AMERICAN BANKRUPTCY INSTITUTE

Mid-Atlantic Bankruptcy Workshop

# Creditor-on-Creditor Violence, Liability Management and Uptier Transactions


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2024

# Creditor on Creditor Violence and Liability Management Transactions


REUTERS June 15, 2018

Tensions rise as private equity-backed companies push limits

"The underlying powder keg is there: All the documents are out there allowing for a ton of flexibility. The execution of this [Serta Simmons] deal is merely the spark."

Judah Gross, Fitch Ratings (Bloomberg July 9, 2020)


LAW.COM April 22, 2024

**Help, the Lenders Are Fighting Again: Creditor Violence Driving Demand in Bankruptcy, Litigation Practices**

Debtwire February 2, 2024

Liability management deals heat up amid widespread borrower stress

"Lenders are sometimes plaintiffs in one case and defendants in another." -- Hon. Christopher M. Lopez (In re Robertshaw US Holding Corp. *et al.)* June 20, 2024

Private Debt Investor December 11, 2023

Creditor-on-creditor violence erupts again in Robertshaw lenders lawsuit


# Introduction

**Types of Liability Management Transactions**

- **Uptier Debt Exchanges**
- **Asset Drop Downs**
- **Double Dips**


## Uptier Debt Exchanges

A distressed borrower accesses new capital by issuing new superpriority senior secured debt provided by a subset of the borrower's existing senior secured lenders in exchange for their existing senior debt

The remaining existing senior debt is effectively subordinated to the new superpriority secured debt.

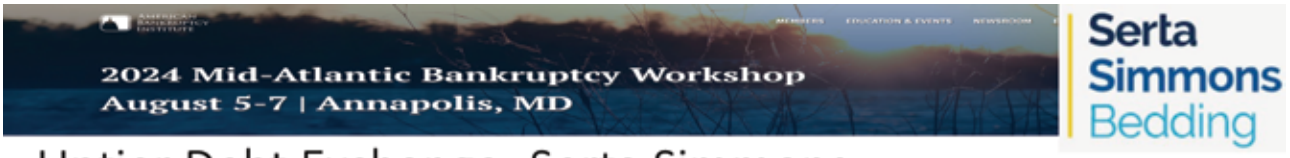
Typically, majority lender consent is required to amend the debt documents


## Uptier Debt Exchanges – Weapons

- "Open market" purchases
- Power to amend by majority or supermajority
- Issuance of additional notes
- Sacred rights
- Affirmative and negative covenants
- Implied covenant of good faith and fair dealing

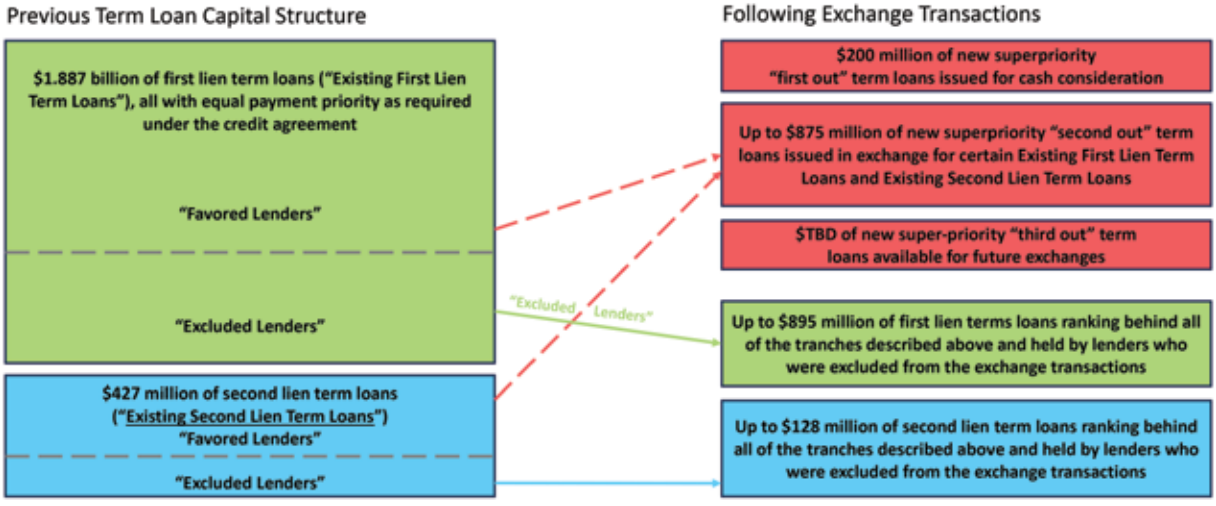

# Uptier Debt Exchanges – Examples

- Serta Simmons
- Boardriders
- TriMark
- Transocean
- Not Your Daughter's Jeans
- Incora / Wesco
- Envision (second transaction)
- Revlon
- Murray Energy
- TPC Group
- Robertshaw
- Loparex
- The RealReal
- Rackspace
- Apex Tool
- GoTo
- Accent Care
- Rodan & Fields
- Aventiv
- Premium Packaging
- LifeScan
- West Marine
- Travelport
- Cineworld




## Uptier Debt Exchange- Serta Simmons

[Chart from https://restructuringinterviews.com/blogs/restructuring/serta-chapter-11]




Serta Simmons Bedding

# Serta Simmons- Litigation Update

On March 28, 2023, the Bankruptcy Court for the Southern District of Texas held a hearing on summary judgment motions. On April 6, 2023, the court granted partial summary judgment declaring that the term "open market purchase" was clear and unambiguous and that the liability management transaction constituted an "open market purchase." Upon further proceedings, on June 6, 2023, the court added that "[a]n open market purchase" is "something obtained for value in competition among private parties."

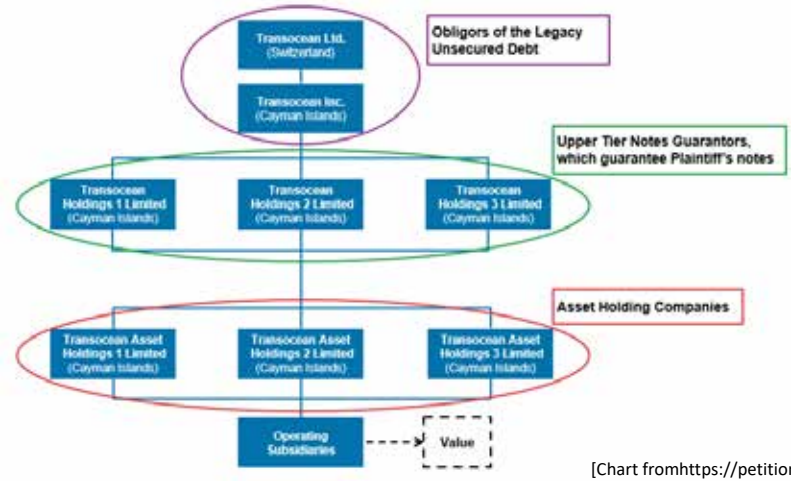
The court held that the liability management transaction did not violate the credit agreement. The court held also that the transaction was entered into in good faith, reasoning (in part) that the parties knew that the credit document was "loose" and understood the implications thereof.

*Serta Simmons Bedding, LLC v. AG Ctr. St. P'ship (In re Serta Simmons Bedding, LLC)*, 2023 Bankr. LEXIS 1479 (Bankr. S.D. Tex. June 6, 2023).

The rulings are on appeal to the Fifth Circuit. Oral argument was held on July 10, 2024.

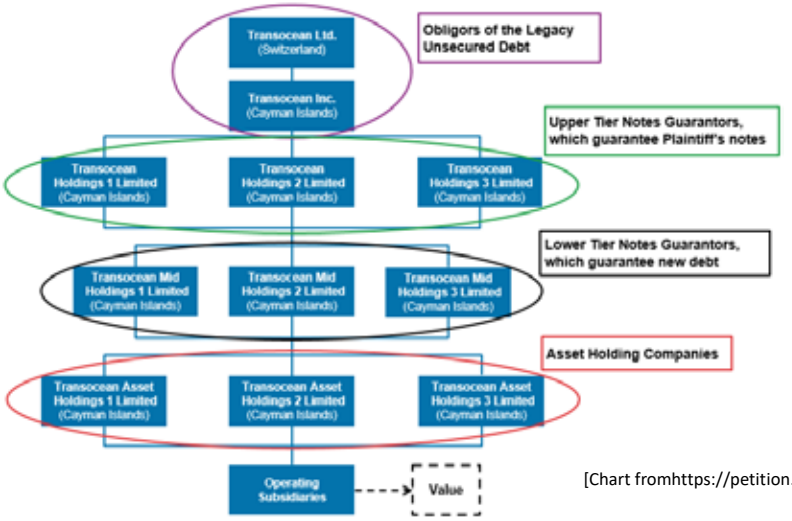

# Uptier Debt Exchange- Transocean (Pre-LMT)

Transocean




[Chart fromhttps://petition.substack.com/p/transocean]


## Uptier Debt Exchange- Transocean (Post-LMT)




[Chart fromhttps://petition.substack.com/p/transocean]


## Transocean – Litigation

The SDNY granted summary judgment in favor of Transocean. The court declared that the transaction did not the covenant not to transfer all or substantially all assets and, therefore, did not trigger a "successor obligation" provision. The court reasoned that, before and after the transaction, guarantors remained holding companies indirectly owning the same underlying assets. *Whitebox Relative Value Partners v. Transocean,* 1:20-cv-07143 (GBD), *Mem. Decision and Order* [ECF No. 60].

On appeal, the Second Circuit dismissed the appeal as moot because Transocean implemented a reorganization eliminating the recently-created intermediate holding companies, thus restoring the seniority of the notes (although with the same effect as the initial restructuring). *Whitebox Relative Value Partners, LP v. Transocean Ltd.*, 2022 U.S. App. LEXIS 2845 (2d Cir. Feb. 1, 2022).

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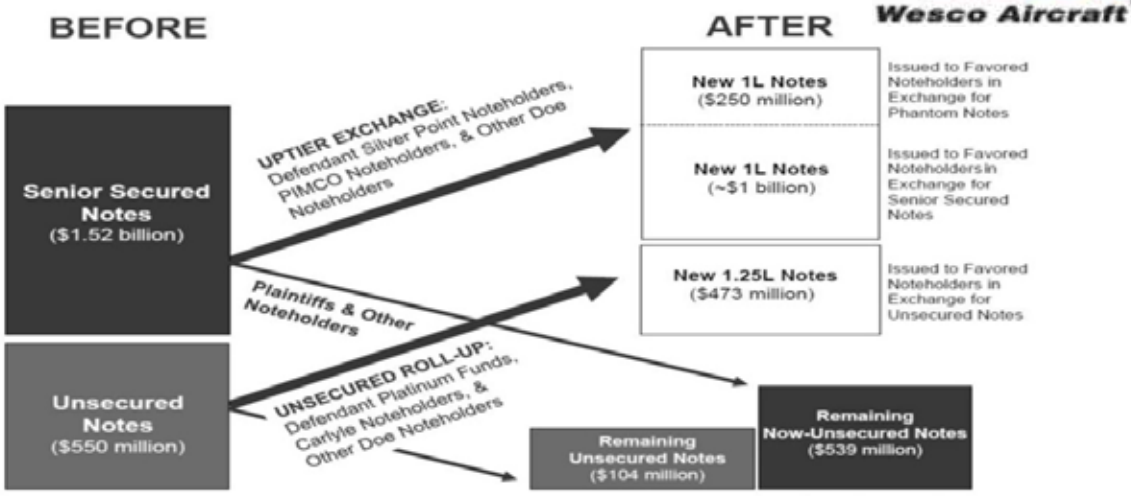
## Uptier Debt Exchange- Wesco




[Chart from https://restructuringinterviews.com/blogs/restructuring/serta-chapter-11]

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## Uptier Debt Exchange- Wesco – Litigation Update

As reported by Reorg Research, on June 26, 2024, during closing arguments, the Bankruptcy Court for the Southern District of Texas advised that, "at this stage" and "with a high degree of certainty," the court believes certain favored noteholders' injection of $250 million in an uptier debt exchange was "unauthorized."

The court agreed that with excluded noteholders that the "automatic" and "direct" effect of the supplemental indenture (which allowed the additional notes issuance to obtain the two-thirds consent to lien strip) was to "grant impermissible liens" to favored noteholders for their new-money loan. Thus, the court concluded that "the entire agreement" to undertake the uptier debt exchange was "void," and the 2026 noteholders' liens must be restored – including the 59% held by the favored lenders before the exchange.


## Uptier Debt Exchange- Wesco – Litigation Update

The Remedy?

- The court will not limit the excluded holders' remedy to an unsecured claim, which would give the favored holders the "entire benefit of their bargain knowing they cheated."
- The court may reshuffle the debtors' capital structure and is considering restoring liens securing all of the 2026 notes and leaving the favored holders with an unsecured claim for the $250 million in new money, a "terribly unfair result."
- The court suggested an equitable solution could be to discount excluded holders' recovery to reflect participating holders' new money - perhaps by creating a hypothetical pro rata version of the secured exchange.


Uptier Debt Exchange- Wesco – Litigation Update

Claims against (among others) the Indenture Trustee:

- Breach of Indenture
  - ❖ Declaratory relief that the defendants (including the indenture trustee) entered into agreements that were unauthorized by the governing indentures to modify excluded noteholders' rights by stripping them of their contracted-for liens and subordinating their payment priority to new notes provided to certain favored noteholders.
    - ❖ Claim dismissed on January 23, 2004 due to failure to allege indenture trustee's bad faith under Ind. Sec. 7.01. *Wesco Aircraft Holdings, Inc. v. SSD Invs. Ltd. (In re Wesco Aircraft Holdings, Inc.)*, 2024 Bankr. LEXIS 149 (Bankr. S.D. Tex. Jan. 23, 2024).


## Uptier Debt Exchange- Wesco – Litigation Update

Claims against (among others) the Indenture Trustee:

- Breach of Indenture
  - ❖ Sec. 3.02: Requires pro rata redemption of unsecured notes if less than all unsecured notes are being redeemed.
    - ❖ Summary judgment denied initially, subject to further review. *Wesco Aircraft Holdings, Inc. v. SSD Invs. (In re Wesco Aircraft Holdings, Inc.)*, 2024 Bankr. LEXIS 85 (Bankr. S.D. Tex. Jan. 14, 2024).
    - ❖ Claim dismissed on January 23, 2004 due to failure to allege indenture trustee's bad faith under Ind. Sec. 7.01. *Wesco Aircraft*, 2024 Bankr. LEXIS 149.


Uptier Debt Exchange- Wesco – Litigation Update

Claims against (among others) the Indenture Trustee:

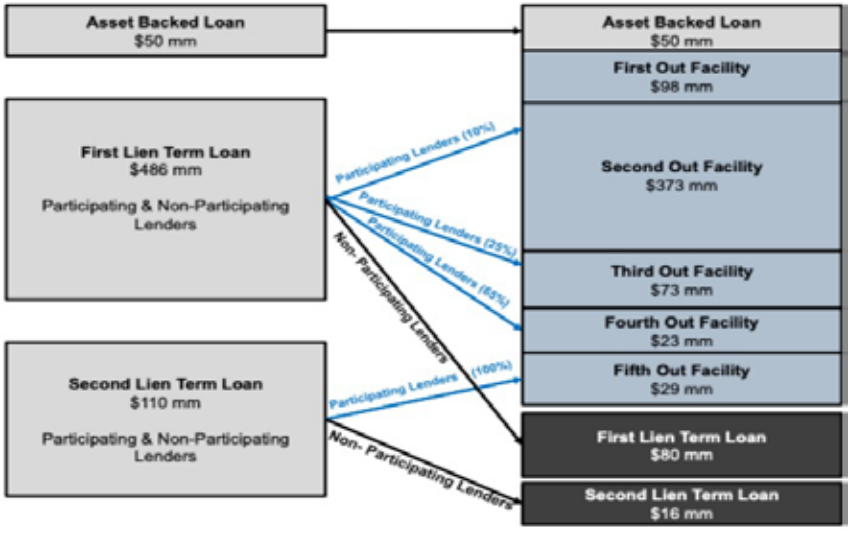
- ❖ Sec. 6.05: Permits majority holders to direct time, method, and place of the exercise of any trust or power conferred upon the trustee, but trustee "may" decline to follow direction that is unduly prejudicial to other holders or may involve the trustee in personal liability
  - ❖ Summary judgment denied initially, subject to further review. *Wesco Aircraft*, 2024 Bankr. LEXIS 85.
  - ❖ Claim dismissed on January 23, 2004. *Wesco Aircraft*, 2024 Bankr. LEXIS 149.


## Uptier Debt Exchange- Wesco – Litigation Update

Claims in which the Indenture Trustee (among others) was a Defendant:

- Breach of Indenture
  - ❖ Sec. 9.02: Requires consent of each affected holder to modify ranking of unsecured notes in respect of a right to payment that adversely affects noteholders
    - ❖ Summary judgment granted in favor of trustee. *Wesco Aircraft*, 2024 Bankr. LEXIS 85.
- Breach of Implied Covenant of Good Faith and Fair Dealing
  - ❖ Summary judgment granted in favor of trustee. *Id.*


## Uptier Debt Exchange- Robertshaw




[chart from https://petition.substack.com/p/another-failed-liability-management-bc6]


## Uptier Debt Exchange- Robertshaw – Litigation Update

After a six-day trial, on June 20, 2024, the United States Bankruptcy Court for the Southern District of Texas held that

- Robertshaw breached the credit agreement by failing to use 100% of the new loans for mandatory prepayments,
- the participating lender plaintiffs did not breach the credit agreement as they had no duties with respect to Robertshaw's prepayment duties,
- Robertshaw's equity sponsor did not tortiously interfere with the credit agreement for multiple reasons, including its economic interest.

*In re Robertshaw US Holding Corp.*, Case No. 24-90052 (CL) (Bankr. S.D. Tex. June 20, 2024) [Dkt. No. 351]



## Uptier Debt Exchange- Robertshaw – Litigation Update

After a six-day trial, on June 20, 2024, the United States Bankruptcy Court for the Southern District of Texas also held that

- Robertshaw, the participating lender plaintiffs, and the equity sponsor are entitled to a declaration that they did not breach the implied covenant of good faith and fair dealing under New York law.

  - ❖ "Based on the record before the Court, no one may claim a breach of the implied duty of good faith and fair dealing."


## Uptier Debt Exchange- Robertshaw – Litigation Update

The Remedy:

"New York law gives Invesco the right to assert money damages against Robertshaw for the prepetition breach of contract. Rescission of an amendment entered during the December Transactions is not required under New York law or warranted on this record. And this Court declines to exercise any equitable remedies."

*Memorandum Decision and Order, In re Robertshaw US Holding Corp. v. Invesco Senior Secured Mgmt. Inc.,*, Adv. No. 24-03024 (CL) (Bankr. S.D. Tex. June 20, 2024) [Adv. Dkt. No. 351]


## Asset Drop Downs

In an asset drop-down, a borrower utilizes its availability under restricted investment and transfer "baskets" in loan documents to transfer collateral away from the reach of existing secured parities by transferring the collateral to an entity that is designated as an "unrestricted subsidiary" (which is not an obligor on the existing secured debt)

The unrestricted subsidiary then uses the collateral (often intellectual property) to secure new financing.

Unlike uptier transactions, majority lender consent is not typically required.

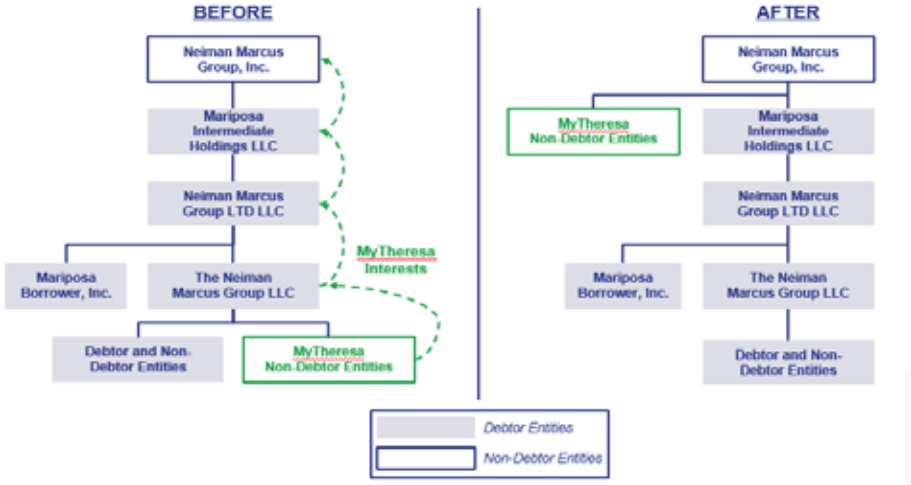

## Asset Drop Downs – Weapons

- Subsidiary payment and investment "baskets"
- Unrestricted or non-guarantor restricted subsidiary
- Power to designate subsidiary as unrestricted and release it from guarantee


## Asset Drop Downs – Examples

- J. Crew
- iHeart
- Neiman Marcus
- PetSmart / Chewy
- Revlon
- Frontier Communications
- iHeart Media
- Instant Brands
- Caesar's Entertainment
- Claire's Stores
- Party City
- U.S. RenalCare
- Envision (first transaction)
- Bausch Health
- Amsurg
- Shutterfly
- Carvana
- Dish


## Asset Drop Down – Neiman Marcus





## Asset Drop Down – Neiman Marcus - Litigation

On December 10, 2018, Marble Ridge (which rejected an exchange offer) sued Neiman Marcus in Texas state court alleging that the asset drop down constituted an actual and constructive fraudulent transfer.

On May 7, 2020, Neiman Marcus and certain of its affiliates filed voluntary chapter 11 petitions in the Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of Texas.

Under a chapter 11 plan, the creditors' committee resolved the asset drop down challenge in exchange for $10 million in cash, waiver of certain secured creditors' deficiency claims and approximately 56% of the series B preferred stock in MyTheresa.

3


## Double Dips

A "double dip" involves a secured loan to non-guarantor subsidiary. That borrower subsidiary then transfers the proceeds to an affiliate.

The affiliate then issues (i) a secured intercompany note to the non-guarantor subsidiary and (ii) a guaranty on the secured loan, both of which are collateral for the secured loan.

The lenders end up with two claims against the affiliate—a claim under the guaranty and an indirect claim under the secured intercompany note.


## Double Dips (Pari Plus)

A "pari plus" financing is a double dip transaction with additional credit support for the new money loan, such as  a guarantee from an additional guarantor outside the existing obligor group.


## Double Dips

Unlike uptier debt exchanges, where the new financing comes from existing "Majority" or "Required" lenders" with authority to amend the loan documents to authorize the new financing, the financing in a double dip transaction can come from third-party lenders (or a combination of existing and third-party lenders).

Unlike asst drop downs, double dip financing does not require an asset transfer.


## Double Dips – Weapons

- Non-guarantor subsidiary
- Debt/lien/investment baskets
- *Ivanhoe Bldg. & Loan Assn. v. Orr*, 295 U.S. 243 (1935) (reaffirmed in *RFC v. Denver & Rio Grande W. R.R. Co.*, 328 U.S. 495 (1946))
  - Under *Ivanhoe*, a creditor may file a proof of claim for the full amount it is owed by a debtor even if it has recovered or may recover all or a portion of that amount from a non-debtor.
  - *Nuveen Mun. Trust v. Withumsmith Brown, P.C.*, 692 F.3d 283, 295 (3d Cir. 2012)


# Double Dip – Examples

- At Home
- Wheel Pros
- Amsurg
- Sabre (pari plus)
- Trinseo
- Rayonier Advanced Materials

# Faculty

**Kurt F. Gwynne** is the global head of the Restructuring & Insolvency Group of the Wilmington, Del., office of Reed Smith LLP and the former managing partner of the firm's Delaware office. He also practices in the firm's New York office and is a member of the firm's Financial Industry Group, with more than 25 years of experience in restructuring, insolvency and related litigation. Mr. Gwynne has served as a court-appointed expert, a court-appointed examiner and a court-appointed trustee in chapter 11 cases. In addition, he has represented indenture trustees, secured creditors, creditors' committees, debtors and other parties in interest in bankruptcy cases throughout the U.S. and its territories. Mr. Gwynne is a Fellow of the American College of Bankruptcy (23rd Class) and is recognized in *Chambers USA: America's Leading Lawyers* as a "Band 1" reorganization/bankruptcy attorney in Delaware. In 2010, he was selected as one of the "10 Most Admired Bankruptcy Attorneys" in the U.S. by *Law360*. He also is recognized in *The Best Lawyers in America* and *Delaware Super Lawyers*. Mr. Gwynne received his B.A. *summa cum laude* in political science, with a minor in business administration, from the University of Central Florida in 1988 and his J.D. in 1992 from the University of Pennsylvania Law School, where he was a senior editor of the *Journal of International Business Law* and a winner of Penn's Edwin R. Keedy Cup Moot Court Competition. Following law school, he clerked for Hon. Bruce Fox of the U.S. Bankruptcy Court for the Eastern District of Pennsylvania.

**Mark B. Joachim** is co-leader of Polsinelli's Special Situations Investing Team in Washington, D.C., and has more than 30 years of experience representing distressed businesses, boards of directors, special committees, independent directors, debtor-in-possession lenders, distressed-debt investors, official committees, ad hoc groups of creditors in connection with special situations, corporate restructurings, liquidity and liability management transactions, recapitalizations, and in- and out-of-court restructurings. He is frequently called upon to advise boards of directors, board committees and senior management of financially troubled companies on a range of issues, including corporate governance and fiduciary duties. In addition to his work in the corporate restructuring arena, Mr. Joachim also represents equity sponsors and borrowers, as well as first- and second-lien lenders, in senior debt, mezzanine and private-equity financing arrangements. His experience and capabilities on the "new money" side of his practice allows him to formulate and implement novel and creative structures and strategies in the context of financially troubled situations. Mr. Joachim received his B.A. in 1989 in political science and philosophy from Stony Brook University and his J.D. in 1992 with distinction from Hofstra University School of Law, where he is managing editor of the *Hofstra Law Review*.

**Ericka F. Johnson** is the chair of the restructuring and reorganization practice at Bayard, P.A. in Wilmington, Del. She advises companies and creditors to maximize the value of assets/recoveries, whether it is through an in-court or out-of-court financial restructuring or dissolution. She also helps buyers navigate the purchase of distressed assets and directors and officers in understanding fiduciary duties in an insolvency setting. Ms. Johnson is a top advocate with a diverse practice spanning a wide range of industries. She has represented debtors in large and small chapter 11 and chapter 7 cases both inside and outside Delaware. She also regularly litigates contested matters, including involuntary bankruptcies, motions for the appointment of chapter 11 trustees, claim objections, plan-confirmation objections and dismissal/conversion motions, as well as bankruptcy adversary matters, including preference, fraudulent transfer, turnover, and breaches of contract and fiduciary duty actions. Ms.

Johnson formerly worked for a leading bank holding company, where she managed consumer finance operations and internal risk assessments and audits from the U.S. Office of the Comptroller of the currency. She is an at-large director on ABI's Executive Committee and she is a member of the International Women's Insolvency & Restructuring Confederation (IWIRC), for which she chairs its Delaware Network. Ms. Johnson is a published author and a frequent speaker on issues and developments in bankruptcy and insolvency law. She received her B.A. from the University of Delaware and her J.D. from Delaware Law School, where she was a member of the Phi Kappa Phi Honor Society, president of the Moot Court Honor Society and a member of the *Delaware Journal of Corporate Law*, and received the Outstanding Service Award.

**Hon. Michael B. Kaplan** is Chief U.S. Bankruptcy Judge for the District of New Jersey in Trenton, initially appointed on Oct. 3, 2006, and named Chief Judge on May 1, 2020. Prior to taking the bench, Judge Kaplan served as a standing chapter 13 bankruptcy trustee, as well as a member of the chapter 7 panel of bankruptcy trustees, where he received case appointments as both a chapter 11 and chapter 12 trustee. His private practice included the representation of institutional lenders consumer debtors (under both chapters 7 and 13), business debtors and individuals undergoing reorganization pursuant to chapter 11. Judge Kaplan is a Fellow of the American College of Bankruptcy and has been appointed by the director of the Administrative Office of the U.S. Courts (AOUSC) to a term as the Third Circuit representative to the Bankruptcy Judges Advisory Group, in addition to appointments as the bankruptcy judge representative for the Risk and Finance Management Advisory Council, Human Resources Advisory Council and Budget & Finance Advisory Council to the AOUSC. As a member of the National Conference of Bankruptcy Judges, Judge Kaplan has served as treasurer and executive board member. He serves currently as a member of the Judiciary Advisory Council for the Rabiej Litigation Law Center. Over the past 30 years, he has spoken to numerous bar associations and business organizations, and since 2009 he has taught as an adjunct professor at Rutgers University School of Law. Judge Kaplan has authored several articles relating to bankruptcy issues and is a co-author of West's *Consumer Bankruptcy Manual* and *Consumer Bankruptcy Handbook*. He received the NCBJ President's Award for Excellence, the Conrad B. Duberstein Memorial Award given by the New York Institute of Credit, the Judicial Service Award from the Association of Insolvency and Restructuring Advisors, the National Association of Chapter 13 Trustees' 2006 Distinguished Service Award and New Jersey State Bar Association's 1999 Legislative Recognition Award. Prior to taking the bench, Judge Kaplan served as mayor and councilman for the Borough of Norwood, N.J., and as a member of the Norwood Planning Board. He received his A.B. from Georgetown University in 1984 and his J.D. from Fordham University School of Law in 1987.

**Robert B. Winning** is a managing director with M3-Partners, LP in New York, where he advises official committees, debtors, lenders, and acquirers of businesses and assets in distressed situations across industries. He has worked with clients through roughly 50 complex chapter 11 cases and out-of-court restructurings, and routinely develops, negotiates and challenges comprehensive restructuring transactions. Most recently, Mr. Winning was a partner at AlixPartners, and prior to that he was special counsel at Cooley LLP. He leverages his experience as both an attorney and a financial advisor. Mr. Winning's notable engagements include advising official committees in the chapter 11 cases of GWG Holdings, Chesapeake Energy, Boy Scouts of America, 24 Hour Fitness, Century 21 Department Stores, Claire's, Republic Metals, Orchard Brands, Radioshack, Mervyn's, Fusion Connect, Brookstone, Atari, Midway Gold, Marsh Supermarkets, KIT digital, Violin Memory, Pacific Sunwear, Blockbuster, Frederick's of Hollywood, Deb Shops, Vertis Holdings and Celadon Trucking.

In 2018, he was selected by the American Bar Association for its "Top 40 Young Lawyers" award. He also is chair of the Governance and Audit committees of the Board of Commonpoint Queens, a nonprofit social services organization that reaches more than 50,000 members of its community each year. Mr. Winning received his undergraduate degree *summa cum laude* from Washington University in St. Louis and his J.D. from Columbia University School of Law, where he was a James Kent Scholar.