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# Liability Management or Opportunity Run Amok: Debt Restructuring Transactions 2.0

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## I. Recent Liability Management Transactions

## II. Sponsor Participation

An ever-increasing number of private equity sponsors have used liability management techniques to address the capital structure needs of their portfolio companies.

- Industry observers expect this list to grow.
- There is little evidence suggesting that sponsors will suffer repercussions in future transactions.

## III. Liability Management Overview

Companies are increasingly pursuing out-of-court liability management transactions to address their capital structure goals.

- These transactions tend to be bespoke and require detailed legal and financial diligence to address the company's goals while adhering to restrictions in applicable debt documents. In all scenarios, compliance with governing debt documents is key to mitigating risk while deploying strategies and pursuing transactions.

- Potential Capital Structure Goals

  - Extend maturity runway
  - Reduce cash debt service requirements (e.g., interest, amortization)
  - Capture trading discount and deleverage
  - Augment liquidity
  - Relax financial covenants

- Considerations

  - Debt document flexibility/restrictions
  - Stakeholder motivations
  - Cross-holder dynamics
  - Tax
  - Litigation risk/appetite
  - Credit default swap dynamics
  - Ratings impact

- Analysis of Key Debt Document Provisions

  - Permitted investments
  - Permitted debt / liens
  - Sale-leaseback
  - Asset sales / prepayments
  - Pro rata sharing / lien subordination and releases
  - Unrestricted / non-guarantor subsidiaries

- Potential Liability Management Transactions

  - Uptier exchanges
  - Drop-down exchanges
  - Amend & Extend transactions
  - Discounted debt buybacks

**IV.** "There is nothing in the law that requires holders of syndicated debt to behave as Musketeers. To the extent such holders want to be protected against self-interested action by borrowers and other holders, they must include such protections in the terms of their agreements." – Judge Craig Goldblatt, TPC Group

## V. Liability Management Transactions in the Loan Market

- In contrast to liability management transactions in the loan market, exit consents, uptiering, and drop-down transactions have been commonplace in the bond market for many years, whether or not the opportunity to participate in those transactions is offered to all bondholders.

- Despite a convergence in investor base (and covenants) between the two markets, the importation of bond market strategies has, in many cases, frustrated traditional expectations of loan market participants. Those strategies include:

  – Pro rata treatment on payments and recoveries (or at least an equal opportunity to participate)
  – Seniority in the capital structure
  – Amendments voted on only by lenders with a continuing exposure post-amendment (contrast exit consents)
  – Limitations on leakage from the credit group (e.g., via investments in non-guarantors)
  – Dynamics between lenders and agents

- "Lender-on-lender violence" has therefore become an increasingly common feature of liability management transactions that continues to surprise the syndicated loan market.

## VI. Liability Management—Uptiering Exchanges

The most common type of uptiering exchange is when a company offers to exchange unsecured bonds for a lower principal amount of secured bonds that are either *pari passu* with or subordinated to the company's existing secured debt (e.g., "1.5 lien" or second lien).

- More generally, an uptier exchange can be any transaction in which a debtholder betters its position, either by (i) gaining liens on collateral or improving its position with respect to such collateral (i.e., moving from second to first lien) or (ii) improving its payment priority.

| ILLUSTRATIVE UPTIERING EXCHANGE | BENEFITS / CONSIDERATIONS |
|---|---|
| | **Benefits to Borrowers** |
| **1. Company exchanges $600mm of unsecured notes for $400mm of new second lien notes (66.67% offer price)**<br>▪ Exchange at discount to par provides $200mm of deleveraging<br>▪ Exchange typically conducted at a premium to market prices | ▪ Delevers through discount capture<br>▪ Can be used to address maturities, reduce cash interest expense, relax covenants, etc.<br>▪ Can provide liquidity injection to company by requiring exchange participants to also provide new money (i.e., a "pay-to-play" exchange) |

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**2. Participating unsecured noteholders receive improved position by gaining second lien on collateral in exchange for discount capture provided to company / residual stakeholders**

- Participating noteholders de-risk downside exposure while capping upside
- Participating noteholders improve position relative to non-participating noteholders

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- Exit consents to strip covenants can be used to incentivize participation
- Not the “last” transaction: Thoughtful structuring can create opportunities for future exchange transactions

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<tr><th>Capital Structure</th><th>Considerations</th></tr>
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<tr><th></th><th>FACE VALUE</th><th>ADJ.</th><th>PF VALUE</th><th>CURRENT LEVERAGE</th><th>PF LEVERAGE</th></tr>
<tr><td>ABL Facility</td><td>$ —</td><td>$ —</td><td>$ —</td><td>0.0x</td><td>0.0x</td></tr>
<tr><td>Term Loan</td><td>1,200</td><td>—</td><td>1,200</td><td>6.0x</td><td>6.0x</td></tr>
<tr><td>New Second Lien Notes</td><td>— 1</td><td>400</td><td>400</td><td>0.0x</td><td>2.0x</td></tr>
<tr><td>Total Secured Debt</td><td>$1,200</td><td>$400</td><td>$1,600</td><td>6.0x</td><td>2 8.0x</td></tr>
<tr><td>Unsecured Notes</td><td>1,000</td><td>(600)</td><td>400</td><td>5.0x</td><td>2.0x</td></tr>
<tr><td>Total Debt</td><td>$2,200</td><td>($200)</td><td>$2,000</td><td>11.0x</td><td>10.0x</td></tr>
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*Discount to company / residual stakeholders*

**Memo**: Illustrative LTM EBITDA of $200 million
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- Often requires scarcity value to incentivize participation
  - At conflict with hold-out problem; limits uptier exchanges’ ability to provide for a comprehensive capital structure solution
- Can give rise to substantial cancellation of debt income
- Agents (particularly commercial banks) may not be willing to participate and will need to be replaced
- Maintaining confidentiality and avoiding the “Serta Mistake”

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## VII. The “New” Way—Uptiers in Credit Agreements

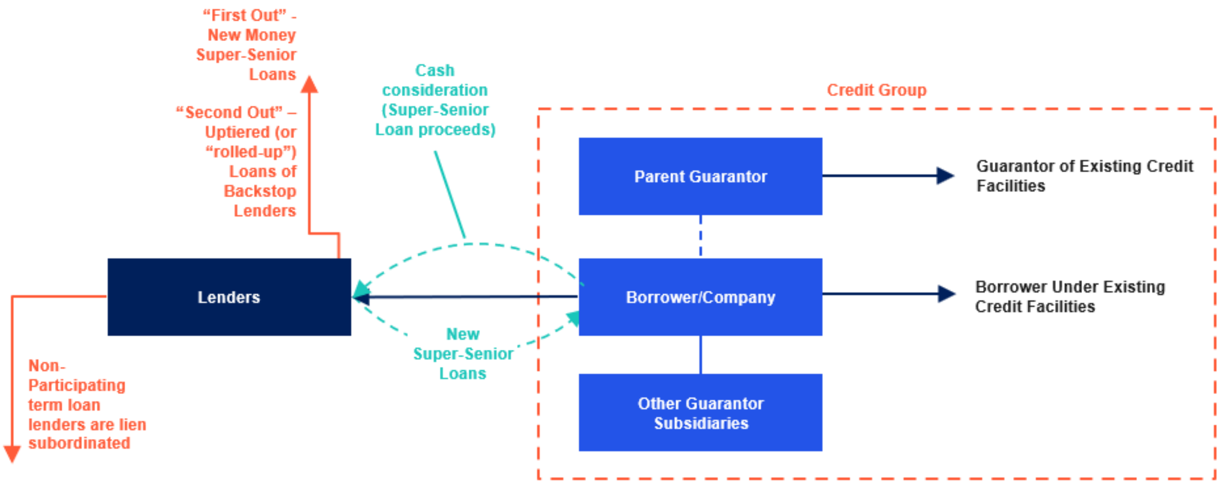
Illustrative Loan Buyback with Exit Consent

- This creates uptier opportunity in first lien only capital structures where none previously existed. Here’s how it works:
  - Certain lenders (the “Backstop Lenders”) constituting a majority under the loan agreement (or new lenders acquiring term loans in contemplation of this transaction) agree to provide a new loan that will rank senior in lien and/or payment priority to the existing loans (the “Super-Senior Loans”).
  - The Backstop Lenders utilize the open market purchase provisions to uptier, sometimes at par, their existing loans into the facility evidencing the Super-Senior Loans.

- Prior to consummating the open market purchase, the Backstop Lenders also amend the existing loan agreement to (i) permit the incurrence and senior priority of the Super-Senior Loans, (ii) direct the agent to enter into an intercreditor agreement, and (iii) strip covenants (similar to an exit consent in the bond context), leaving the non-consenting lenders with lien and/or payment subordinated loans without covenant protections.

- These transactions require only majority consent under the loan agreement on its plain terms and leave non-consenting lenders without covenant protections and with liens and/or payments subordinated to those of the Backstop Lenders.

- Objecting non-consenting lenders may seek to litigate a proposed uptiering transaction on the grounds that it constitutes a violation of their sacred rights that would require the consent of all affected lenders under the loan agreement rather than the majority consent threshold proposed by the Backstop Lenders.



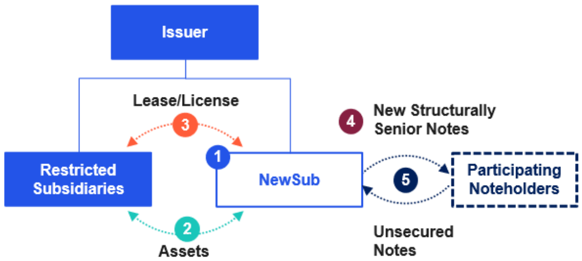

Note: The old loans are purchased by the borrower with the new "second out" loans. This can be done on a cashless basis.

## VIII. Liability Management—"Drop-Downs"

In a "drop-down," a company places certain assets into an unrestricted subsidiary or designates a restricted subsidiary as unrestricted and then uses such assets as negotiating leverage or collateral for new financing or new debt securities which are offered in an exchange for existing debt instruments.

- Unrestricted subsidiaries are not subject to debt document covenants, including debt incurrence and lien restrictions.

| ILLUSTRATIVE "DROP-DOWN" EXCHANGE | BENEFITS / CONSIDERATIONS |
|---|---|
| | **Benefits to Borrowers** |
| **1. Form an unrestricted subsidiary ("NewSub")**<br>♦ Unrestricted subsidiaries are not subject to covenants under debt documents<br>**2. Company contributes assets to NewSub**<br>♦ Requires permitted investments and/or asset sale basket capacity<br>**3. Company enters into intercompany agreements (e.g., leases, licenses, and other services) so that the transferred assets can be utilized by the restricted subsidiaries**<br>**4. NewSub issues and guarantees new debt, the "New Structurally Senior Notes"**<br>♦ Notes have structural seniority with respect to the assets in NewSub<br>**5. Company exchanges current debt for the New Structurally Senior Notes at a discount and/or raises new money** | ▪ Delevers through discount capture<br>▪ Can be used to address maturities, reduce interest expense, relax covenants, etc.<br>▪ In certain situations, noteholder appetite may be even greater than a secured debt exchange<br>♦ If secured debt is trading below par, structural seniority to the transferred assets is often viewed more favorably<br>♦ Appetite will be materially influenced by the type of assets contributed to the unrestricted subsidiary<br>▪ Exit consents to strip covenants can be used to incentivize participation |

| | |
|---|---|
| | |
| <br> | **Considerations**<br>▪ Should be structured to mitigate fraudulent conveyance and fiduciary duty challenges by creditors<br>▪ Gives rise to substantial cancellation of debt income<br>▪ Unconventional structure may invite litigation from creditors<br>▪ Practical difficulty in identifying assets that could be contributed to the unrestricted subsidiary<br>▪ Ability to obtain and/or evidence lien releases by agent<br>▪ Impact on underlying business |

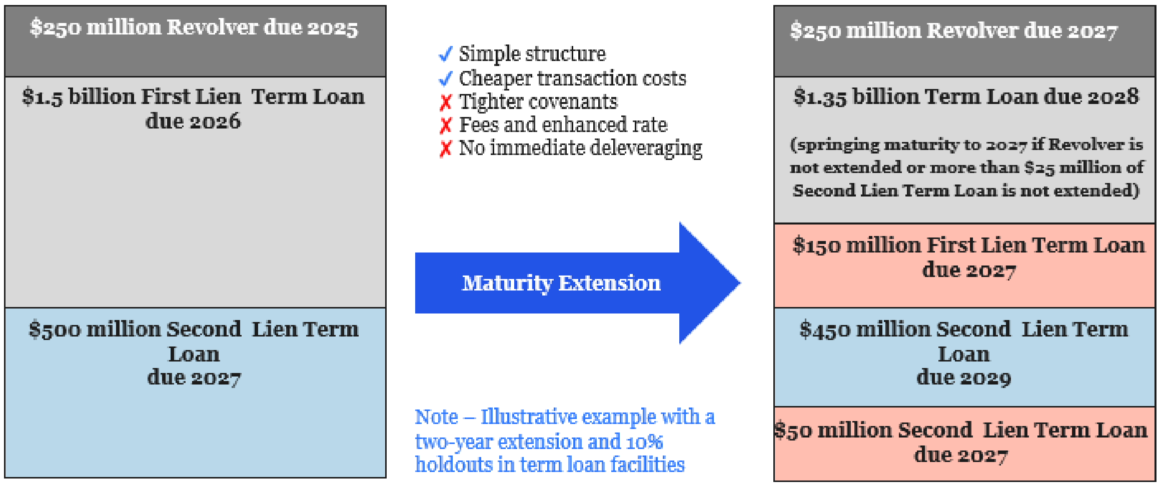
## IX. Amend & Extend

An Amend & Extend ("A&E") transaction provides companies with a maturity extension in exchange for additional economics and certain credit enhancements for participating lenders.

- A variety of "carrots" and "sticks" can be used to incentivize holders to participate in the transaction and reduce the risk of "holdouts."
  - Key carrots include improved rate, make-wholes, fees, enhanced covenants, par paydown, and greater collateral coverage.
  - Key sticks include exit consents provided by transaction participants to subordinate liens and strip covenants.

- Company can require non-consenting lenders to sell their loans (at par) if a majority of lenders of such tranche elects to extend maturity (but it **cannot force non-consenting lenders to agree** to the extension).

| BENEFITS TO BORROWERS | CONSIDERATIONS |
|---|---|
| ▪ Provides management time to execute on its business plan and "grow" back into its capital structure<br>▪ Generally cheaper form of capital relative to raising new primary issuance<br>▪ Not mutually exclusive from other exchange alternatives that a company may need to pursue<br>  ♦ A&E transactions, via amendments to more restrictive senior debt, can provide for additional flexibility in crafting exchanges targeting junior creditors | ▪ Fees and enhanced rate detrimental to liquidity over time<br>▪ May limit future flexibility to pursue other capital structure alternatives<br>▪ Often conducted at par as opposed to a discount to par<br>▪ In distressed scenarios, ultimate success depends on operational turnaround rather than comprehensive capital structure solution |




## X. Discounted Debt Repurchases

- Company (or a subsidiary) repurchases existing loans and/or bonds at discounted prices, including through (1) open market purchases and/or (2) Dutch auctions. Bonds may also be purchased in privately negotiated transactions or tender offers.[1]

- The repurchased loans will be cancelled if purchased by the parent guarantor, borrower, or any subsidiary.[2]

- This transaction does not require consent from lenders or bondholders other than those selling, though existing debt documents may contain certain limitations with which lenders or bondholders must comply.[3]

- **Alternatively, the sponsor could acquire loans and/or bonds in the secondary market and either hold them to use as currency in a future liability management transaction or resell them later at a profit.[4]**

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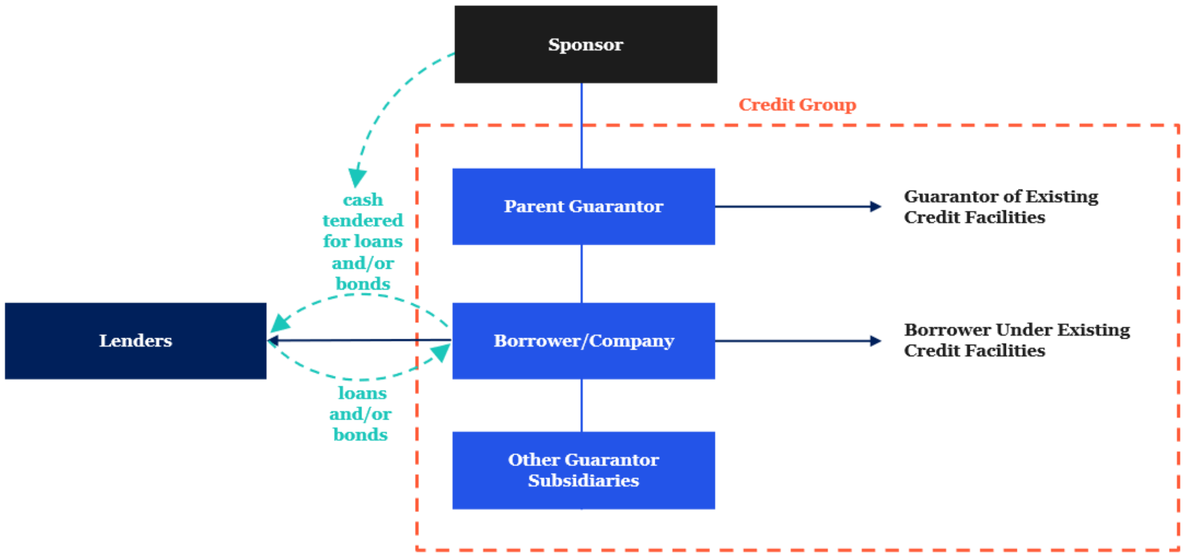
[1] Securities law issues to be analyzed in the context of any discounted debt repurchases.

[2] Bonds governed by English law may be required to be cancelled if repurchased by the issuer or an affiliate thereof.

[3] Under most U.S. indentures, the issuer or its affiliate loses the right to vote any repurchased bonds.

[4] Sponsor debt repurchases may also trigger cancellation of debt income for the company (not solely a purchase by the company); securities and fiduciary duty considerations should also be reviewed.




## XI. Envision Case Study

Envision Healthcare Corporation ("Envision") closed two liability management transactions through asset reorganizations and refinancing transactions, generating \$1.6bn of new liquidity and potentially capturing over \$1bn of discount on a cashless basis.

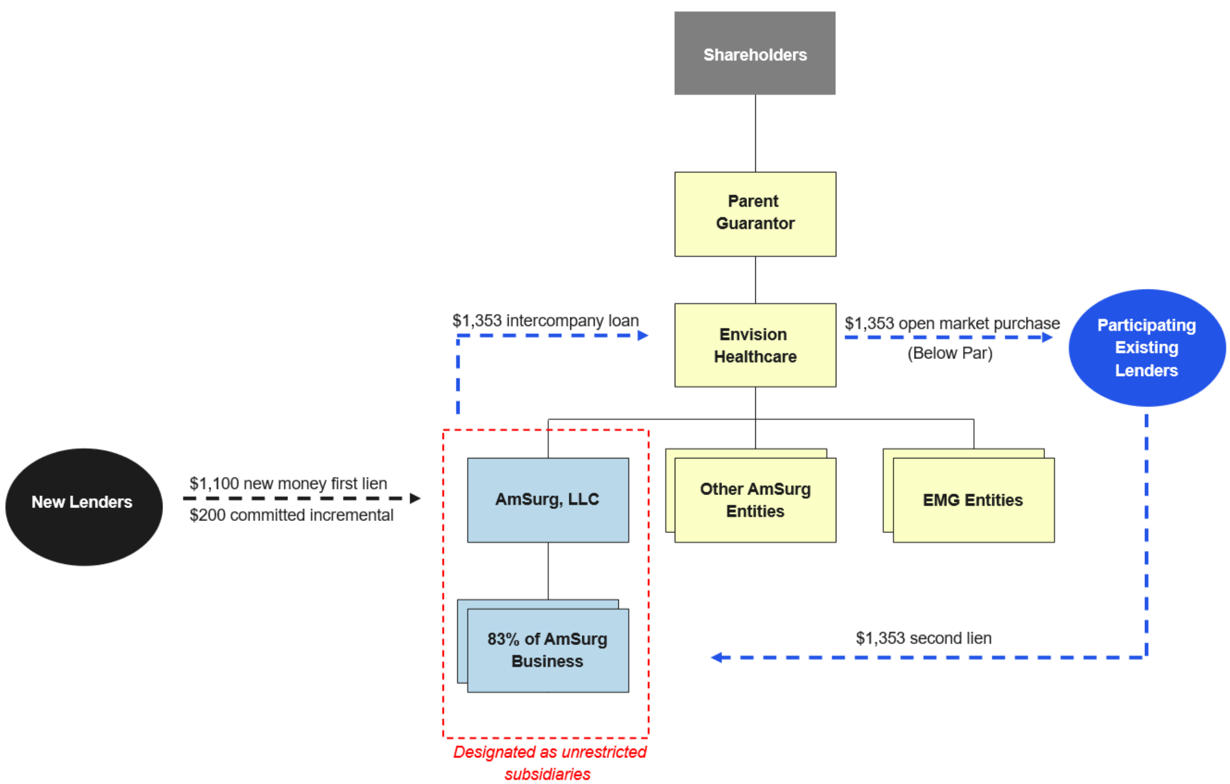
- In an October 2018 leveraged buyout, KKR purchased leading national medical group Envision for \$9.9bn
  - Serves hospitals and healthcare systems in anesthesiology, emergency medicine, hospital medicine, radiology, and other specialties
  - Operates over 250 ambulatory surgery centers across 34 states through its AmSurg, LLC ("AmSurg") business

| April 29, 2022 | July 22, 2022 |
|---|---|
| ▪ Envision designated AmSurg as an unrestricted subsidiary<br>▪ \$1.3bn of new liquidity extended to AmSurg on a first lien basis; new 1L financing did not require evidence of a lien release with respect to AmSurg from the administrative agent<br>▪ \$1.3bn second lien facility at AmSurg, which was used as currency to retire \$1.9bn of Envision's existing term loans and senior notes on a cashless basis via open market purchases<br>▪ Participating lenders providing the new money and the discount included Angelo Gordon, Centerbridge, HPS, King Street, PIMCO, and Sculptor<br>▪ An ad hoc group ("AHG") of Envision term loan lenders organized around legal counsel in response to the transaction | ▪ Envision refinanced its existing revolver and amended its existing term loan<br>▪ Existing revolving lenders agreed to fully "roll" their obligations into a new first-out revolver incurred by AmSurg, resulting in covenant and maturity relief<br>▪ The AHG agreed to backstop an amendment of the existing term loan comprised of a \$300 million new money first out tranche and a second out exchange tranche in which participating lenders exchanged a portion of their existing loans at 83 cents, with their remaining position exchanging into a third out tranche; non-participating lenders continued to hold their original loans in a fourth out tranche<br>▪ Participating lenders agreed to release Envision, KKR, and the AmSurg lenders from any litigation claims arising from the April transaction |

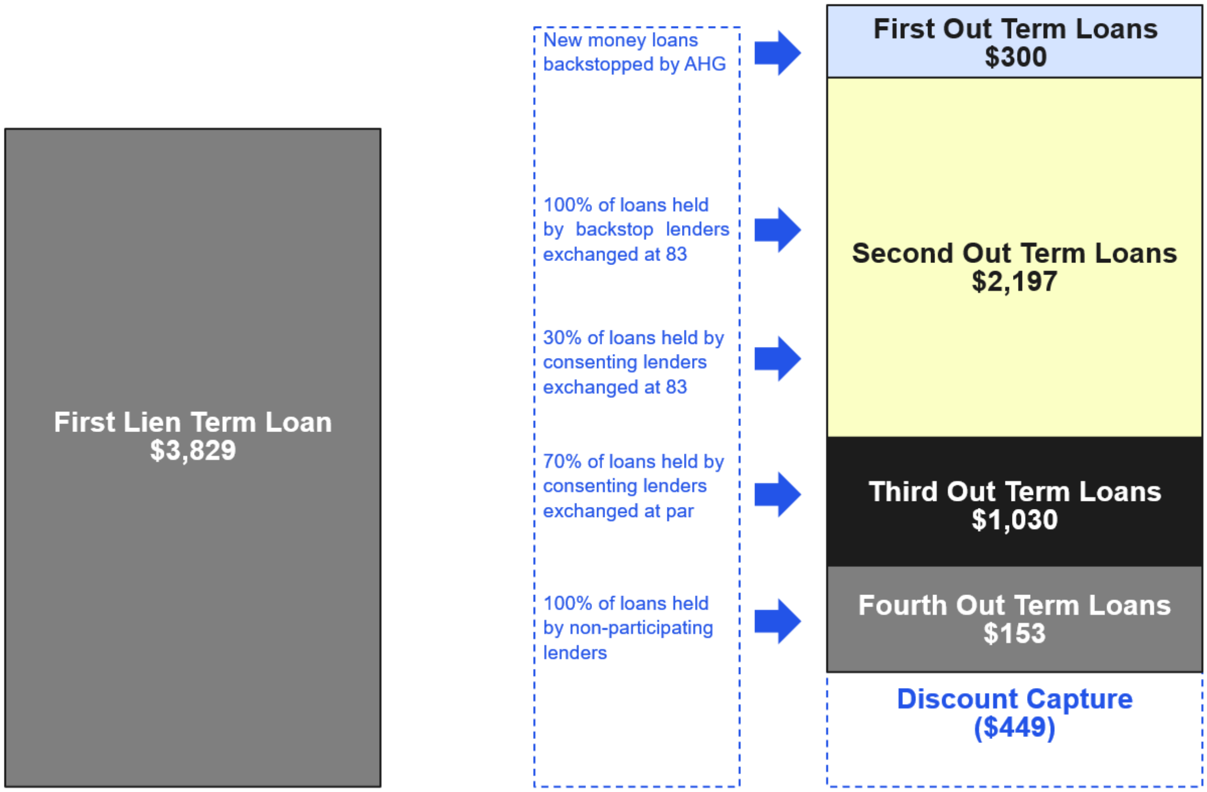
| $1.3bn New Liquidity<br>$600mm Discount Capture | $300mm New Liquidity<br>$450mm Illustrative Discount Capture<br>Maturity Extension & Covenant Relief |
|---|---|

## XII. AmSurg Financing (April 2022)

| | Pre-Closing | Adj. | Post-Closing |
|---|---|---|---|
| **Envision** | | | |
| ABL/RCF | $ 729.0 | $ - | $ 729.0 |
| 1L Term Loan | $ 5,719.0 | $ (1,890.0) | $ 3,829.0 |
| 1L Intercompany Loan | $ - | $ 1,353.0 | $ 1,353.0 |
| 8.75% Senior Notes | $ 1,026.0 | $ (87.0) | $ 939.0 |
| **Net Discount Capture** | | **$ (624.0)** | |
| **AmSurg** | | | |
| RCF | $ - | $ - | $ - |
| 1L Term Loan | $ - | $ 1,100.0 | $ 1,100.0 |
| 2L Term Loan | $ - | $ 1,353.0 | $ 1,353.0 |



## XIII. Envision Term Loan Refinancing (July 2022)



## XIV. Media Fallout (Envision)

> "Here's the bad news: if (i) you're in Envision Healthcare's ~$5.2b in term loan maturing in October 2025 and (ii) you're not PIMCO, Sculptor Capital Management, HPS Investment Partners or King Street, you just got royally f*cked in the latest example of "lender-on-lender violence."" ***Petition, May 2022***

> "Sometimes you get pounded silly, other times you pound silly.
>
> By the way, this basic pattern comes up a lot, but often in companies owned by private equity sponsors. There are reasons for this. One is that private equity tends to buy companies in leveraged buyouts, which means that many private equity companies have a lot of debt, which means that they are more likely to run into distress and have to do this stuff. Another is that private equity sponsors are smart, ruthless and repeat players at this game, so they are better at structuring transactions and playing creditors against each other. (And they have the phone numbers of the big creditors so they can make these deals happen.) If you are a big private equity sponsor, one way that you *create value at companies* (I mean, for you, and for your limited partners who own the equity) is by being good at playing creditors against each other. As distress becomes more common, that's a good skill to have." ***Matt Levine, Bloomberg Opinion, Money Stuff, May 2022***

> "KKR & Co. Inc.'s Envision Healthcare went around some of its lenders to borrow from Centerbridge Partners LP and Angelo Gordon & Co., touching off another clash between distressed-debt investors fighting to deploy capital where opportunities are scarce. ….. The new loans taken out by Envision free up KKR from needing to invest more into the company, while buying it time to weather the headwinds it has faced since its 2018 buyout."
> ***Wall Street Journal, May 2022***

Note: On May 15, 2023, Envision and its affiliates each filed a voluntary petition for relief under chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Southern District of Texas.

## XV. Boardriders Case Study

- Prior to entering into the recapitalization transaction, Boardriders, Inc. ("Boardriders") had two tranches of debt, including a senior secured term loan facility (the "Existing Term Loan Facility" and the loans thereunder, the "Existing Term Loans") and a senior secured asset-based revolving credit facility (the "ABL Facility"), in addition to various local lines of credit.

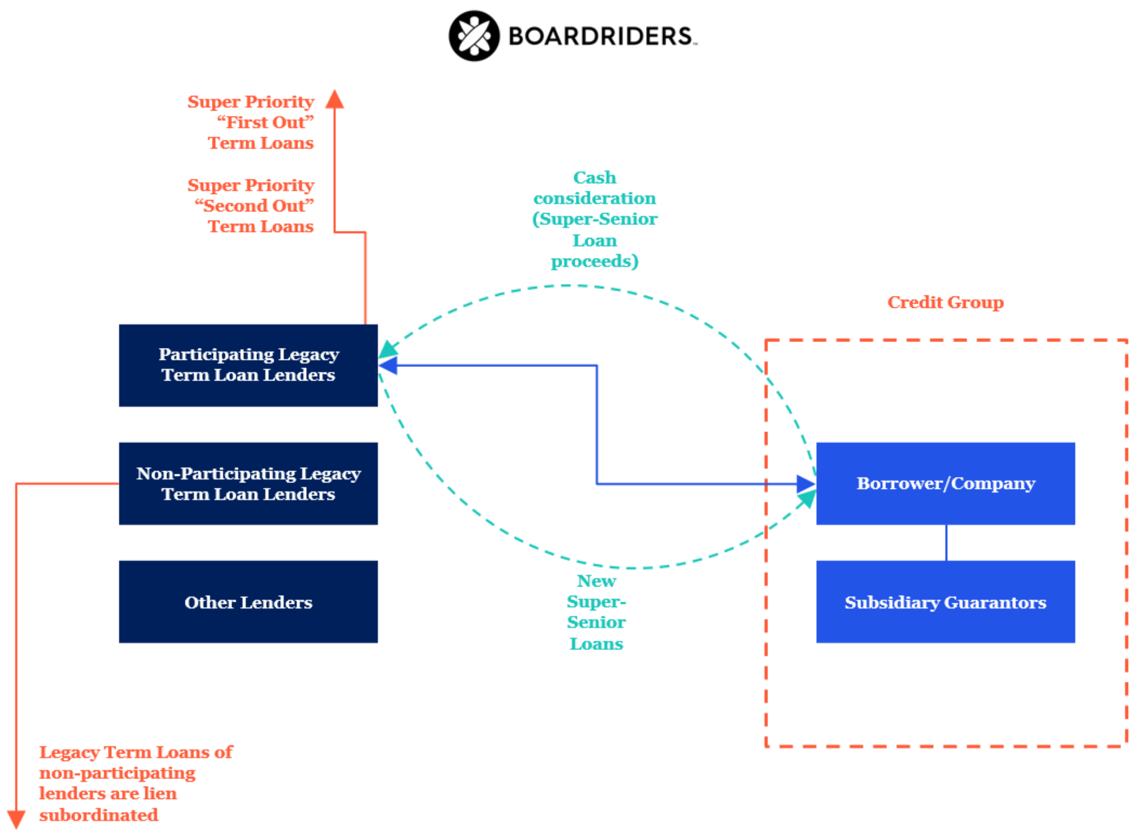
- On August 31, 2020, Boardriders entered into a recapitalization with the holders of a majority of its Existing Term Loans (the "Participating Lenders") that provided Boardriders with $90 million of new capital in the form of superpriority term loans, of which $45 million is on a first out basis (the "New Money Loans"), and $20 million of superpriority delayed draw term loan commitments (the "DDTL Facility") under a new Super Priority Term Loan Credit Agreement. In connection with the recapitalization transaction, the Participating Lenders consented to removing all of the covenants (including debt and lien negative covenants) from the Existing Term Loan Facility.

- Boardriders also agreed to repurchase approximately $321 million of Existing Term Loans from the Participating Lenders at par value in certain open market purchases. Such purchases were financed with the company's issuance to the Participating Lenders of an equivalent amount of new superpriority term loans (together with the New Money Loans and any loans drawn under the DDTL Facility, the "Super Priority Term Loans") under the Super Priority Credit Agreement. The Super Priority Term Loans are senior to the Existing Term Loans and junior to the ABL Facility with respect to ABL-priority collateral.

- The agent for the Existing Term Loan Facility and the agent under the Super Priority Term Loan Credit Agreement entered into a new intercreditor agreement whereby the Super Priority Term Loans were made senior with respect to security to the Existing Term Loans.

- This transaction was effectuated without prior notification to, or participation of, the lender group as a whole.

- The non-participating lenders sued shortly after the transaction closed. They alleged breach of contract, breach of fiduciary duty, and tortious interference, among other claims. On October 17, 2022, the New York State Supreme Court issued a decision denying Boardriders' motion to dismiss the non-participating lenders' suit (except for a tortious interference claim that the non-participating lenders alleged against the sponsor). On November 16, 2022, Boardriders filed a notice of appeal of the decision. The litigation has been put on hold as the parties are in settlement discussions.




## XVI. TriMark Case Study

- Prior to undertaking the recapitalization transaction, TMK Hawk Parent, Corp. ("TriMark") had three tranches of debt, including 1L term loans ("Legacy 1L Term Loans"), 2L term loans ("Legacy 2L Term Loans") and an ABL facility.

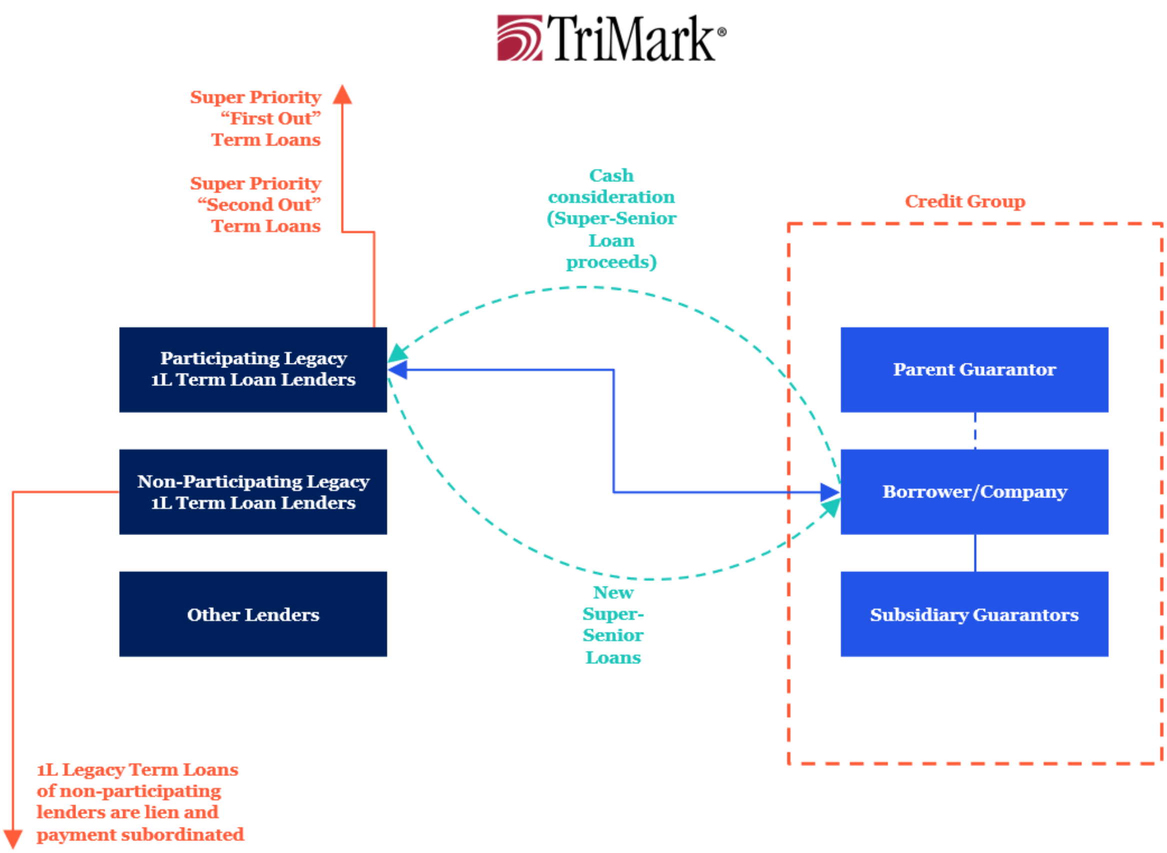
- On September 14, 2020, TriMark entered into a recapitalization transaction (the "Recapitalization Transaction") with the holders of a majority of its Legacy 1L Term Loans (the "Participating Lenders") that provided TriMark with $120 million of new capital in the form of superpriority first out term loans (the "Super Priority First Out Term Loans") under a new Super Priority Credit Agreement. In connection with the recapitalization transaction, the Participating Lenders consented to removing all of the covenants (including debt and lien negative covenants) from the existing 1L credit agreement.

- TriMark also agreed to repurchase approximately $307 million of Legacy 1L Term Loans from the Participating Lenders at par pursuant to open market purchases. Such purchases were financed with the company's issuance to the Participating Lenders of an equivalent amount of new superpriority second out term loans (the "Super Priority Second Out Term Loans"; together with the Super Priority First Out Term Loans, the "Super Priority Term Loans") under the Super Priority Credit Agreement. The Super Priority Second Out Term Loans are senior to both the existing 1L term loans and the existing 2L term loans but are junior in right of payment to the Super Priority First Out Term Loans.

- The agent for the Legacy 1L Term Loans and the agent under the Super Priority Credit Agreement entered into a new intercreditor agreement whereby the Super Priority Term Loans were made senior both in right of payment and with respect to security to the Legacy 1L Term Loans.

- In November 2020, certain Legacy 1L Term lenders initiated litigation against the Participating Lenders, TriMark, and the sponsors, alleging breach of contract, tortious interference, and breach of fiduciary duties, among other claims.

- After the dismissal of the non-contractual claims in August 2021, the parties settled their differences in January 2022, with the Legacy 1L Term lenders getting the opportunity to participate in the Super Priority Second Out Term Loans but still being primed by the Super Priority First Out Term Loans.



## XVII. Media Fallout (Boardriders/TriMark)

"creditor-on-creditor" violence." *Institutional Investor, November 2020*

"When word of the deal, which was driven by Howard Marks's Oaktree Capital Management, first hit the market in mid-September, it sparked a panic. Investors dumped the old loans at such a frenetic pace that the price on one of them cratered 20 cents on the dollar in a matter of days." ***Bloomberg News, October 2020***

"The additional step of removing covenants is highly unusual in the loan world and is a big loss for investors, Xtract's Sullivan said.

"It's gone beyond Serta -- now it's worse. By stripping it down to the ultra bare bones, all that leaves you with is just a promise to pay," he said." ***Bloomberg News, October 2020***

"Oaktree's Howard Marks did signal the firm's thinking in an October appearance on Bloomberg TV. "I don't think of it as screwing," he said after the host asked him whether the deals "screw over" other investors. "I really resist that terminology," Marks said. "We can't go easy on another firm and fail to carry out our duty to our clients, which is to conscionably maximize their interests." " ***Institutional Investor, November 2020***

"Priming transactions such as those executed by Serta and Boardriders are still the exception and the priming play is not the 'new normal,'" said Judah Gross, a director at Fitch Ratings. "That being said, the higher degree of frequency with which such deals get done may indicate that priming transactions are not as taboo as once assumed." ***Bloomberg News, October 2020***

## XVIII. Administrative Agent Considerations

For different distressed liability management structures, what can an agent do? And what is an agent required to do?

| Transaction Step | Considerations of the Agent |
|---|---|
| **Transfer of assets to NewCo (an unrestricted subsidiary) or formation of NewCo or designation of unrestricted subsidiary and incurrence of new debt at resulting entity**<br>▪ Agent may be asked to execute documents evidencing the release of liens and guarantee obligations<br>▪ If NewCo is an unrestricted subsidiary, there could be unlimited structurally senior debt | ▪ Are liens and guarantees automatically released when an otherwise permitted transaction is consummated? Could the agent's execution of release documents fairly be described as "clean-up" of the record?<br>▪ What protections and/or discretion does the credit agreement provide to the agent? Does the agent have any discretion in requesting an officer's certificate from the company stating that the transaction is permitted? Can the agent conclusively rely on that certificate? Is the agent then required or merely authorized to execute release documents?<br>▪ Can the agent rely on advice of counsel (including counsel to the company) or other experts? Does the agent have any responsibility to confirm?<br>▪ Is any lender consent required? If required lender consent is obtained in connection with a drop-down, the agent is more protected, but minority lenders may take action if they were not offered an opportunity to participate.<br>▪ Would taking (or refraining from) action result in a material breach, gross negligence, willful misconduct, or bad faith such that indemnity provisions may not apply?<br>▪ Should the agent provide all lenders with notice of any lien release request by the company? |
| | |
| **Incur superpriority debt at borrower or restricted subsidiary**<br>▪ Amendments to pro rata provisions (if not a sacred right)<br>▪ Subordinating existing liens by entering into a new ICA<br>▪ Open market purchases | ▪ What is the consent threshold for amending the pro rata provisions? Often, an affected lender vote is required. What is the role of an agent if a majority vote is required?<br>▪ Is the agent generally responsible for determining the level of consent required?<br>▪ Even where there is no direct impingement on a sacred right, should the agent be concerned about a permitted amendment that in effect modifies a sacred right?<br>▪ Does the existing credit agreement "authorize" the agent to enter into an ICA, or does it "authorize and instruct" the agent to do so? |

Faced with a distressed liability management transaction, an agent's choices come with certain risks.

| Agent Course of Action | Risks and Potential Mitigating Factors That Might Be Included in the Relevant Definitive Documentation |
|---|---|
| **<u>Continue</u> to serve as administrative agent and collateral agent and take the actions requested by the company** | ▪ **Risks**: Litigation by one or more existing lenders for breach of contract or breach of covenant of good faith and fair dealing to the extent they are not offered participation in the transaction<br>▪ **Potential mitigating factors**: Lenders expressly agree that releases happen automatically by operation of credit agreement provisions and authorize the agent to take the requested actions; agent is indemnified by the company and/or the lenders except in case of gross negligence, bad faith, or willful misconduct<br>▪ **Other considerations**: Reputational and relationship risk with respect to existing lenders and, more generally, ongoing business opportunities |

| | |
|---|---|
| **Continue to serve as administrative agent and collateral agent but <u>refuse</u> to take the actions requested by the company** | ▪ **Risks**: Litigation by the company for breaching obligations to take the requested actions, which may constitute gross negligence or willful misconduct<br>▪ **Potential mitigating factors**: Agent is not required to take any action that, in its counsel's opinion, may expose it to liability or that is contrary to the applicable credit documents and is fully justified in refusing to take action without advice of/instruction from the required lenders<br>▪ **Other considerations**: Relationship risk with respect to the company and other company stakeholders (e.g., a private equity sponsor and/or lenders backstopping the proposed transaction) |
| **<u>Resign</u> as administrative agent and collateral agent** | ▪ **Risks**: In addition to risk of litigation by the company, there may be insufficient time for the agent's resignation to become effective (depending on when the agent decides to resign and the resignation procedures in the definitive documentation) and for a new agent to be appointed before the contemplated transactions are consummated<br>▪ **Potential mitigating factors**: Agent is entitled to resign at any time (and might argue that it made a good-faith attempt to understand the company's position but was unable to conduct diligence and obtain internal approvals in a timely fashion); agent may rely on opinion of counsel and decline to take any action that may expose it to liability or is contrary to the credit documents |

## XIX. Liability Management—Trends

### A. Normalization

- **Sponsors and public companies are more focused on liability management as a strategy than ever before.**
  - Recent high-profile transactions, including Envision, are bringing liability management techniques to the mainstream.
  - Press coverage regarding liability management exercises increasingly focuses on the "creditor-on-creditor violence" angle and less on borrowers' aggressive tactics.

### B. Evolving Views

- **Credit agreements are being treated more like indentures.**
  - Lenders are increasingly accepting that non-pro rata transactions are permitted under credit agreements.

### C. Creditor-on-Creditor Violence

- **Creditors are increasingly willing to cut side deals and leave similarly situated holders out of liability management transactions.**
  - The trend is toward non-pro rata transactions that benefit first movers.

- Lender cooperation agreements (i.e., an agreement among lenders, but not the company, to behave in a coordinated manner) are often weak and may present a drag on the trading price of the debt held by the cooperating lenders.
- Side arrangements are often undisclosed and invisible with respect to other participants.

D. Thought Leadership

- **Creditors can play a meaningful role in shaping the direction of liability management transactions.**

  - Creditors that participate in structuring are less likely to be left behind in non-pro rata transactions.

E. Litigation

- **Litigation is a key part of the story.**

  - Companies and creditors increasingly accept that litigation may be a cost of doing business in this context.
  - Certain borrower strategies actually require litigation.

F. Risk

- **Sponsors and public company boards have higher risk tolerance.**

  - There is less concern about reputational risk.
  - The growing view is that fiduciary duties may compel exploring liability management strategies.

## XX. Litigation Considerations in Liability Management Transactions

- Liability management transactions can give rise to potential claims against both participating and non-participating lenders.

- Non-participating lenders may be sued for calling a default or taking other measures intended to block the transaction.

  - In response to agreed or proposed liability management transactions, some creditors have attempted to prevent such transactions from being consummated by calling defaults.

  - There are material downsides to creditors calling (or threatening to call) defaults. Companies may:

  - run to court seeking a declaratory judgment that they are not in default and related injunctive relief;
  - seek damages related to alleged creditor misconduct; or
  - use counterclaims as bargaining chips in ensuing bankruptcies.

- Participating lenders may be sued for their role in the transaction, as they were in connection with uptier transactions launched by Revlon, TriMark, Serta, and Boardriders, among others.

  - Causes of action asserted against participating lenders include:

    - breach of contract, including breach of the covenant of good faith and fair dealing;
    - intentional fraudulent transfer;
    - conversion (in connection with drop-down financing transactions); and
    - unjust enrichment.

  - Remedies sought against participating lenders include injunctive relief to block or unwind the transaction, invalidation of credit agreement amendments, compensatory and punitive damages and payment of attorneys' fees, equitable subordination (in bankruptcy), and constructive trust. Claims against participating lenders have a mixed record upon motions to dismiss or summary judgment.

## XXI. Recent Liability Management Exercises with Litigation[5]

| YEAR | LME | SPONSOR | CLAIMS BROUGHT | LITIGATION RESOLUTION / STATUS |
|---|---|---|---|---|
| 2022 | TPC Group | FR Sawgrass, L.P., SK Sawgrass, L.P., and certain affiliates of both entities | ▸ DJ | ▸ Bankruptcy Court denied request for declaratory judgment, finding that the original loan documents permitted the majority lenders to amend the loan documents to provide for the subordination of the old debt to the new debt |
| 2022 | incora | Platinum Equity | ▸ Breach of contract, DJ, implied covenant, tortious interference with contract*, fraudulent transfer*, preferential transfer,* conversion*, aiding and abetting conversion | ▸ Ongoing |
| 2022 | Envision Healthcare | KKR | ▸ None | ▸ No litigation filed |
| 2020 | TriMark | Centerbridge | ▸ Breach of contract, DJ, implied covenant, tortious interference with contract *, fraudulent transfer | ▸ The company settled with the plaintiffs by rolling up their left behind 1L loans into a second out tranche under the super priority credit agreement |
| 2020 | Boardriders | Oaktree | ▸ Breach of contract, DJ, implied covenant, tortious interference with contract*, fraudulent transfer*, preferential transfer* | ▸ Ongoing — motion to dismiss denied (except with respect to sponsors). Parties have agreed to negotiate settlement of litigation |
| 2020 | Serta | Advent International | ▸ Breach of contract, DJ, implied covenant | ▸ Two actions: SDNY - motion to dismiss was denied. State Court; re-filed; motions to dismiss pending<br>▸ Bankruptcy Court found up-tier transactions were "open market purchases"; debtors and participating lenders did not breach duties of "good faith and fair dealing" under the credit agreement |
| 2020 | macy's | N/A | ▸ None | ▸ No litigation filed |
| 2020 | Travelport | Siris<br>Elliott | ▸ Breach of contract, DJ, implied covenant, fraudulent transfer* | ▸ Company initiated litigation against the agent seeking a declaration that no Event of Default occurred as a result of the dropdown transaction. Litigation resolved via settlement and subsequent transaction |
| 2020 | Revlon | MacAndrews & Forbes Holdings Inc. | ▸ Breach of contract, DJ, implied covenant, conversion, aiding and abetting conversion, unjust enrichment, equitable subordination, tortious interference with contract, constructive trust | ▸ Bankruptcy Court dismissed claims against Debtors for lack of standing; litigation against non-debtors revolved via global settlement in Plan of Reorganization. |
| 2018 | Neiman Marcus | Ares | ▸ Fraudulent transfer, tortious interference with contract*, appointment of receiver (in Texas action) | ▸ Texas litigation was dismissed and the NY litigation was resolved via chapter 11 |
| 2018 | PetSmart | BC Partners | ▸ Breach of contract, DJ, fraudulent transfer, illegal dividend | ▸ Resolved via settlement and amendment to credit docs<br>▸ Chewy eventually IPO'd and certain of the proceeds of the IPO were used to prepay secured debt |
| 2017 | J.Crew | TPG<br>LGP Leonard Green & Partners | ▸ Breach of contract, DJ, fraudulent conveyance, fraud | ▸ First litigation with the ad hoc group was resolved via exchange offer and consent solicitation<br>▸ Second litigation with Eaton Vance was resolved via successful partial motion to dismiss and then remaining claim in chapter 11 |
| 2017 | NYDJ | Crestview | ▸ Breach of contract, DJ, implied covenant | ▸ TRO issued, temporarily blocking transaction<br>▸ Settlement reached before PI hearing |

[5] An asterisk indicates that the claim was brought against the sponsor (not in its capacity as a lender).