AMERICAN BANKRUPTCY INSTITUTE

Southeast Bankruptcy Workshop

The Rise of Private Credit

CONCURRENT SESSION

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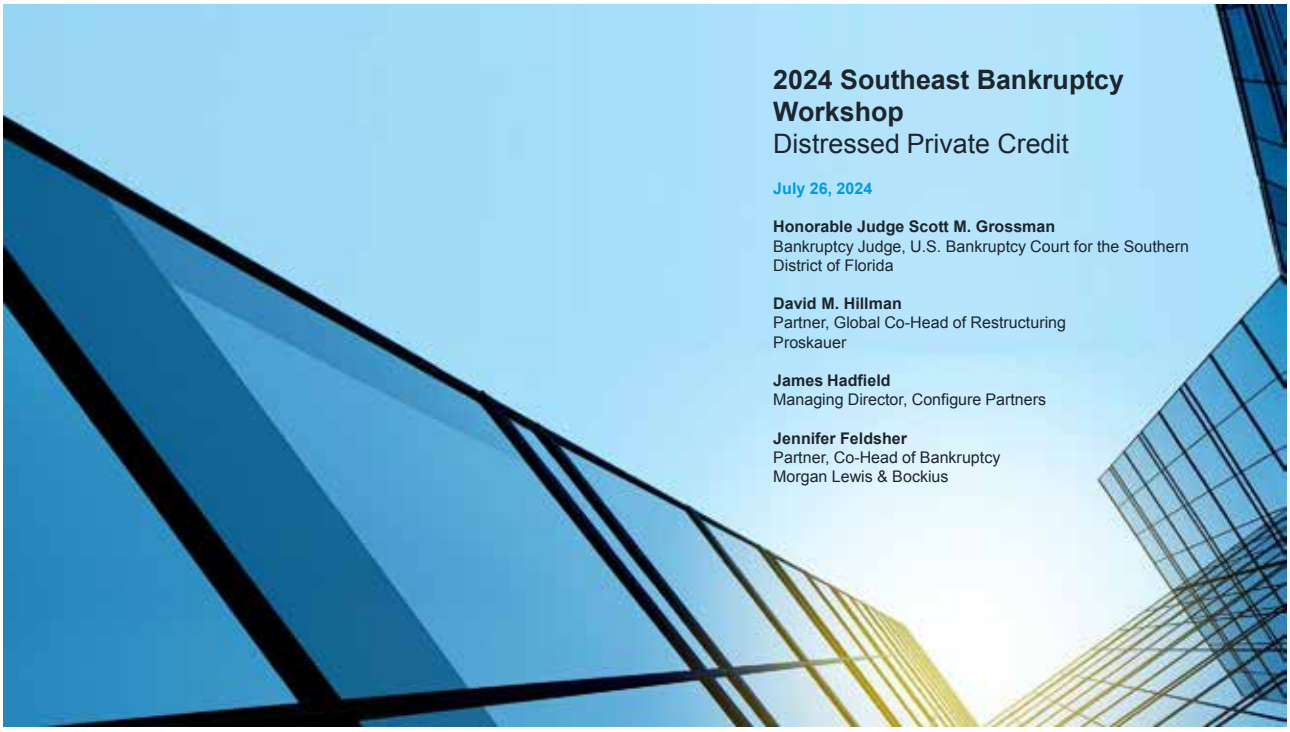
2024



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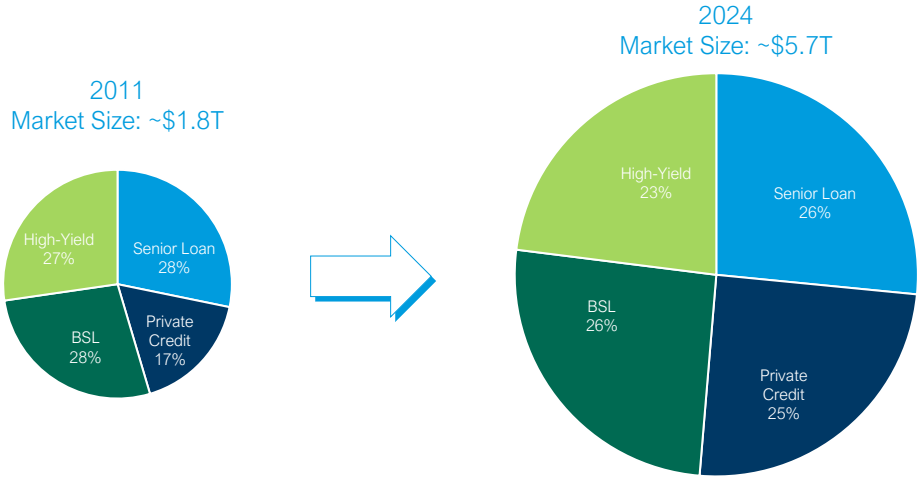
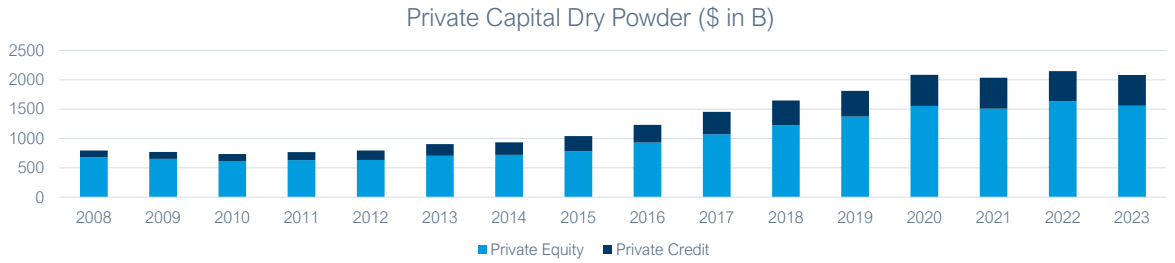
What is Private Credit?

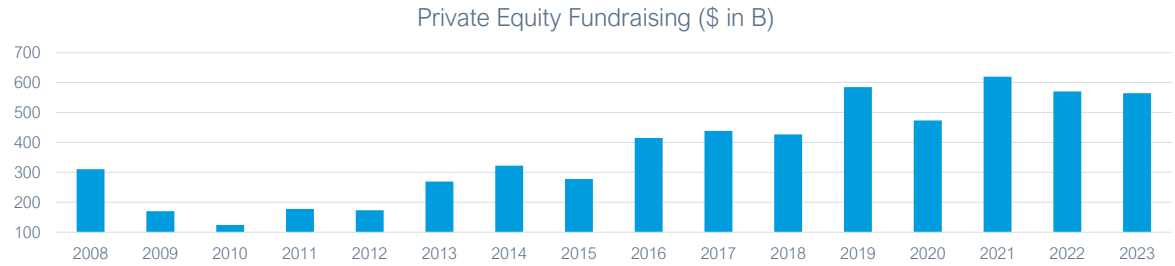


Source: Private Debt Investor, Morgan Stanley

*U.S. Debt Market sizes excluding corporate investment grade bonds

Market Statistics



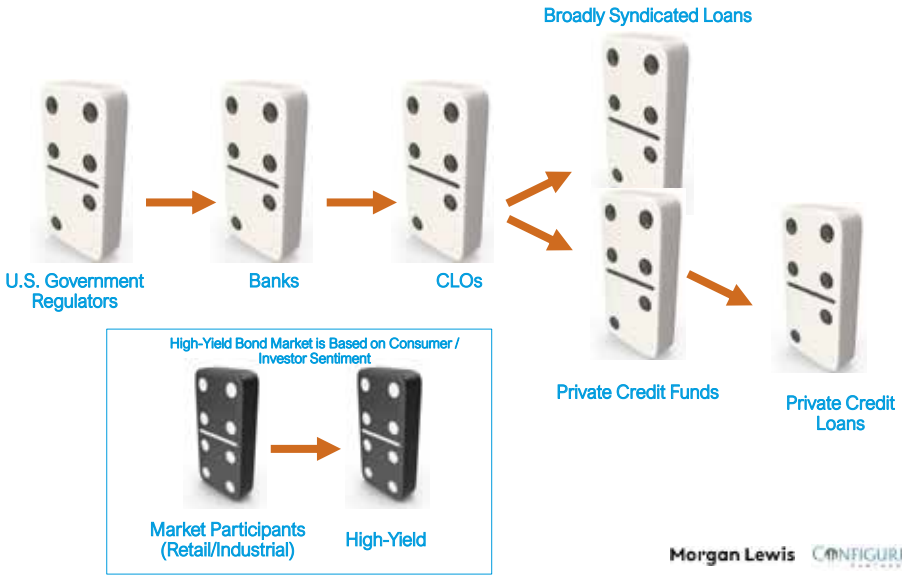


Key Differences in Private Credit vs Broadly Syndicated Loans

Key Considerations – Stakeholder Motivations			
Banks	Private Credit	Bond Holders	BSL Holders
Performing debt vs. in workout	Par holder	Par vs. 80 cent buyers vs. 50 cent buyers Advisor to bondholder group often calling shots; usually a larger financial advisor or investment bank	Par vs. 80 cent buyers vs. 50 cent buyers Advisor can be calling shots, but often 1 or 2 larger hedge funds are controlling behind the scenes

- *Stakeholders driving the process for a distressed business can have dramatically different motivations and behavior*

Ratings / Marks / Regulation



Out of Court Transactions

- Restructurings defy a one-size fits all approach because every deal is unique and different tools are required to solve different problems.
- Bankruptcy is expensive, time-consuming and introduces significant legal, financial and operational uncertainty. But also comes with advantages in asset sales or to right-size footprints or address litigation liabilities.
- In the middle of these scenarios are debt for equity transactions that can be implemented out of court through different legal structures.
- A company facing distress may have a viable restructuring path by working with its lenders to raise additional capital to bridge its liquidity needs and to eliminate funded debt from its balance sheet in an out of court change of control transaction. While this type of transaction can fix a broken balance sheet more quickly and cost effectively than chapter 11, it will not fix a broken business.

Factors Driving Success of OOC Transactions

Factors driving success of out-of-court change of control transaction involving a debt-for-equity swap:

1. Consent
   - Borrower consent and cooperation are critical features of an out of court change of control transaction.
2. Scope of Problem: Debt v. Operations
   - A debt for equity change of control transaction will not — without more — fix a company's operational problems and is therefore best suited for fundamentally sound companies that have an excessive debt relative to earnings capacity.
3. Existence of Legacy Liabilities
   - A debt for equity transaction is equally ineffective at addressing the needs of companies suffering from so-called "legacy liabilities."
4. Limited Change of Control Consequences
   - Navigating change of control implications in key contracts is critical for an out of court change of control transaction.
5. Managing Elevated Risk Profile
   - The are various risks involved in an out of court transaction, such as potential claims for successor liability and fraudulent transfer.
6. Aligning Employment Incentives
   - Lenders engaging in debt for equity transactions must work with management to recalibrate and restructure equity awards, bonuses and change in control payments.
7. Tax Efficient Structuring
   - The success of an out of court transaction may depend on whether tax risks can be successfully neutralized in a tax efficient structure.

Board Flips
How Effective is the Pre-Petition Exercise of Proxy Rights in the Face of Bankruptcy?

- What is a “Board Flip”?
  - Distress happens, even at companies that once appeared financially solid. When it does, the company, its board, and its lenders often enter into restructuring discussions in search of a consensual path forward.
  - However, in the event debt restructuring discussions are at an impasse, lenders may replace a borrower’s board of directors with a new board made up of independent directors through the exercise of proxy rights.
- Should a “Board Flip” be unwound in bankruptcy?
  - Some have argued that a board flip should be unwound if the parent holding company promptly files for bankruptcy and makes a demand on the lender to relinquish voting control over the borrower, arguing that such voting control violates the automatic stay provisions of the Bankruptcy Code prohibiting creditors from controlling estate property or from attempting to collect a debt after the filing.
- The “CII Decision”
  - Judge Laurie Selber Silberstein of the United States Bankruptcy Court for the District of Delaware, in an April 2023 decision squarely rejected this position.

Golden Shares

- What is a “Golden Share”?
  - A "golden share" refers to an equity interest in a company that affords the owner a number of consent rights. A key right is the right to block a company from filing for bankruptcy. Private credit lenders may rely upon a "golden share" structure when making preferred equity investments or in connection with a loan restructuring.
- The Checkered History of the Enforceability of the "Golden Share" in Delaware
  1. *In re Intervention Energy Holdings, LLC*, 553 B.R. 258 (Bankr. D. Del. 2016)
     - The Delaware Bankruptcy Court deemed a "golden share“ provision entered into between a company and a secured creditor as unenforceable, as the secured creditor was only a nominal unitholder and was primarily a creditor which, unlike a director, does not owe any fiduciary duties to the company.
  2. *In re Franchise Services of North America, Inc*., 891 F.3d 198 (5th Cir. 2018)
     - The Fifth Circuit Court of Appeals came to a different conclusion, upholding a “golden share” provision, were it was held by a preferred shareholder.
  3. *In re Pace Industries, LLC*, Case No. 20-10927-MFW (Bankr. D. Del. 2020)
     - Recently, Judge Walrath, of the Delaware Bankruptcy Court, deemed a “golden share” provision unenforceable, holding that permitting the bankruptcy filing would likely benefit the greatest number of stakeholders, while dismissing the bankruptcy case would violate federal public policy by taking away a debtor's constitutional right to bankruptcy relief.

Relationship Between Private Credit and Private Equity

- Unlike in BSL and HY environment where investment banks source product that is syndicated or sold to investors, Private Credit funds are a primary sources and issuers of credit
- Actions taken, like board flips, (especially those that become public knowledge) can therefore impact the ability of private credit funds to source business from sponsors (and other lenders)
- Why other lenders?
  - Unlike BSL where an agent investment bank syndicates, private credit is often clubbed up and therefore lenders bring other lenders into the deals. Actions one takes to advantage themselves against other lenders has reputational and sourcing consequences.
- So the key question is, what's more important to the lender. Maximum recovery or continued deployment or access to new loans to grow AUM?

Liability Management

- Debt funds are responding to an increasing number of distressed loans
- Despite the desire to stay out of court, the ability to do so may be more difficult going forward
  - Competition has stretched available collateral and with limited unencumbered assets, restructuring debt becomes more challenging
- Alongside liability management transactions, cooperation agreements continue to increase and expanding, representing a trend aimed toward broader lender consensus
- Co-op agreements have evolved into sophisticated arrangements covering a variety of aspects in a restructuring
- Similarly, private credit club deals have increased and expanded in transaction size

Faculty

Jennifer Feldsher is a partner with Morgan, Lewis & Bockius LLP in New York and is a co-leader of its bankruptcy, restructuring and insolvency practice. Her primary focus is representing secured creditors, private credit providers, special situations investment funds and other major stakeholders in bankruptcy proceedings, § 363 sales, and in-court and out-of-court complex corporate debt restructurings and recapitalizations. She also represents troubled corporate debtors in reorganizations, asset sales, loan restructurings and commercial loan transactions. Ms. Feldsher has directed all aspects of the bankruptcy process for debtors and creditors. She has experience in chapter 11 plan formulation and confirmation, relief-from-stay and cash-collateral negotiations, and debtor-in-possession (DIP)/exit-financing negotiations. She also routinely advises on innovative financing solutions, intercreditor agreement terms and enforcement, and "zone of insolvency" issues and fiduciary duties. Ms. Feldsher has acted as counsel to companies involved in many of the largest restructurings in retail, commercial real estate, energy, telecommunications, technology, airline, automotive, gaming and financial services industries. Her recent public engagements include representing the prepetition syndicate agent and lenders in multinational REIT Eagle Hospitality Group's restructuring and chapter 11 cases, the prepetition agent and lenders in the chapter 11 cases of Bowflex, Rockport Shoes, Polished Appliances, ArtVan Furniture and Guitar Center, the agent and second-lien lenders in Teligent, Inc., the agent and first-lien lenders in the McClatchy chapter 11 cases, a significant warehouse lender in the First Guaranty Mortgage chapter 11 cases, a global bank in connection with the out-of-court restructuring of Archegos Capital Management, and Bruker Corp. in connection with its acquisition of Nanostrings Technologies. Ms. Feldsher received her B.A. in 1997 from Columbia University and her J.D. in 2000 from Georgetown University Law Center.

Hon. Scott M. Grossman is a U.S. Bankruptcy Judge for the Southern District of Florida in Fort Lauderdale, sworn in on Oct. 2, 2019. He previously was a shareholder with a large international law firm in its global restructuring and bankruptcy practice, and he represented distressed companies, debtors, secured and unsecured creditors, official committees, trustees, landlords and purchasers of distressed assets, and worked on bankruptcy cases across various industries, including real estate, hospitality, health care, entertainment, banking, technology, energy and financial fraud. While primarily involved in chapter 11 reorganizations, he also represented clients in out-of-court workouts and restructurings, chapter 7 liquidations, receiverships, assignments for the benefit of creditors and insolvency-related litigation. Judge Grossman was active in local bar activities, including having served as president of the Bankruptcy Bar Association of the Southern District of Florida. When in private practice, he was listed in *Chambers USA*, *The Best Lawyers in America* and *Super Lawyers* magazine, and was a member of the winning teams for the Global M&A Network's Turnaround Atlas Awards for both "Cross Border Special Situation M&A Deal (Small-Mid Markets)" in 2019, as well as "Turnaround of the Year — Small Markets" in 2015. Judge Grossman began his legal career in the Attorney General's Honors Program at the U.S. Department of Justice, where he was a trial attorney in the Tax Division, Civil Trial Southern Section, from 1999-2004. He received his B.S. in 1996 from the University of Florida and his J.D. in 1999 from George Washington University Law School.

James S. Hadfield is a co-founder and managing director at Configure Partners in Atlanta, a boutique investment bank that specializes in debt placement, credit resolution, special situations and M&A

advisory. Over his career, he has held a variety of positions across middle-market credit, investing and advisory platforms. Prior to joining Configure, Mr. Hadfield was a managing director at Guggenheim Securities, which he joined in 2013 to expand Guggenheim's reach in the middle market. Before joining Guggenheim, he established the Atlanta office for Cerberus Capital Management with a focus on direct lending and equity investment activities. While at Cerberus, his responsibilities included sourcing of new debt and equity investment opportunities, underwriting transactions, and portfolio management. Prior to joining Cerberus, Mr. Hadfield spent three years at Houlihan Lokey after beginning his career at IBM and Standard & Poor's. He is a FINRA General Securities Registered Representative (Series 24, 7 and 63).

David M. Hillman is a partner with Proskauer LLP in New York, and co-head of both its Private Credit Restructuring Group and its Business Solutions, Governance, Restructuring & Bankruptcy Group. He has nearly 30 years of experience with an emphasis on representing private credit lenders, private funds, sovereign wealth funds and other alternative lenders and distressed investors in special situations and restructurings, both in and out of court. Mr. Hillman has substantial experience in every phase of restructuring and distressed investing, including credit-bid sales under § 363, debt-for-equity swaps, chapter 11 plans, out-of-court restructurings and foreclosures, as well as navigating intercreditor issues involving liability management transactions the relative rights of majority and minority lenders. He also litigates the issues facing private credit lenders, including issues involving plan confirmation, solvency, valuation, intercreditor disputes, financing and cash-collateral disputes, fraudulent transfers, equitable subordination, recharacterization, breach of fiduciary duty and similar disputes. Mr. Hillman was listed as a "leading individual" in bankruptcy/restructuring by *Chambers USA* and in *New York Super Lawyers* as well. An ABI member, he speaks frequently on bankruptcy-related topics, including recent decisions affecting secured creditor rights and preparing creditors for bankruptcy risks. Mr. Hillman received his B.A. *cum laude* from the State University of New York at Oneonta and his J.D. *cum laude* from Albany Law School, where he was associate editor of the *Albany Law Review*.