on most debt by 3 years and reduced total debt by ~\$440mm</li> <li>• ~\$4.8bn (~92%) participation with existing secured creditors exchanging into new secured debt and unsecured noteholders exchanging into new 2L notes</li> </ul>
MultiPlan	Dec-24	✓			✓		<ul style="list-style-type: none"> <li>• <b>Uptier exchange to extend maturities</b> from 2027/2028 to 2030/2031 supported by AHG holding 78% of debt</li> <li>• Term loan holders exchanged at par into 11% first out 1L and 89% second out 1L term loans</li> <li>• SUNs exchanged at par into 18% first out 1L term loan, 28% second out 1L Notes and 54% second out 1L Notes</li> <li>• Existing opco SUNs and convertible holders exchanged at par into a mix of first, second, and third out notes</li> </ul>
Better Health	Dec-24	✓	✓	✓	✓	✓	<ul style="list-style-type: none"> <li>• Raised <b>\$113mm first out new money</b> from the AHG</li> <li>• AHG exchanged at par into combination of 1<sup>st</sup> and 2<sup>nd</sup> out</li> <li>• Transaction structured to enable <b>non-pro-rata treatment</b> without relying on open market purchase exception</li> </ul>

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Company	Date	Transaction Benefit			Transaction Structure		Transaction Summary
		Maturity Extension	Discount Capture	Liquidity	Amended Docs	Non Pro Rata	
SPRINGS WINDOW FASHIONS	Dec-24	✓	✓	✓	✓		<ul style="list-style-type: none"> <li>• Raised <b>\$350mm first out new money</b></li> <li>• 1L term loan lenders exchanged at 95c into a new superpriority second out term loan</li> <li>• SUNs holders exchanged at 84c into new 2L notes</li> </ul>
ECHOSTAR	Nov-24	✓	✓	✓			<ul style="list-style-type: none"> <li>• Raised <b>\$5.2bn of new money</b>, secured by spectrum assets, from convertible holders to fund the wireless build-out</li> <li>• <b>Extended maturities</b> by exchanging 2025 convertible notes at 92c into 52% new spectrum secured notes and 40% into new spectrum secured convertibles and exchanging 2026 convertible notes at 87c into 47% spectrum secured notes and 40% spectrum secured convertible notes</li> </ul>
OnTrac	Nov-24	✓	✓	✓	✓		<ul style="list-style-type: none"> <li>• Raised <b>\$300mm 1L first out new money</b> offered pro rata</li> <li>• 1L TL lenders exchanged at 75c into equal parts second out and third out term loans</li> <li>• 2L TL lenders exchanged at 70c into third out term loans</li> <li>• Non-participating lenders subordinated to new debt</li> </ul>

9



Company	Date	Transaction Benefit			Transaction Structure		Transaction Summary
		Maturity Extension	Discount Capture	Liquidity	Amended Docs	Non Pro Rata	
VERITAS	Nov-24	✓					<ul style="list-style-type: none"> <li>• Veritas sold its Data Protection segment to Cohesity for \$2.4bn of cash plus \$1bn of preferred equity in the combined Data Protection / Cohesity business ("NewCo")</li> <li>• Lenders received <b>par recovery</b> cash (72c), RemainCo takeback debt (17c), NewCo preferred equity (6c), and a margin loan backed by NewCo preferred equity (5c)</li> <li>• RemainCo required to reduce total funded debt to \$450mm (from \$780 at close) within 3 years; if not achieved, lenders have the <b>option to partially equitize</b> debt and <b>receive 99.99% of common equity</b></li> </ul>
STG	Oct-24	✓	✓	✓	✓	✓	<ul style="list-style-type: none"> <li>• Company <b>dropped down</b> half of its assets to a subsidiary which <b>raised \$137mm first out new money</b></li> <li>• AHG exchanged into first out and second out term loans</li> <li>• Non-steerco AHG lenders exchanged into second and third out term loans; non-AHG lenders exchanged at worse terms</li> </ul>

10



### Where We Go from Here?

- Efforts to avoid costly, in-court restructurings likely to continue
- LME landscape will continue to evolve and adapt
- Circumstances will likely continue to dictate how aggressive LMEs are in any situation
- Other out-of-court restructuring alternatives (schemes, article 9 foreclosures, ABCs, receiverships) will continue to exist alongside LMEs, where appropriate

### Aggressiveness of LMEs Is Situation-Specific

Recent Uptier Transactions

	Company	Tent Date	Size of Ad Hoc	% of Value Moved <sup>1</sup>		
				Away from Non-Ad Hoc	To Ad Hoc Group	Moved to Ad Hoc Group
Most Aggressive	Wesco	May-22	56%	+107%	\$240	+41%
	Mitel	Oct-22	66%	+103%	\$209	+46%
	Robertshaw	May-23	73% Participating Abstaining	-8.7% +103%	\$64	+30%
	Envision	Jul-22	56% Participating Abstaining	5.7% +103%	\$265	+45%
	Apex Tool	Feb-24	68%	-58%	\$97	+21%
	Rackspace	Mar-24	69%	-1.7%	\$48	+7%
	City Brewing	Apr-24	73%	1.8%	\$22	+5%
	GoTo Group	Feb-24	72%	-1.3%	\$64	+5%
	Eyecare Partners	May-24	77% Participating Abstaining	-1.3% +103%	\$36	+5%
	Valcour	Jun-24	87%	-1.2%	\$5	+2%
Least Aggressive						



### Where We Go from Here?

- **Promoting LME Utility/Availability**
  - Semi-*pro rata*/tiered transactions
  - Reduction of cash interest burden
  - Pre-wiring hand-over post-LME business plan not met
  - LME Insurance
  - Exceptions to “Sacred Rights”
- **“Creep” of LME Technology to In-Court Realm**
  - Selective Roll-Ups – *American Tire Distributors*
- **Evolving Leverage Dynamics in Documents**
  - LME “blockers”
  - Anti Co-Op language in new issues
  - Waivers of covenant of good faith and fair dealing
  - Integrated transactions waiver
  - Expanded lender DQ language
  - Inside-out transaction





### New Tactics to Prevent LME Litigation:

- **Tiered Offers:** Offers are now structured in multiple tiers, as opposed to pitting “haves” against “have-nots”
- **NDAs**
  - Borrowers use NDAs to (1) prevent information leaks about the deal and (2) stall the formation of lender groups to demand better treatment from the company or bring a lawsuit
  - Lenders often sign NDAs assuming they would receive treatment equal to the Ad Hoc Group but only later find they are in the second tier, or worse
- **Indemnification Narrowing & No-Action Clauses:**
  - Amendments purport to deprive excluded lenders of their entitlement to indemnification for attorneys’ fees in enforcing rights under credit agreement and sometimes require excluded lenders who bring litigation to reimburse participating lenders who prevail
  - New punitive language is added to deter legal actions
- **Interest Payment Suspension:**
  - Excluded lenders face a stark choice: accept the consolation prize or risk suspension of interest payments until maturity



## Appendix





## Uptier Transaction Example



### Apex Tool: An Opportunistic Uptier

- Apex reflects a more opportunistic variety of uptier transaction that we can expect to see more of in the coming years
- Apex was not the prototypical uptier candidate “with its back against the wall”:
  - Trading prices were stressed, but not distressed:
    - 1L Loans – ~90
    - 2L Loans – ~84
  - The company had reported YoY improvement in EBITDA for two consecutive quarters, although it was still burning cash
  - Expectation was that the sponsor was (again) looking to divest of Apex, and a limited liquidity bridge might be needed
- The uptier was designed with two steps: (a) the first step fully funded the new capital raise without increasing leverage; and (b) the second step further deleveraged the capital structure to allow the sponsor to capture additional value upon future divestiture

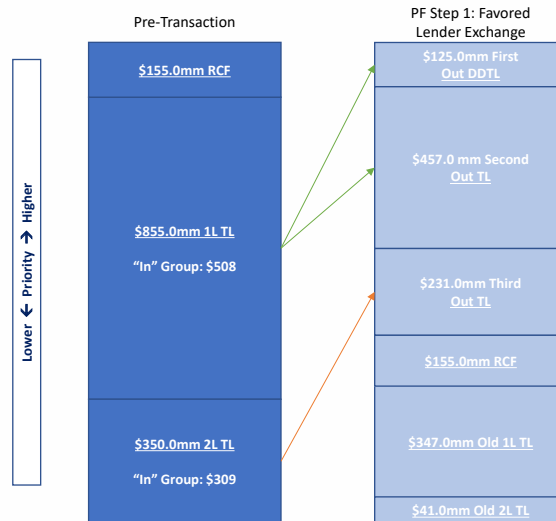
### Uptier Transaction Checklist

- ✓ Lien subordination excluded from sacred rights?
- ✓ Non pro rata purchases permitted?
- ✓ Apex also had drop-down capacity, allowing it to structure its uptier transaction coercively



## Apex Tool Group: Step 1 - The “In” Group

Step 1 of the uptier transaction provided Apex with \$125mm of new capital, while leaving its leverage profile virtually unchanged



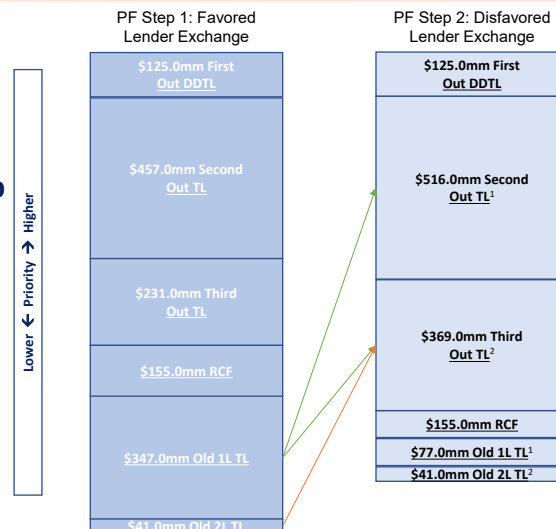
### Step 1 Exchange Offer

- Limited to “In” Group that held ~60% of 1L TL and ~88% of 2L TL
- In Group:
  - Provided new, \$125mm First Out DD TL
  - Exchanged 1L TL for new, Second Out TL, at 90% of par
  - Exchanged 2L TL for new, Third Out TL, at 75% of par and 15% of common equity
- RCF and “Out” Group not offered exchange in Step 1
- Borrower leverage profile remained nearly unchanged
  - Pre-transaction Total Debt: \$1,360mm
  - Post-transaction Total Debt: \$1,356mm



## Apex Tool Group: Step 2 - The “Out” Group

Step 2 of the uptier transaction substantially de-levered Apex, providing additional upside for sponsor and “friends and family” in potential divestiture



### Step 2 Exchange Offer

- “Out” Group offered tag-on exchange on inferior terms
  - Old 1L TL exchanged for:
    - 21.9% of face amount of exchanged debt in Second Out TL
    - 51.1% of face amount of exchanged debt in Third Out TL
  - Old 2L TL exchanged for:
    - 65% of face amount of exchanged debt in Third Out TL
- Step 2 materially de-levered Apex’s capital structure, providing sponsor with greater upside in anticipated divestiture of the business:
  - Pre-Step 2 Total Debt: \$1,356mm
  - Post-Step 2 Total Debt: \$1,283mm
- 15% of disposition upside shared with “in” group “family and friends”

#### Notes

<sup>1</sup> Based on public reporting that 91% of 1L TL tendered

<sup>2</sup> No publicly reported data regarding amount of 2L TL tendered in step 2. PF stack shows no further exchanges



## Drop-Down Transaction Example



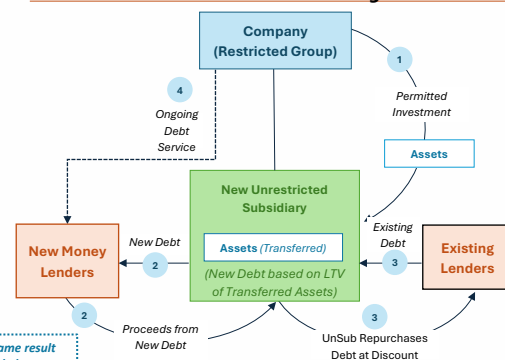
## Asset Drop-Down Structure Overview

- By transferring assets to an unrestricted subsidiary (“UnSub”), the company can use the transferred collateral to raise new debt at a lower cost than the company could otherwise. See steps 1 & 2 below
- Proceeds of the new money raise can be used to repurchase existing debt at a discount, allowing the company to de-lever as it captures the discount on current trading prices. See step 3 below

- 1 Permitted Investment:** Company transfers assets to new UnSub using existing permitted investment capacity  
 – Note: Depending on credit docs, the Company may also be able to unrestrict a currently restricted subsidiary via passing required pro forma tests (e.g. – Party City’s drop-down of Anagram)
- 2 New Money Raise:** UnSub raises new debt against appraised value of assets at an appropriate LTV from new or existing lenders
- 3 Discounted Debt Repurchase:** UnSub uses proceeds from new debt raise to repurchase existing debt at a discount, which UnSub keeps outstanding
- 4 Ongoing Debt Service:** Company pays interest on existing debt to UnSub, which in turns uses the proceeds to fund its ongoing interest costs on the new debt

*A discounted exchange with existing lenders achieves the same result (e.g., discount capture & de-levering) as step 3 depicted above*

### Illustrative Transaction Diagram





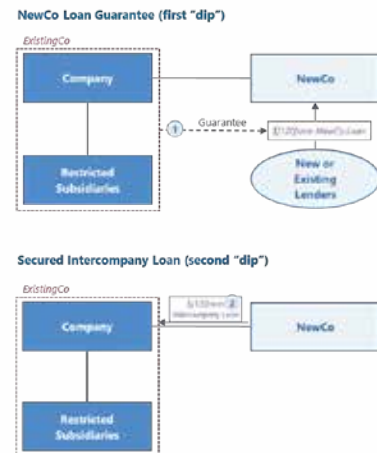
## Double-Dip Transaction Example



## Double-Dip Financing Structure Overview

The below illustrates a “double-dip” financing transaction which results in lenders having a double claim against Company’s guarantors

1. Company creates a non-guarantor restructured subsidiary or unrestricted subsidiary (“**NewCo**”) that will not be a guarantor under the Company’s existing debt facilities
2. NewCo incurs \$[120]mm of debt (“**NewCo Loan**”), subject to existing debt capacity
3. Company and its guarantor restricted subsidiaries (“**ExistingCo**”) guarantee the NewCo Loan on a first lien basis using pari 1L debt capacity 1
4. NewCo on-lends the \$[120]mm of proceeds from the NewCo Loan to ExistingCo on a 1L basis using additional pari 1L debt capacity, creating a secured intercompany loan; results in lenders having a double claim against the ExistingCo 2



# Faculty

**Andrew Benjamin, CFA** is a director with Houlihan Lokey in Los Angeles and a member of the firm's Financial Restructuring and Liability Management Group. During his 10 years with the firm, he has advised companies and creditors in liability-management transactions, restructurings (both in and out of court), M&A and financings, primarily in the health care and other industries. Prior to joining Houlihan Lokey, Mr. Benjamin was an assistant vice president with Bank of America's Alternative Investment Group. Before that, he was an analyst at Citadel Investment Group. Mr. Benjamin received his B.S. from the University of Colorado and his M.B.A. from the Darden School of Business at the University of Virginia.

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**Nicole L. Greenblatt** is a restructuring partner with Kirkland & Ellis LLP in New York and represents debtors, creditors, equity-holders and investors in all aspects of complex corporate restructurings, including chapter 11 cases, out-of-court restructurings and special-situation investments or acquisitions. She has a broad range of experience across a number of industries and has represented clients in multijurisdictional and cross-border matters. Ms. Greenblatt's practice includes advising clients with respect to business operations in chapter 11, advising senior managers and boards of directors of financially troubled companies with respect to restructuring strategies, providing advice relating to mass tort and environmental liabilities of financially troubled companies, providing advice, negotiating and structuring financings and other commercial transactions, and advising clients seeking to purchase businesses and related assets out of chapter 11 proceedings. She has been recognized by *Chambers USA* and *Legal 500 US*, was named a 2017 "MVP of the Year" by *Law360* and was featured in *Crain's New York Business's* inaugural list of the "Leading Women Lawyers in New York City" in 2018. She was recently nominated by the *International Financial Law Review* for the *Euro-money* Legal Media Group Americas Women in Business Law Award, and in 2011, she was selected as one of the top 30 nominees nationwide to participate in the inaugural Next Generation Program at

the National Conference of Bankruptcy Judges. Ms. Greenblatt is a member of ABI, the Turnaround Management Association and the New York City Bar Association's Bankruptcy Committee, and she sits on the board of Her Justice. She received her B.B.A. in economics in 1999 with distinction from the University of Michigan and her J.D. *cum laude* in 2002 from Fordham University School of Law, where she was a member of the Order of the Coif.

**James A. Newton** is a partner in Morrison & Foerster LLP's Business Restructuring + Insolvency Group in New York. His practice focuses primarily on advising financial institutions, alternative investment advisors, and other clients in connection with a wide array of out-of-court transactions, including exchange offers and other liability-management transactions, swap and hedging transactions, structured finance transactions, and distressed M&A and rescue financing transactions. He also has experience advising lenders, bondholders, debtors, creditors' committees, individual creditors and purchasers of assets in bankruptcy cases. Mr. Newton regularly advises clients regarding the permissibility of liability-management transactions under existing credit documentation, both in connection with exploring and executing transactions on behalf of majority lenders and from the perspective of identifying potential challenges to a previously executed transaction. He received his B.S.B.A. in finance from the University of Florida, his J.D. and M.B.A. from Temple University, and his LL.M. in bankruptcy law from St. John's University School of Law.