LSTA AND LMA NEW YORK CONFERENCE

Welcome and Introduction

Speakers

- **Lee Shaiman, Executive Director, LSTA**
- **Amelia Slocombe, Managing Director and Head of Legal – LMA**

LSTA ADVANCING THE CORPORATE LOAN MARKET LMA Loan Market Association

Thursday, May 18, 2023

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Global Economic Outlook

Speaker

- Carl Riccadonna, Chief US Economist – BNP Paribas

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BNP Paribas US Economic Forecasts

	Yearly		2022	2023				2024			
	2023	2024	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP											
%q/q saar			2.6	1.1	1.0	-1.5	-1.8	-0.5	1.0	1.5	1.5
%y/y	1.0	-0.1	0.9	1.6	2.0	0.8	-0.3	-0.7	-0.7	0.0	0.9
Nominal GDP											
%y/y	5.0	2.3	7.3	7.0	6.3	4.3	2.7	1.9	1.7	2.4	3.1
CPI											
%y/y	4.1	2.6	7.1	5.8	4.1	3.5	3.2	2.9	2.7	2.5	2.2
Core CPI											
%y/y	4.5	2.5	6.0	5.6	4.9	4.0	3.4	2.8	2.5	2.4	2.2
Unemployment rate											
period-average	3.8	4.8	3.6	3.5	3.5	3.7	4.3	4.6	4.7	4.9	5.0
Policy rate (upper bound)											
end-of-period	5.25	3.50	4.50	5.00	5.25	5.25	5.25	5.00	4.50	4.00	3.50

Sources: BEA, BLS, Federal Reserve, BNP Paribas

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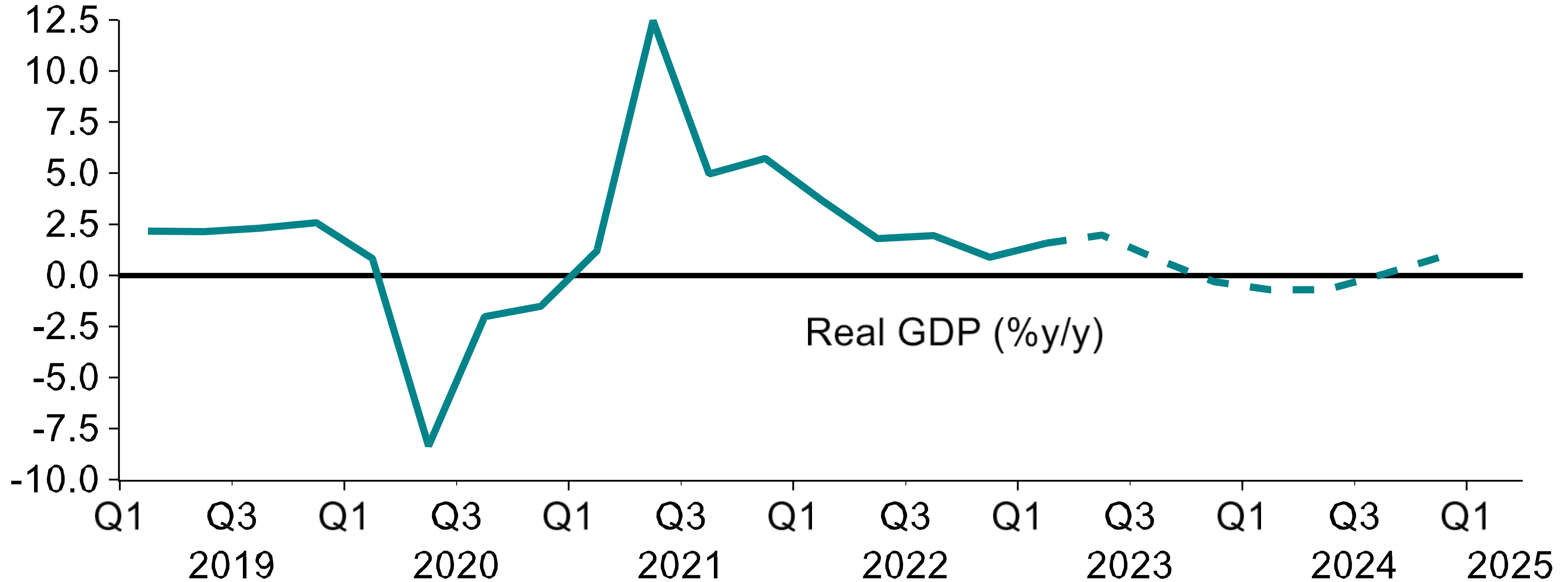
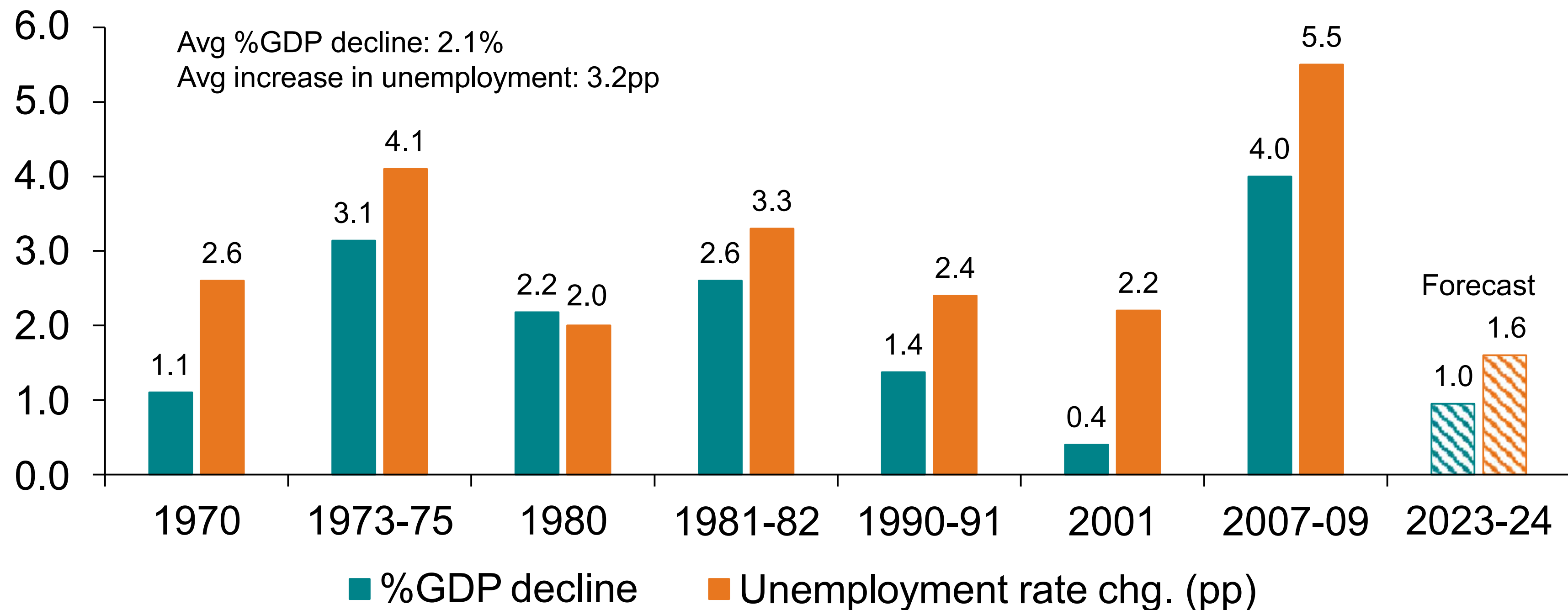
Massive growth slowdown underway, recession in view



Sources: BEA, Macrobond, BNP Paribas

Two point rise in unemployment hardly unusual in downturn



Sources: BEA, BLS, BNP Paribas

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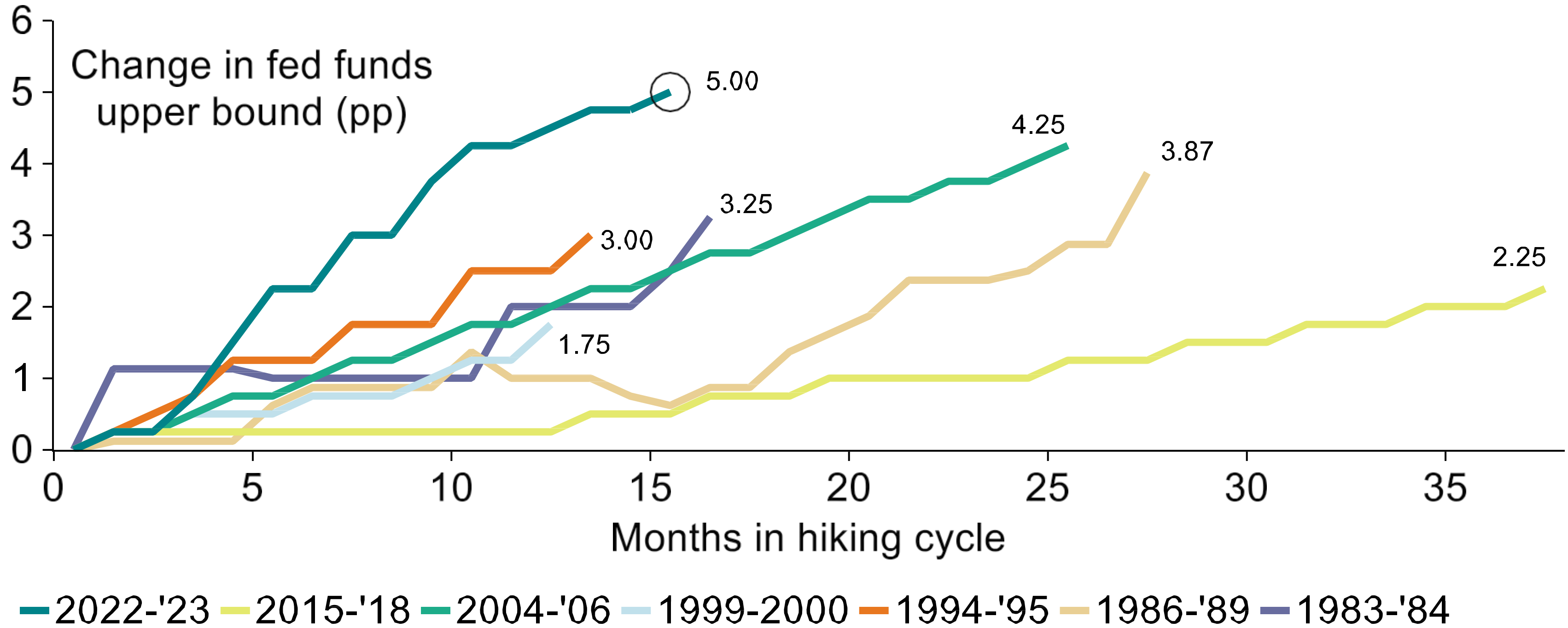
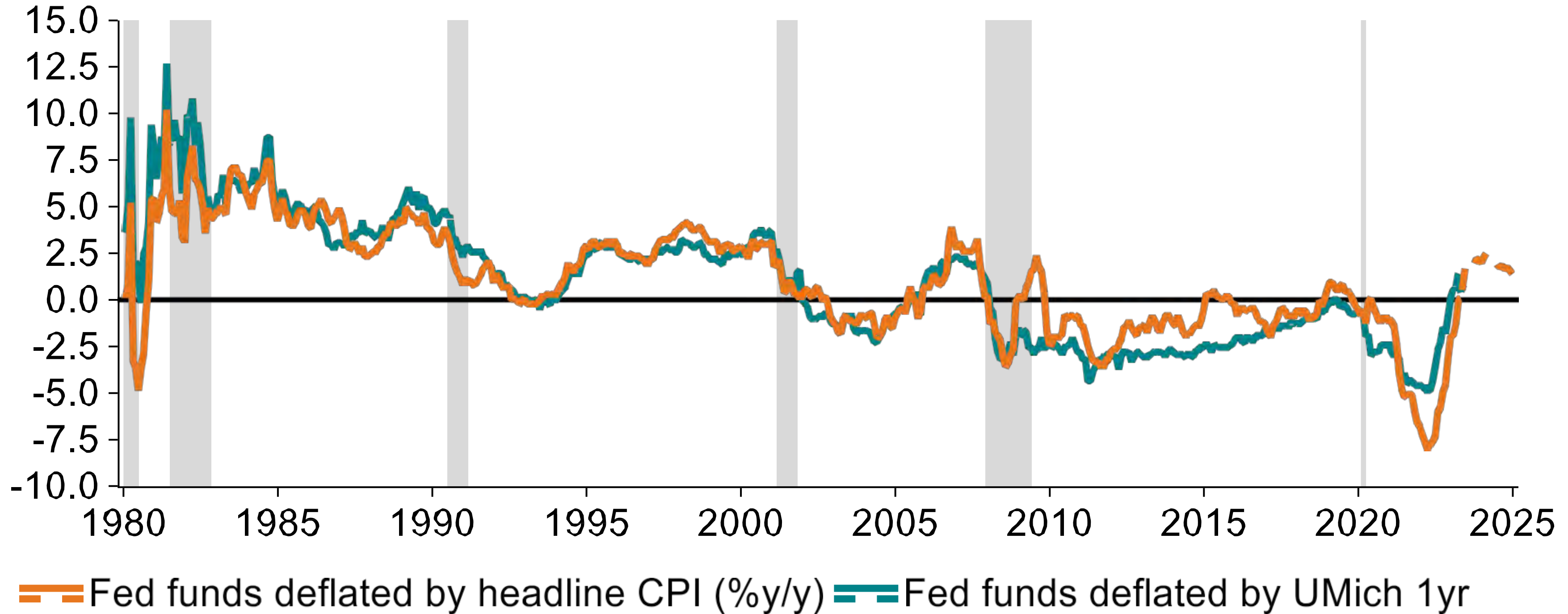
Fed concluding record-fast tightening cycle



Sources: Federal Reserve, Macrobond, BNP Paribas

Fed funds less restrictive than meets the eye



Sources: BLS, Federal Reserve, University of Michigan, Macrobond, BNP Paribas

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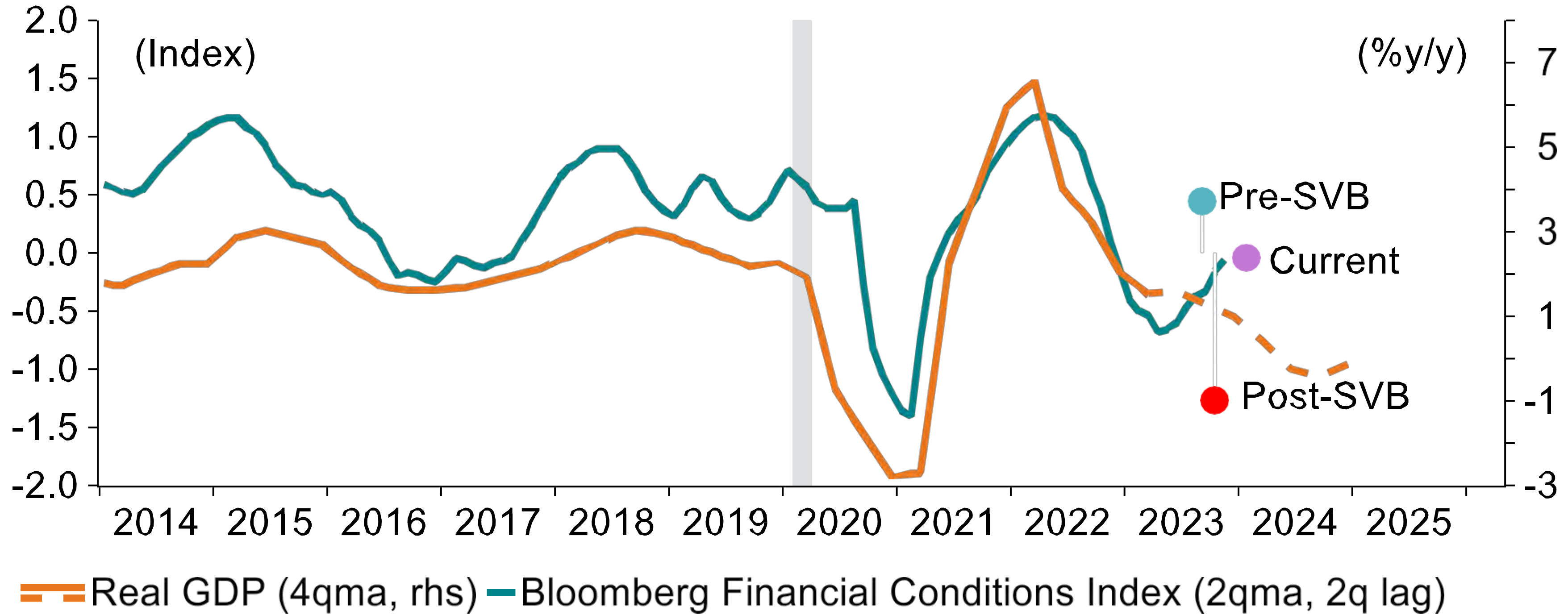
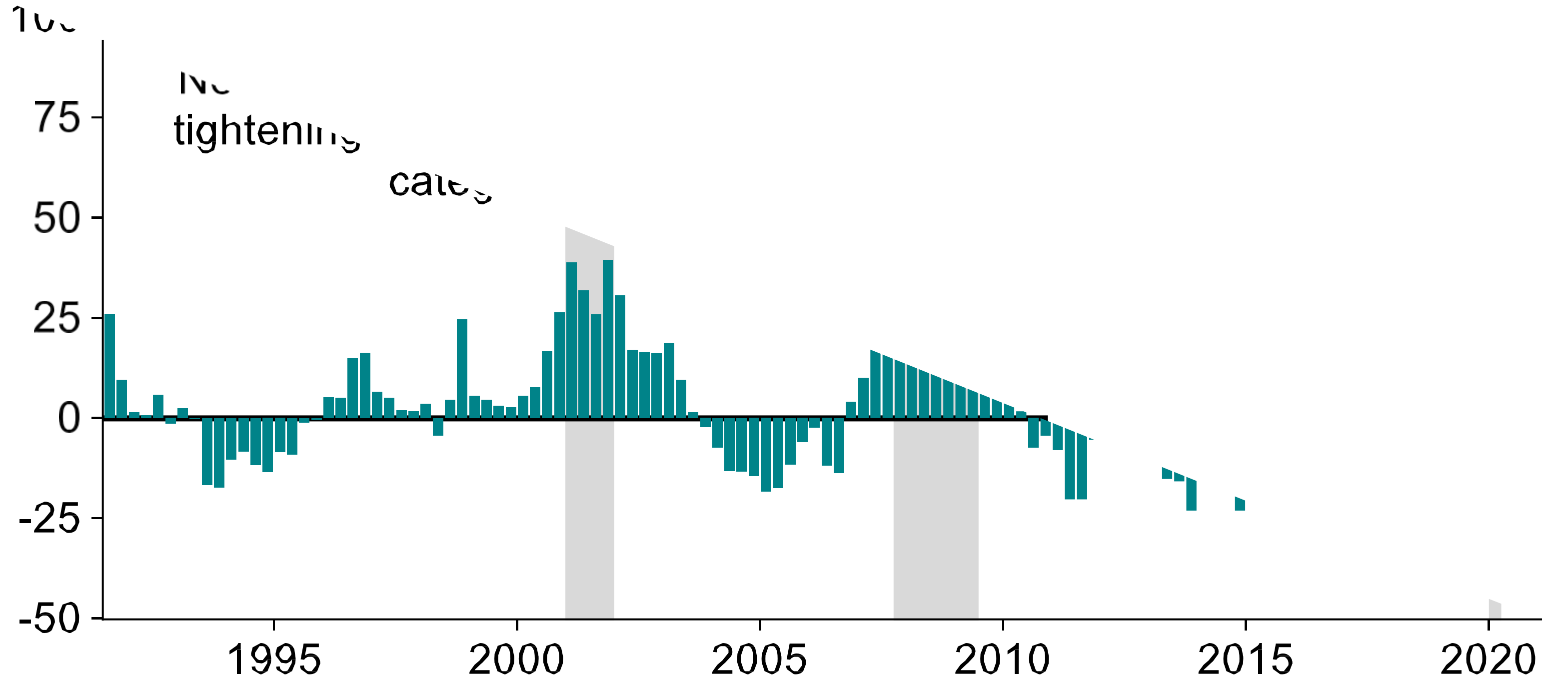
Financial conditions do not fully reflect banking sector strains



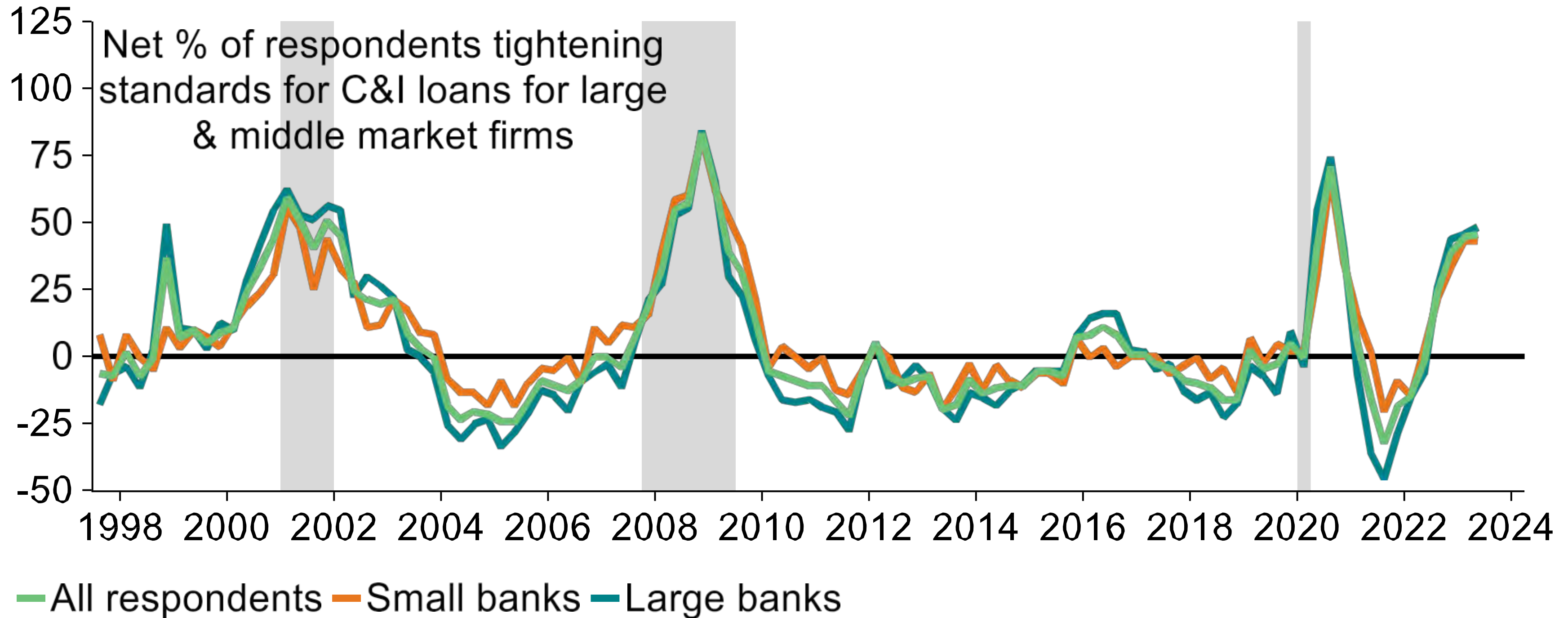
Sources: BEA, Bloomberg, Macrobond, BNP Paribas

More tightening across lending categories



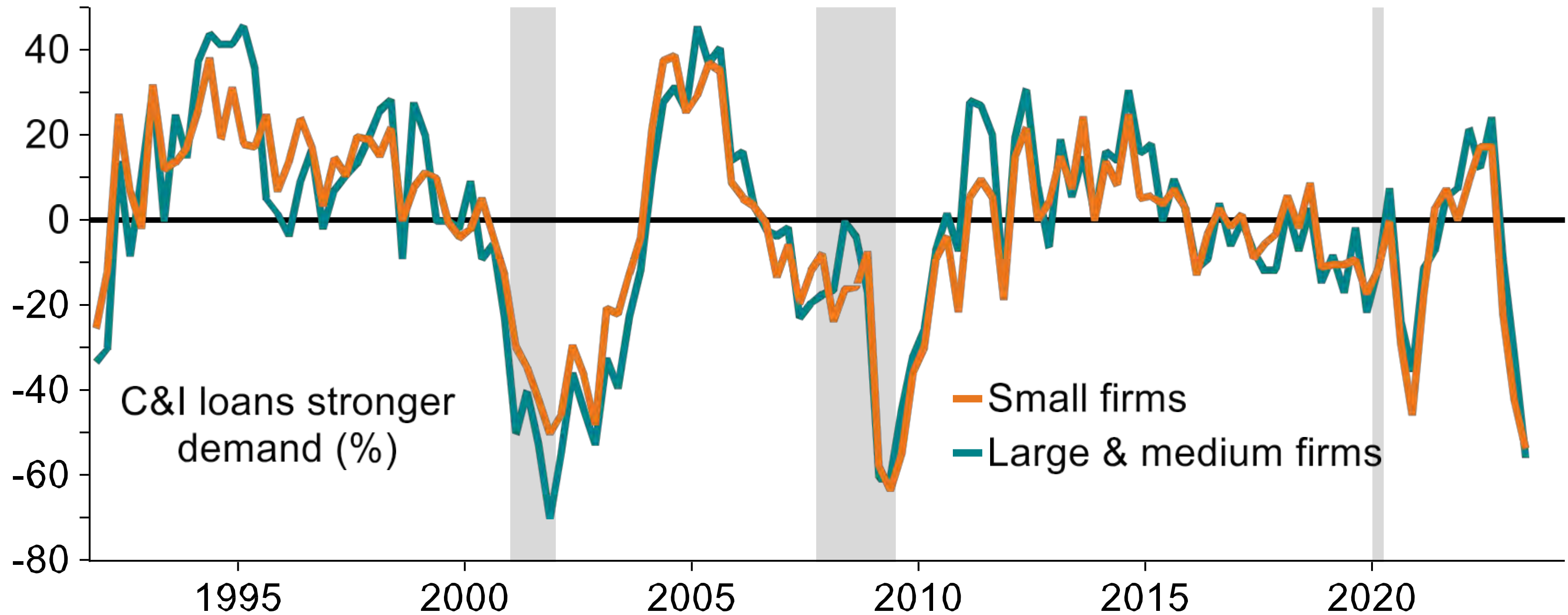
Sources: Federal Reserve, Macrobond, BNP Paribas

Lending standards continued tightening through Q1



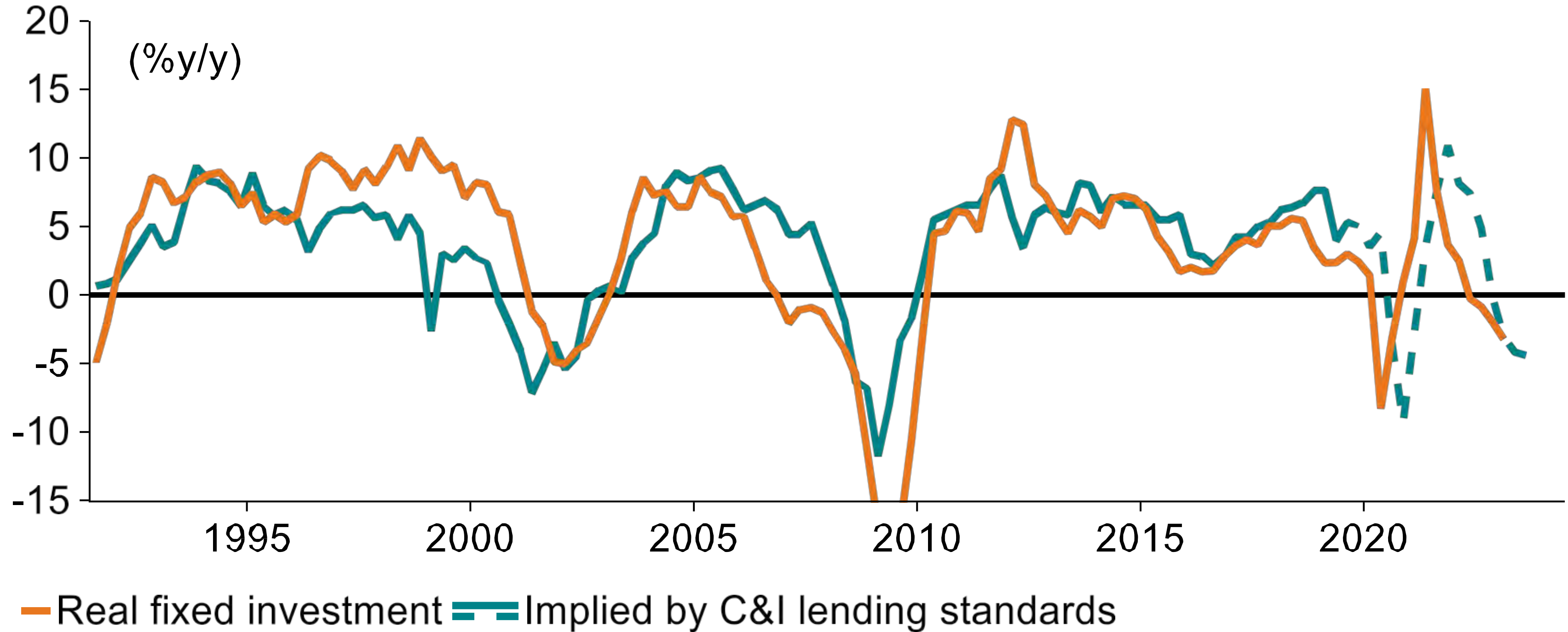
Sources: Federal Reserve, Macrobond, BNP Paribas

Business loan demand plunging



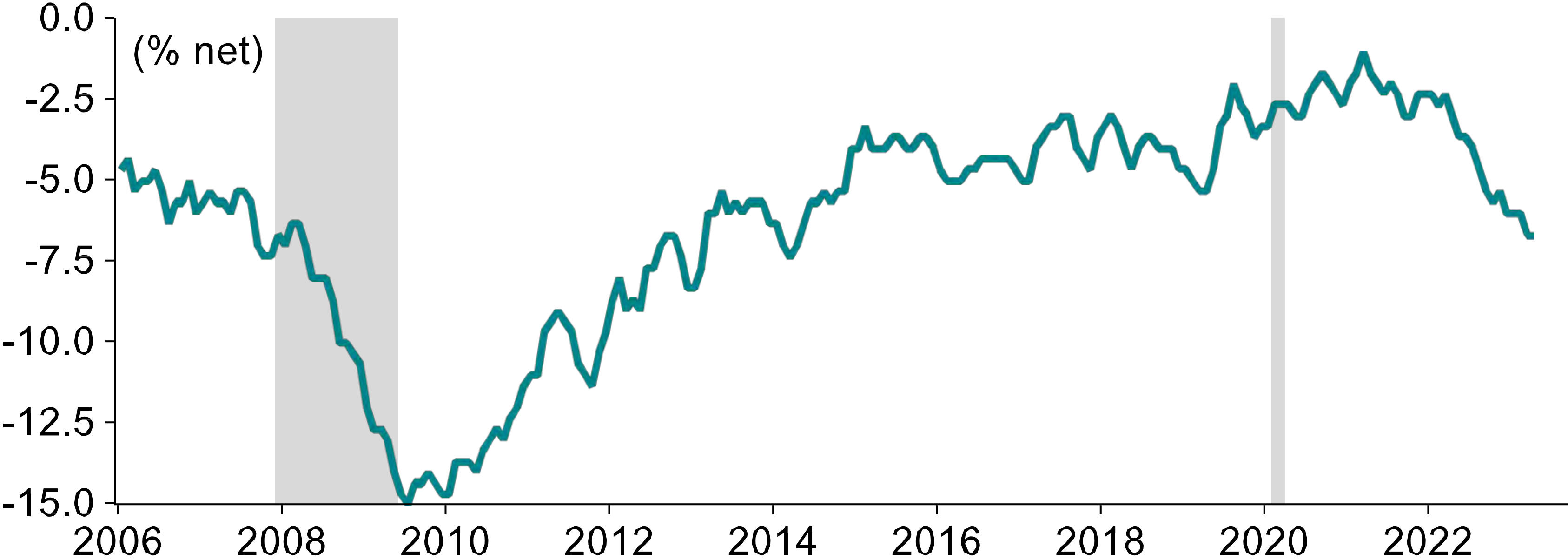
Sources: Federal Reserve, Macrobond, BNP Paribas

C&I loan tightening reinforces weaker investment trend



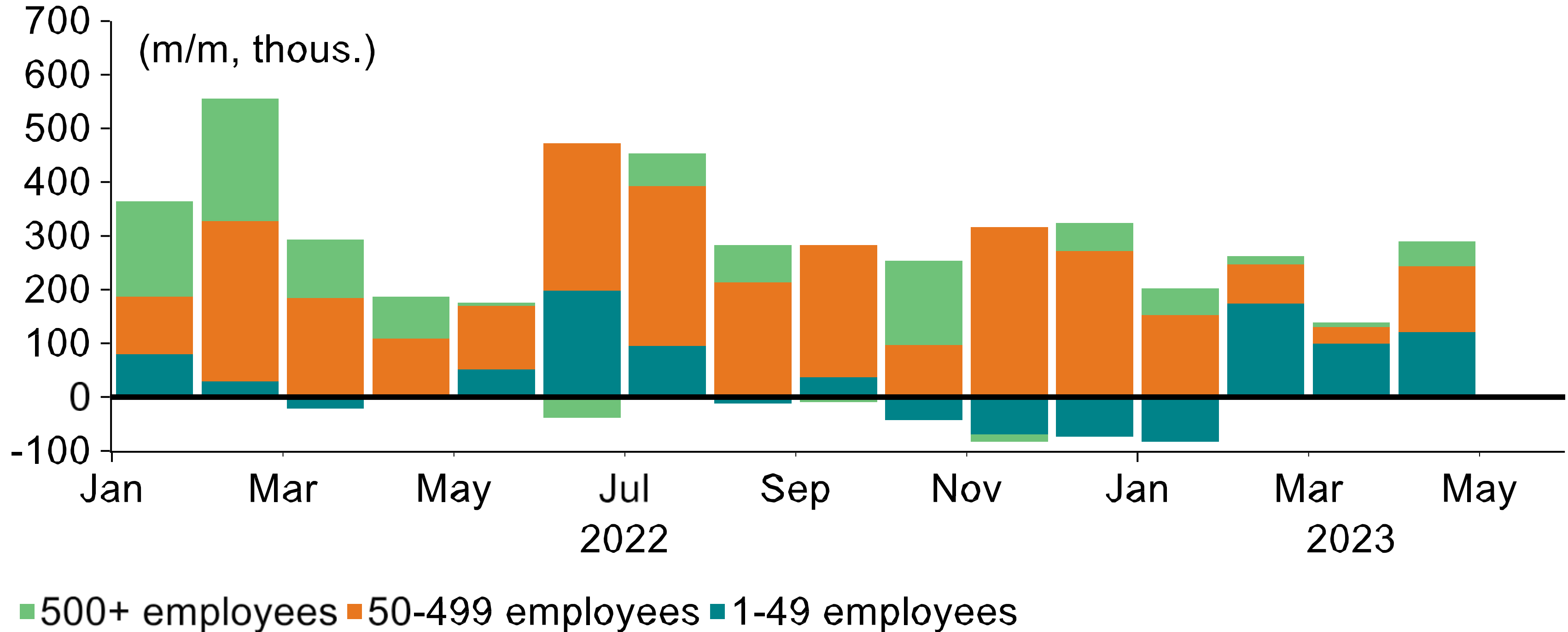
Sources: Federal Reserve, Macrobond, BNP Paribas

Small business access to credit is falling



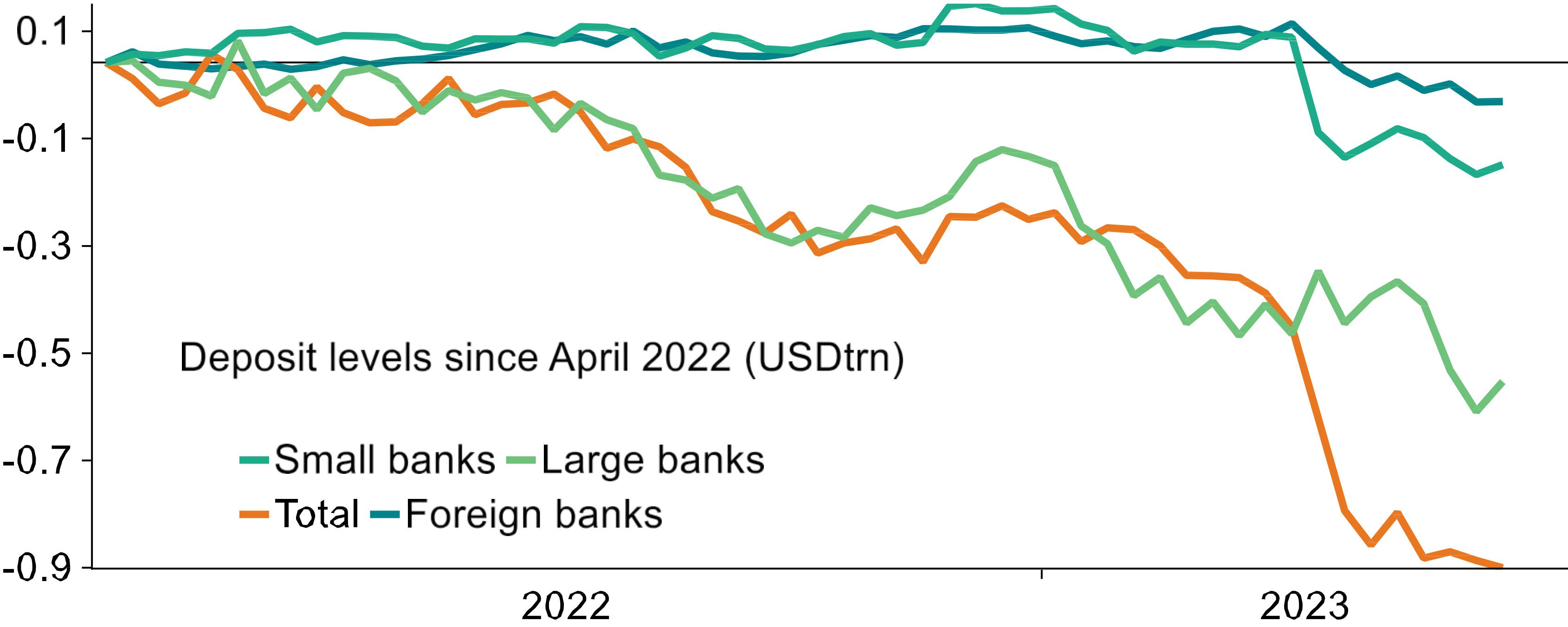
Sources: National Federation of Independent Business, Macrobond, BNP Paribas

Risking the prime driver of recent job gains



Sources: ADP, Macrobond, BNP Paribas

System deposits continue to decline



Sources: Federal Reserve, Macrobond, BNP Paribas

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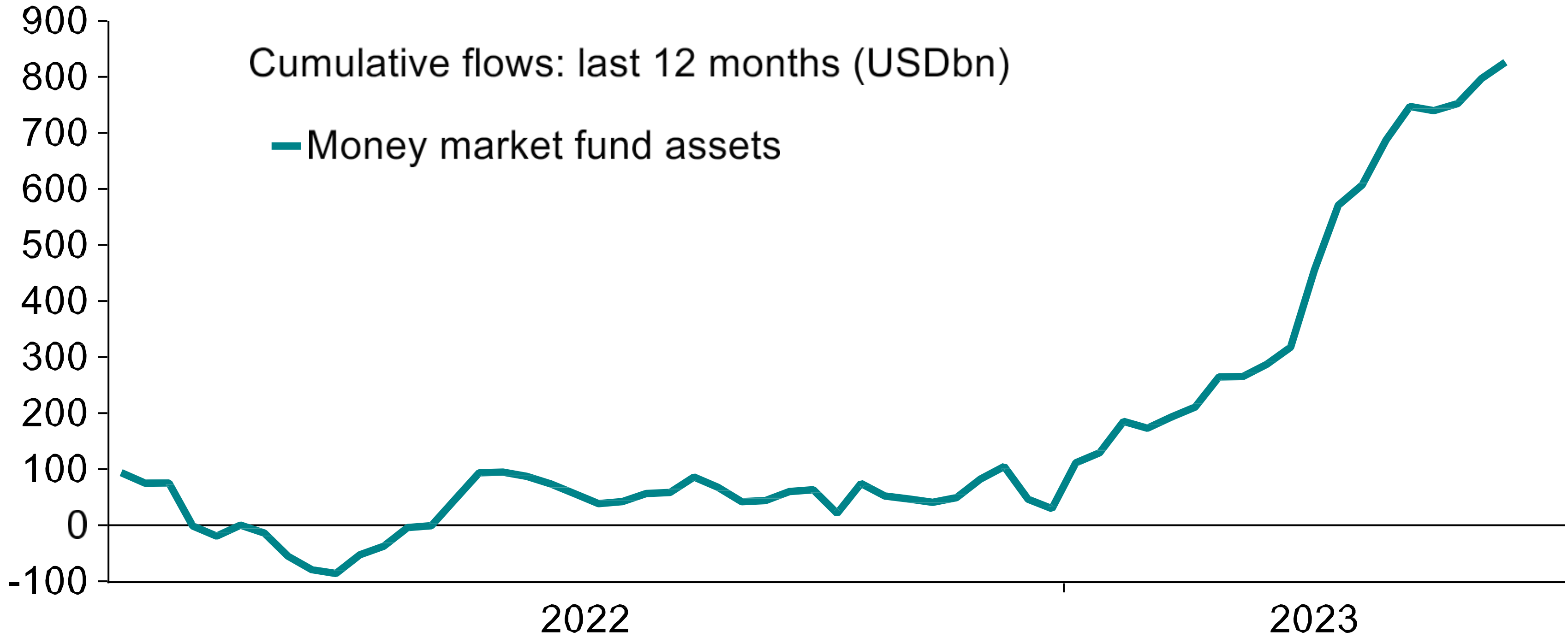
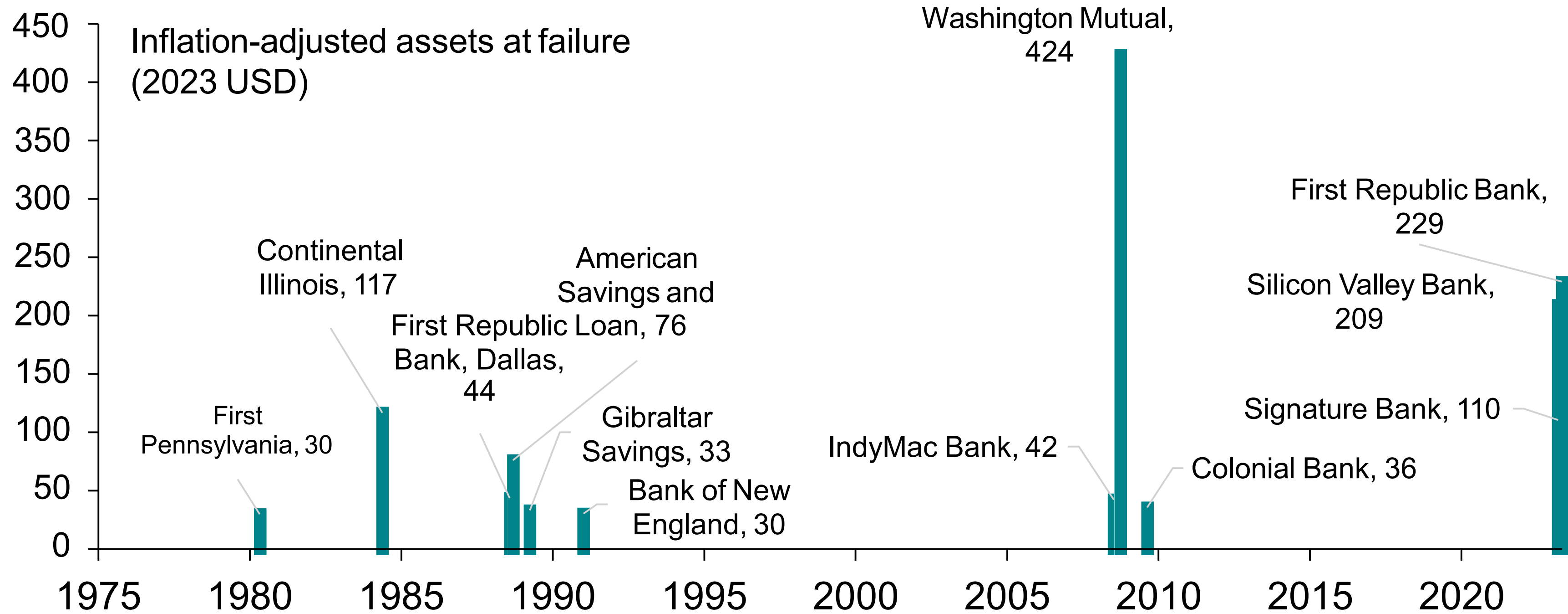
Ongoing shift to money market funds



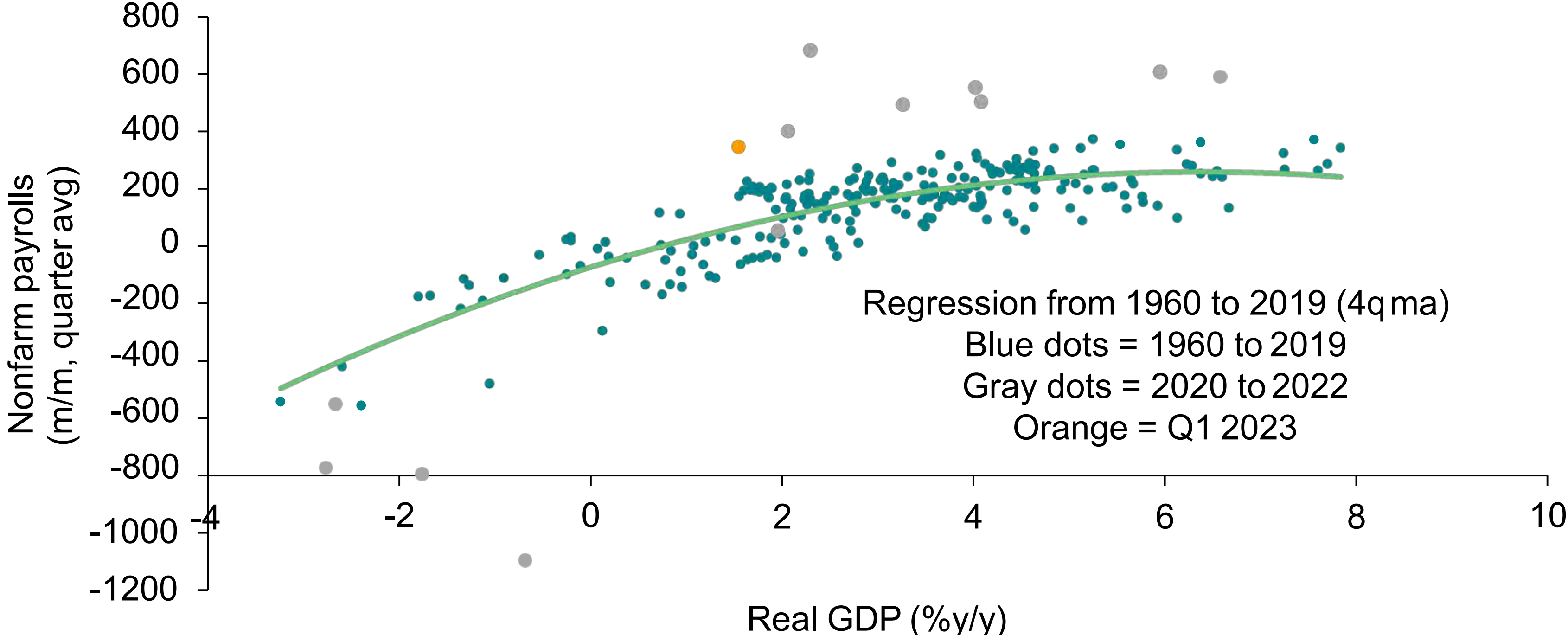
Sources: Investment Company Institute, Macrobond, BNP Paribas

Bank failures through history



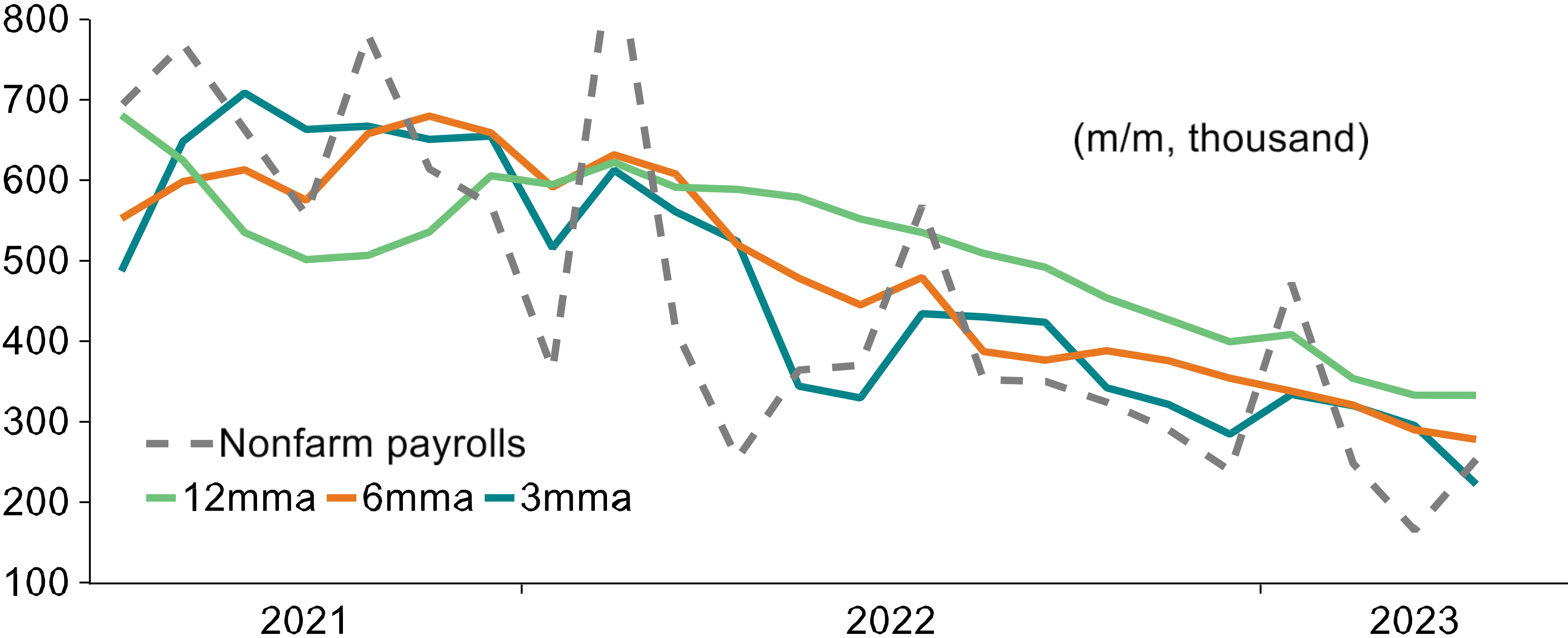
Sources: BLS, FDIC, BNP Paribas

Slow growth will take a toll on labor conditions



Sources: BEA, BLS, BNP Paribas

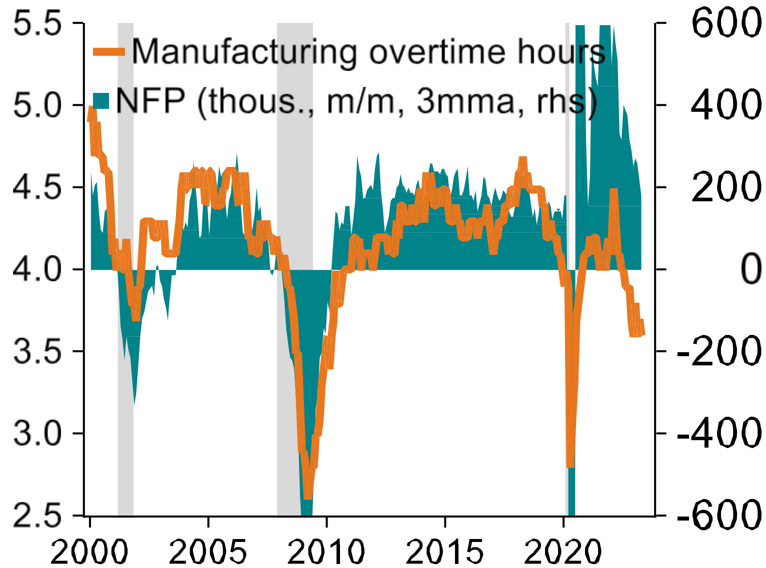
Too soon to declare hiring downtrend interrupted



Sources: BLS, Macrobond, BNP Paribas

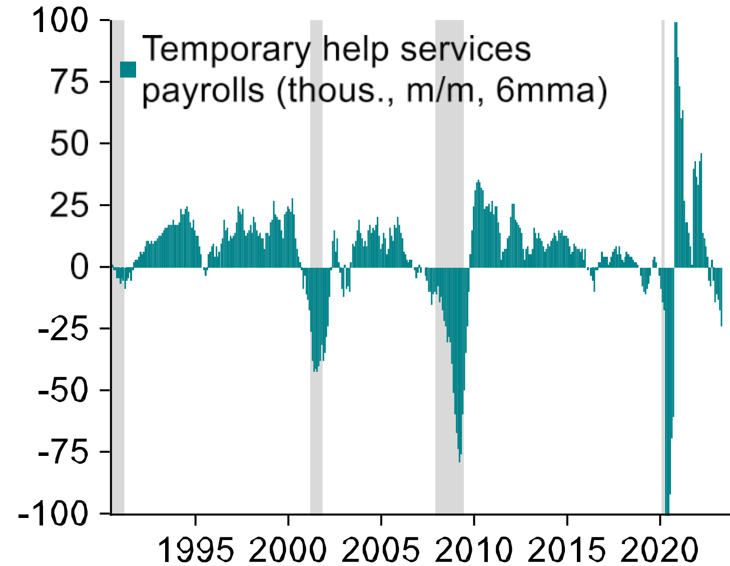
Hints of waning labor demand in overtime & temp help

Manufacturing overtime hours vs non-farm payrolls



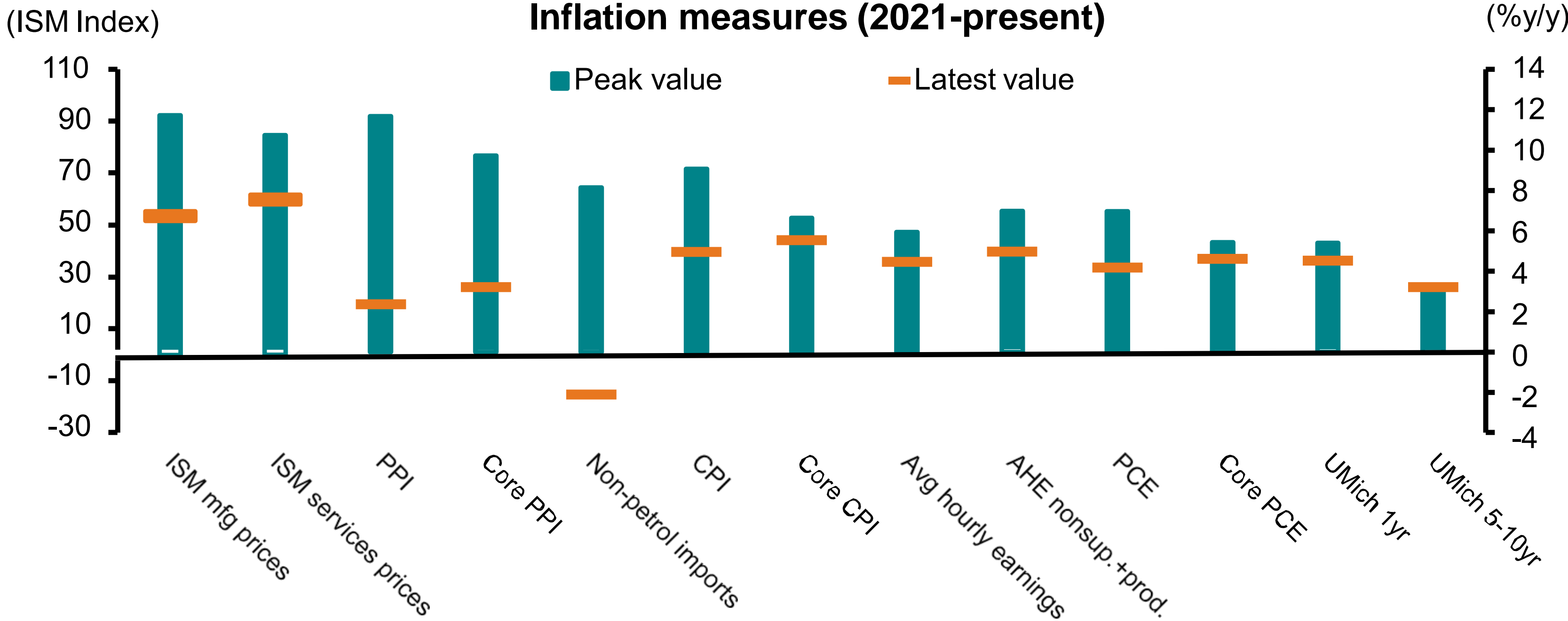
Sources: BLS, Macrobond, BNP Paribas

Temporary help services payrolls



Sources: BLS, Macrobond, BNP Paribas

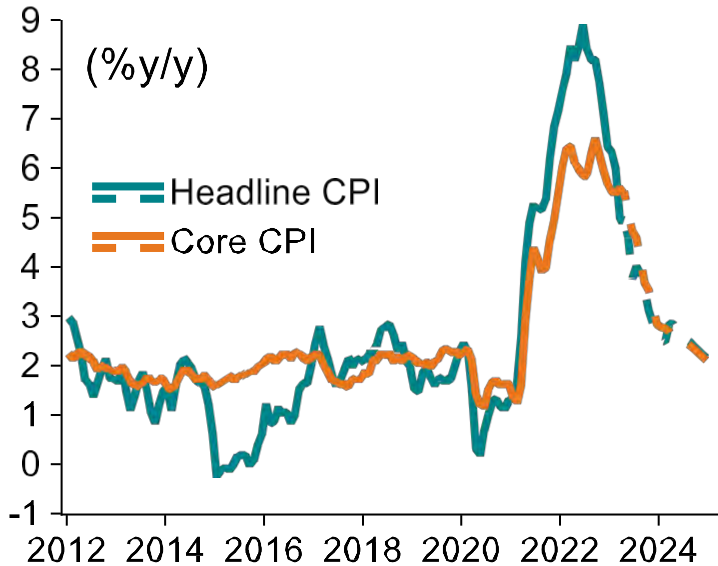
A wide array of inflation gauges appear to have crested



Sources: Sources: BEA, BLS, ISM, University of Michigan, BNP Paribas

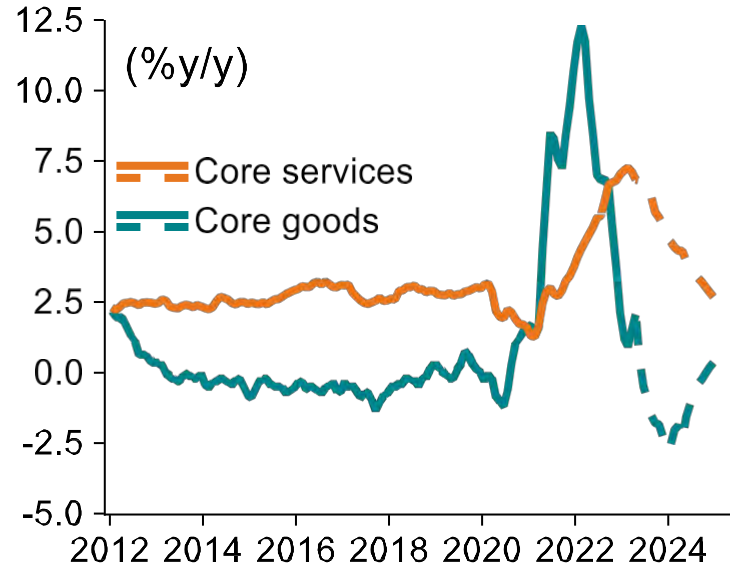
Inflation deceleration has been mostly driven by goods

Headline vs core CPI



Sources: BLS, Macrobond, BNP Paribas

Core goods vs services



Sources: BLS, Macrobond, BNP Paribas

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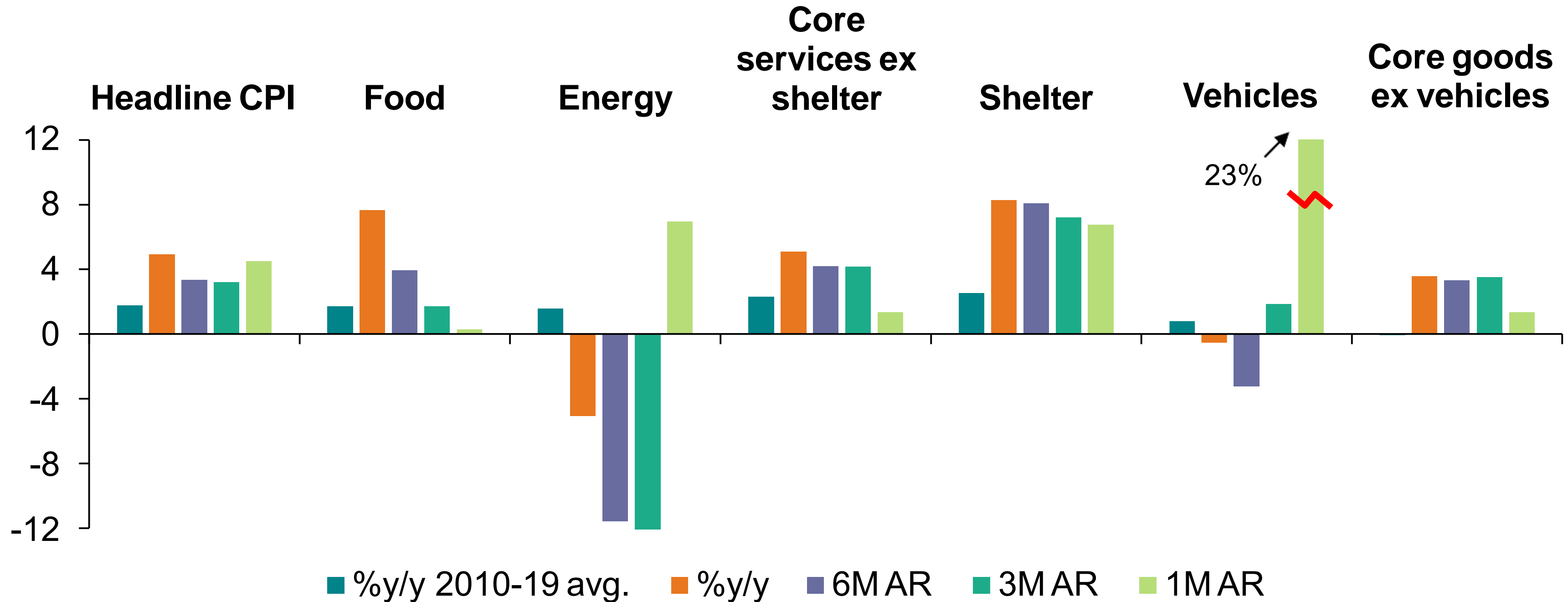
Details show inflation moderation less promising



Sources: BLS, BNP Paribas

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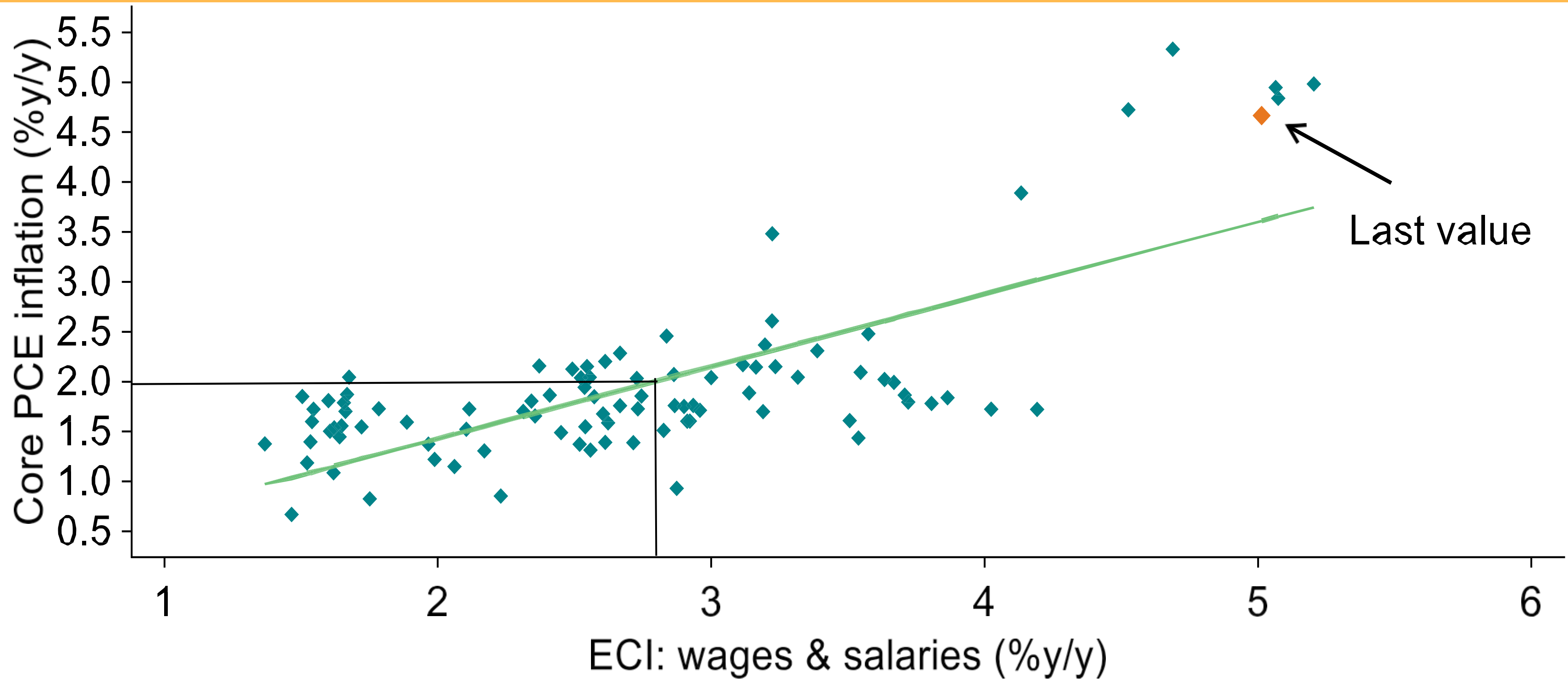
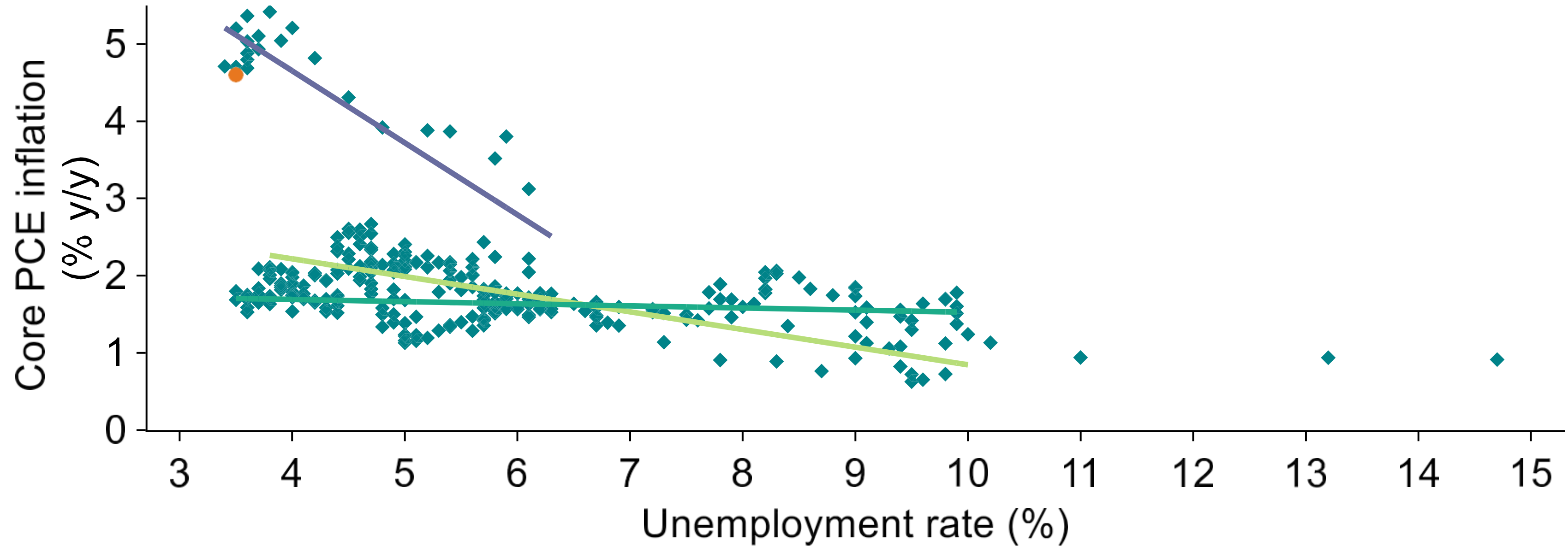
Fed-preferred wage gauge cooling, but not enough



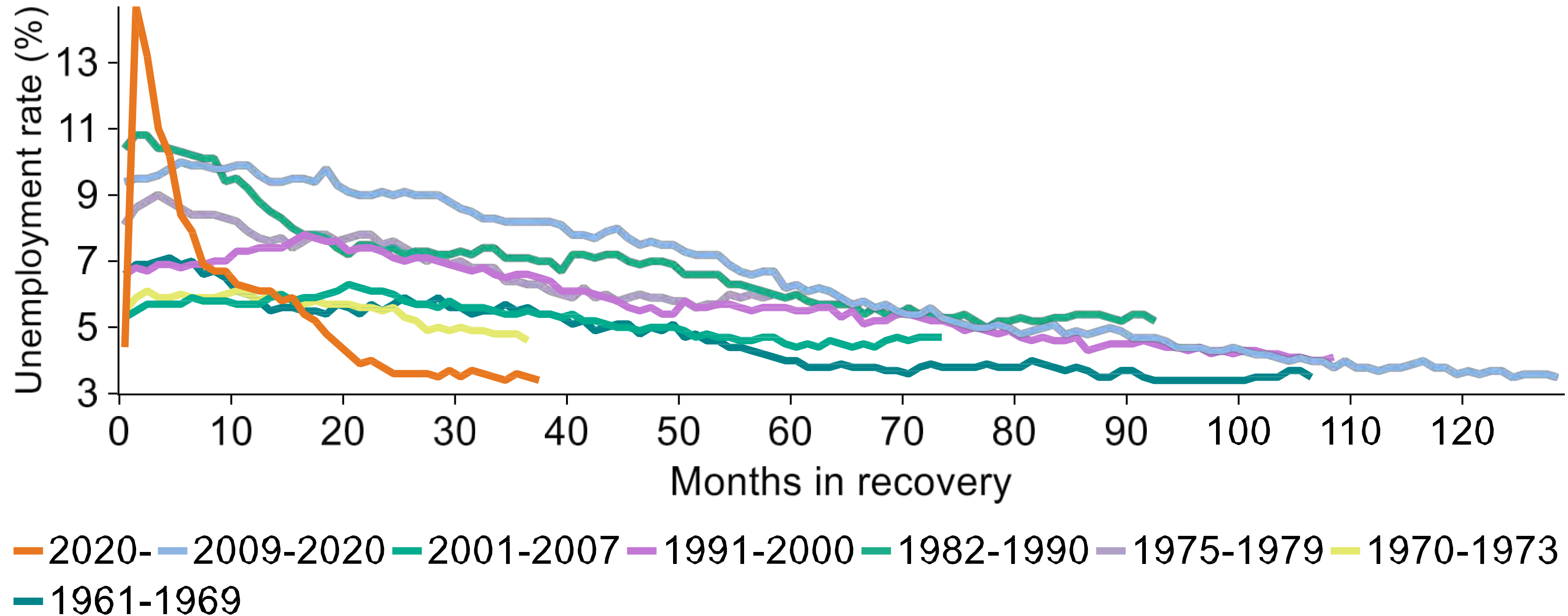
Sources: BEA, BLS, Macrobond, BNP Paribas

Phillips Curve implies big labor reset to cool inflation



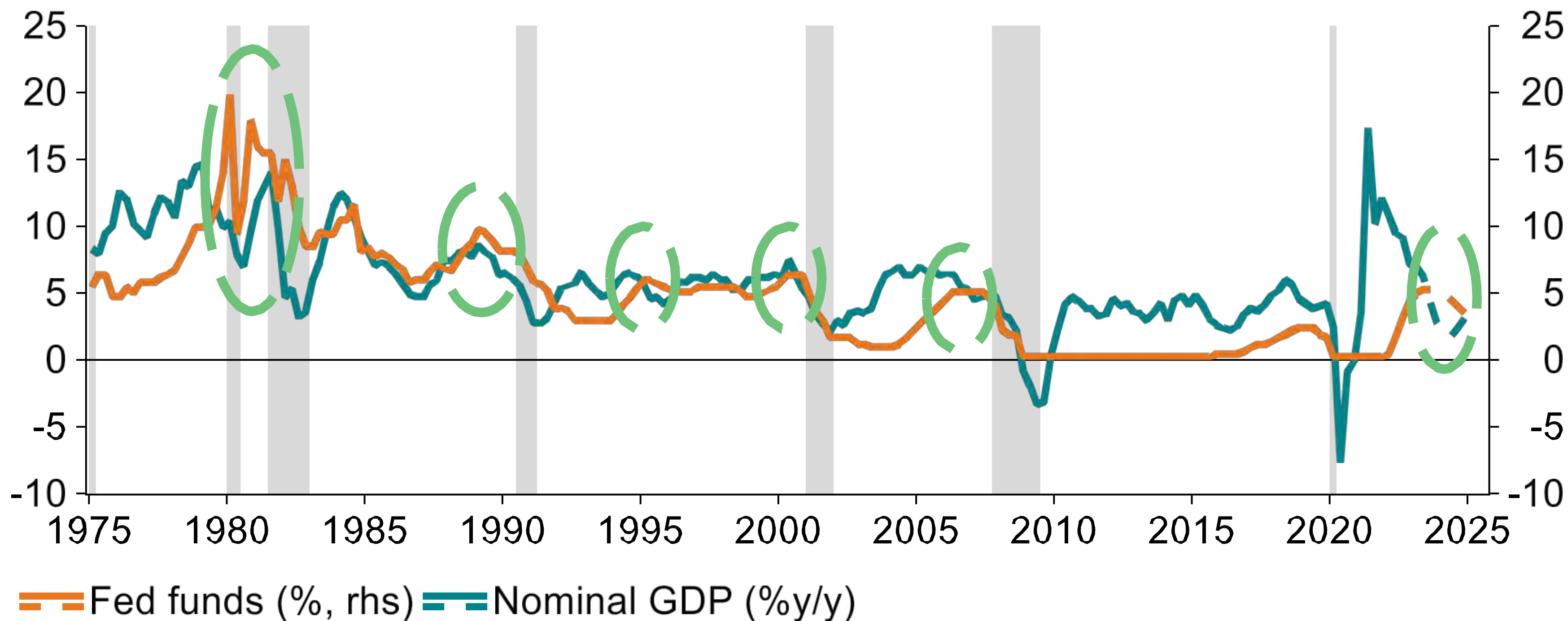
Sources: BEA, BLS, Macrobond, BNP Paribas

Rising unemployment without a recession extremely rare



Sources: BLS, Macrobond, BNP Paribas

Fed funds above 5% likely to induce downturn



Sources: BEA, Federal Reserve, Macrobond, BNP Paribas

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European and US Loan Markets: Trends and Deal Terms

Moderator

- Amelia Slocombe, Managing Director and Head of Legal – LMA

Speakers

- Lewis Grimm, Partner – Jones Day
- Seth Misshula, Head of US Trading and Portfolio Manager – Invesco Senior Secured Management, Inc.
- Elizabeth Tabas Carson, Partner - Sidley Austin LLP
- Jane Summers, Partner – Latham & Watkins LLP

LSTA ADVANCING THE CORPORATE LOAN MARKET | LMA Loan Market Association

Thursday, May 18, 2023

LIABILITY MANAGEMENT
TRANSACTIONS: OVERVIEW

An Introduction to Liability Management Transactions

Liability management transactions are simply transactions undertaken by a company to restructure the liabilities on its balance sheet. Common objectives of liability management include additional liquidity, deleveraging and the extension of upcoming debt maturities.

While liability management transactions may take a variety of forms, in recent years two types have become by far the most important (and newsworthy) in the loan market: **asset dropdowns** and **"uptiering" priming transactions**. Challenging market conditions have led to the increased use of these tools, and that trend is likely to continue.

Specifically, these techniques are used by distressed borrowers to, among other things, obtain liquidity, capture discount, and/or extend maturities by offering a group of lenders the benefit of a senior claim against all of the borrower's or a specific subset of the borrower's assets. This can prove critical to a company that may otherwise be unable to incur new debt or amend and extend its existing facilities through conventional means, or may only be able to do so on unfavorable terms.

J. Crew is the best-known example of an asset dropdown, while **Serta** is now regarded as the archetypal uptiering priming transaction.

Liability Management Transactions in Europe and the US

Liability management transactions are becoming an increasingly mainstream tool in the United States, but they have been less prevalent in the UK and European markets due to a lack of flexibility in the credit documentation and unfavorable case law.

However, as macroeconomic pressure continues to apply to companies through rising inflation, increasing interest rates, supply chain disruption and geopolitical instability, we expect to see an increase in the number of distressed companies seeking more bespoke refinancing techniques (including those based in Europe).

This presentation will look at liability management transactions, the case law surrounding them and how the these transactions are shaping LMA and LSTA documentation and current transactions in the US and Europeans markets.

STATE OF THE MARKET

Spotlight on Liability Management Jargon

Popular jargon which we will discuss at length during this presentation includes:

- **Pulling a J Crew**: refers to a Borrower transferring material assets (the "crown jewels") to an unrestricted subsidiary
- **J Crew trapdoor**: flexibility in the documentation that permits transfers to non-guarantor restricted subs and then subsequent transfers to unrestricted subsidiaries
    - Sample language of a basket that freely permits using proceeds of investments in non-guarantor restricted subsidiaries by loan parties to transfer value to unrestricted subsidiaries: "Investments made by any Restricted Subsidiary that is not a Loan Party with proceeds received by such Restricted Subsidiary from an Investment made by any Loan Party in such Restricted Subsidiary pursuant to this Section [__]"
- **J Crew Blocker**: a provision intended to prevent a borrower from transferring material assets to an unrestricted subsidiary
- **Chobani Black Hole**: in the Chobani deal, there was an unlimited ability to transfer value to non-guarantor restricted subsidiaries. When paired with the sample language above, this creates the "black hole", effectively allowing for unlimited investments in unrestricted subsidiaries
- **Chewy Blocker**: provisions in a credit agreement intended to prevent a subsidiary guarantor from being released from its guaranty obligations solely because it is no longer wholly-owned by the Borrower
- **Serta Protection:** protection in the credit agreement intended to prevent the subordination of the liens on the collateral, and often subordination of the payment priority of the loans as well, by a simple majority vote.

ASSET DROPDOWN TRANSACTIONS:
AN OVERVIEW

Overview of Asset Dropdowns

Asset dropdowns involve the transfer of assets to a non-loan party subsidiary, and the incurrence of new debt secured by those transferred assets. That new debt can then be used for purposes of additional liquidity and/or to facilitate a debt exchange.

Assets/equity are typically moved to a foreign or non-wholly owned subsidiary or an "unrestricted" subsidiary. Under most syndicated credit facilities (and secured indentures), these entities are not required to provide credit support for the borrower's debt. Accordingly, while the assets to be transferred may have secured the borrower's existing credit facilities, those liens will typically be released once the assets are transferred to a non-loan party, **thus allowing them to be used as collateral for a new financing**. Any new lenders will have a direct claim to those assets, while the borrower's existing lenders will only have a residual claim via the borrower's equity in the non-loan party (referred to as "structural subordination").

A key aspect of a dropdown is that, by virtue of being transferred in compliance with the borrower's existing debt documents, **no consent from its creditors is required**.

A critical question for any potential dropdown is whether the borrower has sufficient capacity under its debt documents to transfer the assets to the non-loan party. Creditors may challenge a dropdown on the basis that the transfer breached the covenants to which the borrower is subject, e.g., by arguing that the value of the transferred assets exceeded available capacity. Another frequent challenge in the US is that the transfer constituted a fraudulent conveyance.

In LMA/European facilities agreements, asset dropdown transactions are permissible so long as there is relevant capacity under the borrower's existing debt documents. However, to the extent exit consents are required, availability may be limited as a result of an unfavorable ruling in the **Assénagon** case (discussed on pages 70-71).

Each of these challenges is highly fact-specific, oftentimes relating more to valuation (or reasonably equivalent value) and less to interpretation of provisions in the credit documentation.

Overview of Asset Dropdowns (cont'd)

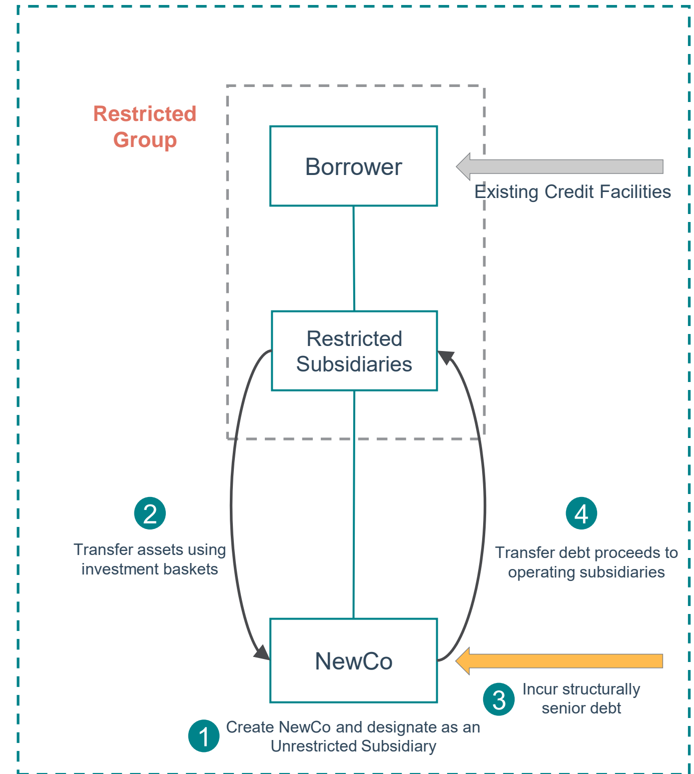
Asset Dropdowns: Key Takeaways	
Description	• Borrower transfers assets to a non-guarantor using available capacity under its negative covenants. Those assets can then be used to incur structurally senior debt. • Structurally senior debt may be provided by third-party financing sources or existing lenders. • Viability depends on whether assets are sufficiently valuable for market to lend against. • Transferred assets are licensed back so transaction does not impair borrower's operations.
Benefits to Company	• Structurally senior debt backed by transferred assets can be used for purposes of additional liquidity and/or to facilitate a debt exchange. • Does not require lender consent if permitted under the negative covenants. • A possible dropdown can be used as leverage in negotiations with creditors.
Key Documentation Considerations	• Permitted investment and/or disposition capacity. • Permitted debt capacity (if assets are transferred to a non-guarantor restricted subsidiary vs. an unrestricted subsidiary). • Restrictions on transferring assets material to the business to non-guarantors. • Conditions for designation of unrestricted subsidiaries. • Potentially, restrictions on affiliate transactions.
Potential for Legal Challenges	• May be challenged by lenders who are no longer secured by transferred assets (e.g., by alleging value of transferred assets exceeded available investment and/or disposition capacity and/or transaction was a fraudulent conveyance).

Typical Structure and Applicable Credit Agreement Provisions

Typical Structure	Applicable Credit Agreement Provision
Formation or identification of NewCo	• Definition of “unrestricted subsidiary” and unrestricted sub “designation” provisions • Collateral and guarantee requirements / excluded subsidiary provisions
Transfer of assets to NewCo (often accompanied by a license of the transferred asset back to borrower)	• Investments covenant • Asset sale covenant • Collateral release provisions • Sale leaseback covenant • Limitations on release of all or substantially all of the collateral (if applicable)
Incurrence of new indebtedness by NewCo (the “New Structurally Senior Debt”), which will either be: • unlimited (if NewCo is an unrestricted subsidiary); or • subject to the existing credit facility covenants (if NewCo is an excluded restricted subsidiary)	• If applicable, restrictions on unrestricted subsidiaries guaranteeing, or being guaranteed by, credit parties • If incurred at or guaranteed by an excluded restricted subsidiary, debt and lien capacity (subject to any “non-guarantor” caps or sublimits)
Where applicable, exchange or “roll-up” all or a portion of any existing loans of the new creditors for or into the New Structurally Senior Loans	• Pro rata sharing provisions • Borrower buybacks and/or Dutch auction provisions

Illustrative Transaction Structure

1. Company creates "NewCo" and designates it as an Unrestricted Subsidiary:
   - Because NewCo is an Unrestricted Subsidiary, covenants in the existing credit agreement do not restrict its activities.
   - NewCo can be formed at the time of, or prior to, the transaction.
   - Designation of Unrestricted Subsidiaries may require compliance with certain conditions (such as financial ratio tests and/or default blocker).
2. Company then transfers assets to NewCo using available investment and/or disposition baskets in the credit agreement.
3. Incur structurally senior debt at NewCo from existing lenders, sponsor, or 3rd party:
   - Quantum of debt raised will be a function of value transferred and market debt.
4. Proceeds of new debt up-streamed to the borrower/operating entities to fund cash flow shortfalls and bolster liquidity (and also refreshing investment capacity as returns on investments).



Notable Asset Dropdowns

Among the most notable asset dropdowns are:

- J. Crew (2016)
- PetSmart/Chewy (2018)
- Neiman Marcus (2018)

More recent examples include:

- Travelport (2020)
- Cirque du Soleil (2020)
- Revlon (2020)
- Envision Healthcare (2022)
- Bausch Health (2022)

"UPTIERING" PRIMING TRANSACTIONS:
AN OVERVIEW

Overview Of “Uptiering” Priming Transactions

Priming transactions have gained prominence as a tool for borrowers to raise additional secured debt capacity in distressed situations by creating a new class (or classes) of debt that are senior in priority to the borrower’s existing secured debt.

Specifically, a borrower and at least a majority of its existing creditors will amend the borrower’s debt documents to permit the incurrence of new super-priority debt. That new debt will typically be incurred under a separate agreement, with the priority being documented under a new intercreditor agreement. The super-priority debt may be comprised of a new money tranche, and frequently the exchanged debt of creditors who consent to the transaction. This can enable a borrower to obtain liquidity, and potentially deleverage and/or extend debt maturities through the debt exchange.

If the priming transaction does involve an exchange, the opportunity to exchange into new super-priority debt is a critical enticement for creditors to consent to the transaction, as those who do not consent will be left with a subordinated claim. In some priming transactions, each creditor is given the opportunity to consent to and participate in the priming debt. However, in many instances, the opportunity to participate is only provided to a group of creditors who collectively hold enough voting power to effect the necessary amendments. Generally speaking, transactions that do not give all creditors a chance to participate have historically been more vulnerable to court intervention.

A critical aspect of any potential priming transaction is determining the consent requirement for subordinating the priority of existing debt. In the US agreements may only require the consent of a majority of creditors, or possibly each affected creditor (or some other amount).

Amendments of ranking or subordination provisions under LMA/European credit agreements generally require unanimous consent and as such, makes uptearing transactions in the Europe particularly difficult.

Overview Of “Uptiering” Priming Transactions (cont’d)

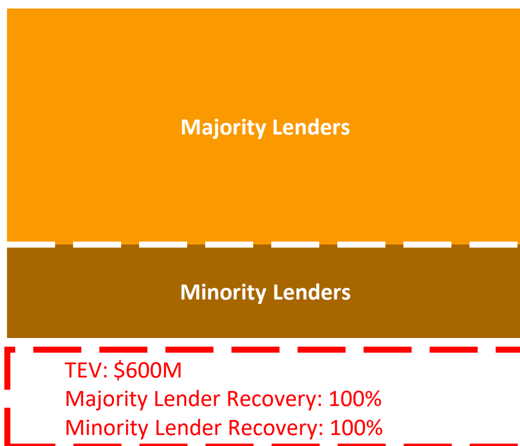
Priming Transactions: Key Takeaways	
Description	• Amend existing documents with consent of requisite creditors to permit the incurrence of super-priority debt. • Super-priority debt may consist solely of new money debt, or a combination of new money debt and the rolled-up debt of exchanging creditors consenting to the transaction. • Opportunity to participate in super-priority debt may be given to all creditors, or only a subset of creditors who possess the voting power to effectuate the transaction.
Benefits to Company	• Additional liquidity, deleveraging, and/or maturity extensions.
Key Documentation Considerations	• Consent requirements for subordination and changes to pro rata sharing. May not be possible depending on the language in credit agreement/indenture. • Restrictions on the ability of borrower and sponsor to repurchase debt. • Often in credit agreements, changes to waterfall requires all affected lender consent, which is why these are often done in separate agreements.
Potential for Legal Challenges	• May be challenged by non-participating creditors. • Case law on these transactions is evolving and currently uncertain.

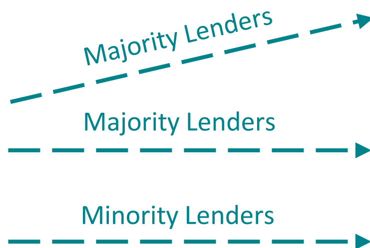
Typical Structure and Applicable Credit Agreement Provisions

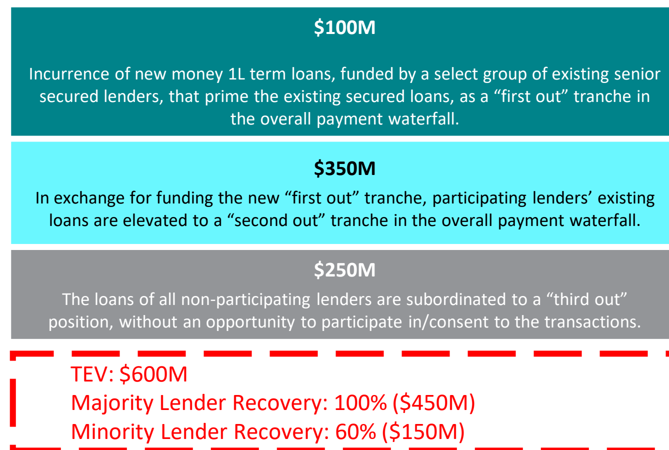
Typical Structure	Applicable Credit Agreement Provision
Incurrence of new debt by the borrower that is senior to existing loans.	• Debt and liens covenants • Limits on subordination of existing debt
Exchange/rollup of all or a portion of existing loans into senior debt that is pari with or junior to the New Superpriority Debt (but senior to the existing loans) ("Rolled Up Superpriority Debt").	• Pro rata sharing provisions • Borrower buybacks and/or Dutch auction provisions
The New Superpriority Debt and the Rolled Up Superpriority Debt may take the form of: • a new tranche of loans within the loan document, with priority governed by a payment "waterfall"; or • new loans under a separate credit facility, with priority governed by an intercreditor agreement.	• Pro rata sharing/waterfall provisions (including related amendment requirements) • Subordination/release of all or substantially all collateral • Intercreditor requirements

Illustrative Transaction Structure

- Company incurs new money "super-priority" loans provided by a group of existing lenders that is senior to the company's existing debt. This is done through a new Credit Agreement, and priority is governed by a new Intercreditor Agreement.
- Participating Lenders amend existing credit docs to permit "super-priority" incurrence and direct agent to enter new intercreditor agreement.
- In exchange, existing debt of participating lenders is exchanged for or "rolled up" into (typically a lesser amount of) "second" priority loans.
- Existing loans of non-participating lenders are then effectively subordinated to a "third" priority position.
- Equity (or equity-like) instruments may be included to provide participating lenders with potential equity upside.







Notable "Uptiering" Priming Transactions

As mentioned above, Serta (2020) has become the most famous example of an "uptiering" priming transaction.

Other notable examples include:

- Murray Energy (2018; litigated in 2020);
- McDermott (2019);
- Boardriders (2020);
- TriMark (2020);
- TPC (2021);
- Incora (2022);
- Mitel (2022); and
- Rodan + Fields (2023).

LIABILITY MANAGEMENT TRANSACTIONS: US V. UK/EUROPE

Distinctions in Liability Management Transactions Between the US and the UK

The following chart highlights several key differences between the US and UK market practices that can affect the ability to implement liability management transactions:

Liability Management Transactions		
	United Kingdom	**United States**
Legal Fees	• If the losing party has to pay the winner's legal costs, this can disincentivize aggressive moves. • Much less ability to pursue frivolous derivative actions on behalf of the company.	• Usually agreed in the underlying credit documentation. Typically the borrower covers legal fees of the lender, irrespective of the outcome. • Broader ability to pursue shareholder laws and similar actions (including actions on a contingent fee basis).
Director liability	• Directors might avoid actions that could result in civil / criminal liability for trading while insolvent.	• No personal action against Directors typically for trading while insolvent.
Legal framework	• English law 'anti-abuse' restrictions limit the majority creditors' ability to exercise power to the detriment of the minority.	• [No anti-abuse protections. Protections negotiated in debt documentation.]

Distinctions in Liability Management Transactions Between the United States and the United Kingdom (cont'd)

Liability Management Transactions		
	United Kingdom	United States
Governing laws	• Many sponsor facility agreements have English law govern the body of the agreement and New York law govern the covenants. Potential jurisdictional arbitrage or conflicts depending on the type of liability transaction being considered.	• Credit agreements are generally governed by New York Law, but there has been a trend in recent years for distressed borrowers to forum shop as they consider insolvency.
Amendments / Voting	• Typically 66 2/3 (rather than a simple majority).	• To be determined on case-by-case basis; can be majority consent, super majority consent or all lender consents
Intercreditor Agreements	• Comprehensive intercreditor agreement in place even if multiple tranches do not exist; some intercreditor agreements include a "hollow" super senior tranche, which would hardwire the ability to implement an uptier transaction.	• Typically, unless there is existing first lien and second lien debt, it is not common to have an intercreditor agreement in place due to the comprehensive protections under the Bankruptcy Code.

Distinctions in Liability Management Transactions Between the US and the UK (cont'd)

Liability Management Transactions		
	United Kingdom	United States
Exit Consent	• Exit consents limited under credit agreements but may be possible under indentures. • "Payments for consent" provisions in indenture may limit ability to offer priming exchange transaction to subset of holders to build voting position for exit consents.	• Exit consents are fairly common and are offered to all lenders whose rights are affected by such exit consent. • Pro rata sharing provisions not common in indentures.
Open Market Purchases	• Typically, no open market purchases, repurchases of debt provisions typically require the participation of all lenders and repurchases to be accepted in inverse order of the prices offered, but most European issued bonds will also permit private exchanges with a subset of bondholders.	• Most US governed documents permit open market purchase language a la Serta. • Private exchanges in the US need to be carefully structured to avoid having the repurchase classified as a "creeping tender offer" under US tender offer rules, which include additional protections for bondholders.
Market implications	• Smaller market means actions of borrowers / sponsors could have greater impact on ability to borrow or enter into amendments or waivers in the future.	• While liability management transactions are becoming more common, they still represent a relatively small portion of restructuring transactions.

LMA & LSTA
DOCUMENTATION RESPONSES

Overview of Documentation Changes

In response to high-profile asset dropdown and priming transactions, lenders have sought documentation changes that attempt to prevent these maneuvers in the future. The market has coalesced around three types of such provisions:

- J. Crew blockers,
- Chewy blockers, and
- Serta protection.

We discuss these provisions in the following slides. However, there are several common themes to be aware of:

- The market has settled on these specific provisions instead of (or without modifying) other provisions necessary to effectuate a liability management transaction.
- These provisions are far from universally adopted. Whether or not a particular agreement includes some or all of these protections is negotiated and will likely reflect broader market dynamics at the time of incurrence.
- These provisions can take a variety of forms. Consequently, there is a spectrum of how protective these actually are to a lender (or permissive to a borrower).

As a result, there is a large degree of variation in the market as to whether individual agreements include flexibility for a potential dropdown or priming transaction.

J. Crew Blockers

These provisions seek to prevent material intellectual property from being transferred to a non-guarantor subsidiary. In most cases, the blocker will only restrict transfers to unrestricted subsidiaries, as opposed to any non-guarantor (more on that below).

In its most conventional formulation, a J. Crew blocker will provide that: "The Borrower shall not, and shall not permit any of its Restricted Subsidiaries to, sell, convey, transfer or otherwise dispose of or exclusively license any Material Intellectual Property to any Unrestricted Subsidiary."

However, there are many variations on the J. Crew blocker. Two of the most notable are the following:

- **Variation 1:** In order for a subsidiary to be "unrestricted," credit agreements require the borrower to affirmatively designate a restricted subsidiary as such. Some agreements do not actually restrict the *transfer* of material IP to unrestricted subsidiaries, but instead provide only that a restricted subsidiary that owns material IP may not be designated as unrestricted. While this may sound effective, a borrower could simply designate a subsidiary as unrestricted, and then transfer material IP to it some time later.
- Note that Variation 1 and the conventional formulation can both be included in the same agreement (and frequently are).

J. Crew Blockers (cont'd)

- **Variation 2:** Some J. Crew blockers prohibit the transfer of material IP owned by a borrower or guarantor to any non-guarantor. This is more expansive than the conventional formulation, because in addition to prohibiting transfers to unrestricted subsidiaries, it also prohibits transfers to non-guarantor restricted subsidiaries (most likely foreign or non-wholly-owned subsidiaries, which could otherwise use the transferred assets as security for new debt).
- Note that Variation 2 can be less meaningful given non-guarantor subsidiaries that are restricted subsidiaries (unlike unrestricted subsidiaries) typically have limited debt and lien capacity to leverage the transferred assets.

Apart from the formulation, another issue is the definition of "Material IP" to which the blocker applies. Consider the following definitions: "IP material to the business or operations of the Borrower or its Restricted Subsidiaries" vs. "IP that, if disposed, would reasonably be expected to result in a Material Adverse Effect." The first definition is more lender-friendly, as it restricts the transfer of any IP which is material in a more conventional sense. The second is more borrower-friendly, because it only restricts the transfer of IP that is so important that it would rise to the level of a Material Adverse Effect (which is a higher standard).

Finally, note that there is an important limitation on J. Crew blockers, regardless of what form they take: they almost always only apply to IP assets. Accordingly, they do not restrict a borrower from engaging in a dropdown of non-IP assets (such as equity interests in a subsidiary); although there are formulations that include equity in entities that own IP assets. Moreover, amendments to these provisions are usually not a sacred right and thus protections can be removed or modified in a transaction where the majority lenders/holders are supportive.

LSTA Drop-Down Financing Rider

Notwithstanding anything herein to the contrary, in no event shall [(i) any Loan Party contribute, or otherwise invest, any [Material Asset] in, or Dispose of any [Material Asset] to, any Subsidiary that is not a Loan Party,][1] (ii) any Restricted Subsidiary contribute, or otherwise invest, any [Material Asset] in, or Dispose of any [Material Asset] to, any Unrestricted Subsidiary or (iii) any Subsidiary be designated as an Unrestricted Subsidiary if such subsidiary owns any [Material Asset].

"Material Asset" means any [asset] owned by any Loan Party that is, [in the reasonable determination of the Borrower], material to the operation of the business of the Borrower and its Restricted Subsidiaries, taken as a whole. [2]

[1] Borrowers will often seek to limit the restrictions on investments in or dispositions to unrestricted subsidiaries (vs. any non-credit party) covered by (ii).
[2] The scope of these assets is often limited to "Material Intellectual Property".

Chewy Blockers

Chewy blockers are provisions designed to prevent a subsidiary guarantor from being released from its obligations on the grounds that it is no longer wholly-owned, as happened in PetSmart/Chewy. Under many syndicated credit facilities and secured indentures, non-wholly-owned subsidiaries are not required to provide credit support for the borrower's debt and a guarantor is automatically released from its guaranty (and the lien on its assets automatically released) upon becoming an Excluded Subsidiary (i.e., a subsidiary not required to provide a guaranty). Accordingly, absent such a provision, a subsidiary guarantor could be automatically released from its guarantee (as will any liens on its assets) if it ceases to be wholly-owned.

Chewy blockers work by requiring that, before a subsidiary guarantor is automatically released from its obligations, the relevant transaction must satisfy one or more of the following specified conditions. While those conditions vary considerably, a Chewy blocker will often include some combination of the following:

- The transaction is made for a bona fide business purpose;
- Any remaining investment in (and debt and liens of) such subsidiary permitted as if invested (or incurred) at the time it became non-wholly-owned;
- The disposition is not entered into primarily for the purpose of releasing the subsidiary from its guarantee;
- The party to whom the shares are transferred is not affiliated with the borrower; and/or
- The disposition of the shares is made for fair market value.

Because there is a variety in the conditions required, there is also a variety in the effectiveness of Chewy blockers. Accordingly, whether a Chewy blocker actually prevents a subsidiary guarantor from being automatically released in a particular circumstance depends on how the blocker is drafted.

Serta Protection

Serta protection, as its name suggests, was developed following Serta to prevent the type of uptier priming maneuver that occurred in that transaction. It works by requiring the consent of each (or each adversely affected) lender to subordinate the loans, effectively giving minority lenders a veto right over potential subordination.

More specifically, Serta protection applies to the subordination of the liens on the collateral, and often subordination of the payment priority of the loans as well.

One of the most common variations is providing that the heightened consent requirement will not apply if the opportunity to participate in new priming debt is offered to each affected lender on a pro rata basis. In so doing, it takes a more nuanced approach: it allows for priming by the majority as long as the minority lenders are not excluded from the transactions, as happened in cases such as Serta, Boardriders, and TriMark. In this way, it addresses what is considered by many to be the most concerning aspect of these transactions (from a lender's perspective).

LSTA Uptiering Transaction Rider

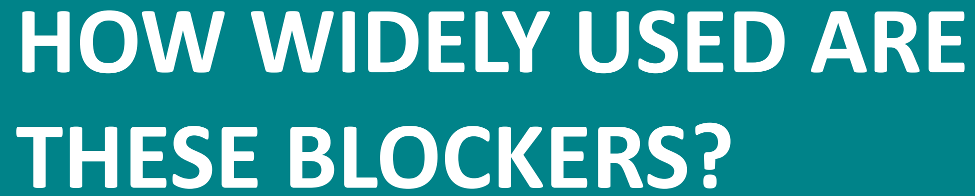
[No amendment, waiver or consent shall] without the prior written consent of each Lender directly affected thereby, (i) subordinate, or have the effect of subordinating, the Obligations hereunder to any other Indebtedness, (ii) subordinate, or have the effect of subordinating, the Liens securing the Obligations to Liens securing any other Indebtedness, or (iii) modify Section *[include pro rata sharing, pro rata treatment, post default waterfall and borrower/affiliate buyback mechanics if appropriate]* or any other provision hereof in a manner that would have the effect of altering the ratable reduction of Commitments or the pro rata sharing of payments otherwise required hereunder.

LSTA Liability Management Checklist

1. *Investment Covenant*
   - ✓ What is the aggregate capacity for a drop-down financings? For this analysis, it is critical to take into account all relevant baskets as a whole, including ratio-based baskets, cumulative credit (including capacity that may have been built by earlier capital contributions) and other baskets that can be reallocated from the restricted payments or other covenant.
   - ✓ Is there a cap on [non ordinary course] investments by credit parties in non-credit party restricted subsidiaries? Would such a cap be appropriate given the operations of this borrower?
   - ✓ Does the document contain the "J. Crew" provision?[4]
   - ✓ Are there limitations on moving certain categories of assets outside the credit group (e.g. intellectual property or distinct lines of business)?
   - ✓ Are there specific provisions permitting the movement of intellectual property within the corporate group that would permit a drop-down financing (this has become more common in recent transactions)?
   - ✓ Consider requiring a leveraged-based or interest coverage ratio test on the use of cumulative credit for investments.
   - ✓ When investing assets, how is the value of the assets to be determined? By the borrower in good faith? Subject to a third-party verification if over a threshold (this would be unusual in loan agreements)?

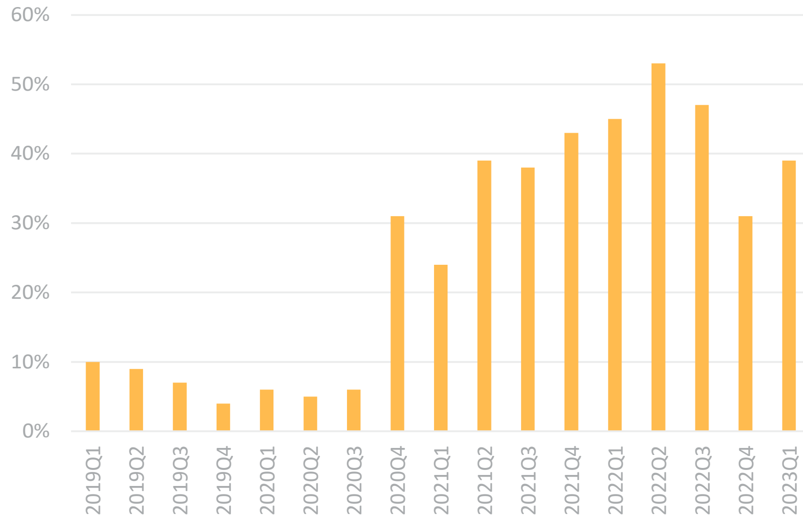
2. *Unrestricted Subsidiaries*
   - ✓ Are there any unrestricted subsidiaries at closing that may be used to consummate a drop-down financing in future without complying with the applicable "designation" requirements?
   - ✓ Is there a leveraged-based or interest coverage ratio test that must be satisfied as a condition to designating unrestricted subsidiaries?
   - ✓ What limits, if any, exist on unrestricted subsidiaries guaranteeing obligations of, or being guaranteed by, credit parties?
   - ✓ Are there any significant – and meaningful – exclusions from the requirements that the borrower and its subsidiaries provide guarantees and collateral?
   - ✓ Is the exclusion of foreign subsidiaries appropriate given the transaction structure and tax regulations?

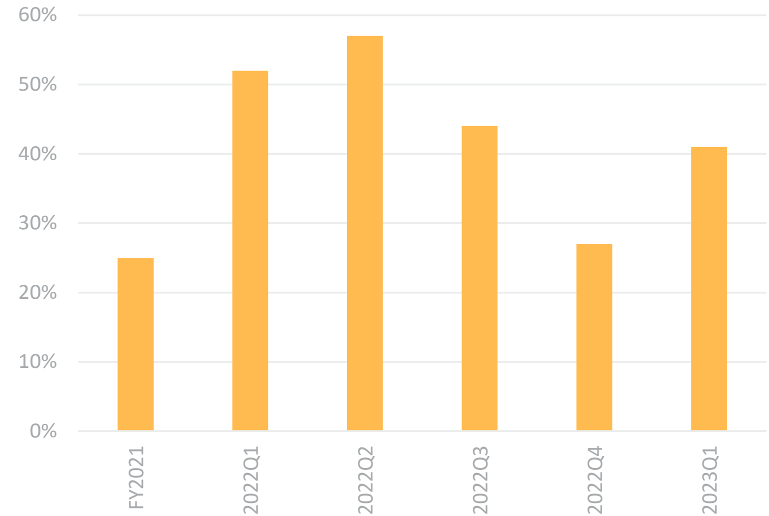
[4] If there is no cap on investments by credit parties in non-credit party restricted subsidiaries, the "J. Crew" provision creates unlimited capacity to invest in unrestricted subsidiaries.



HOW WIDELY USED ARE THESE BLOCKERS?

Use of Blockers Increased, Then Declined



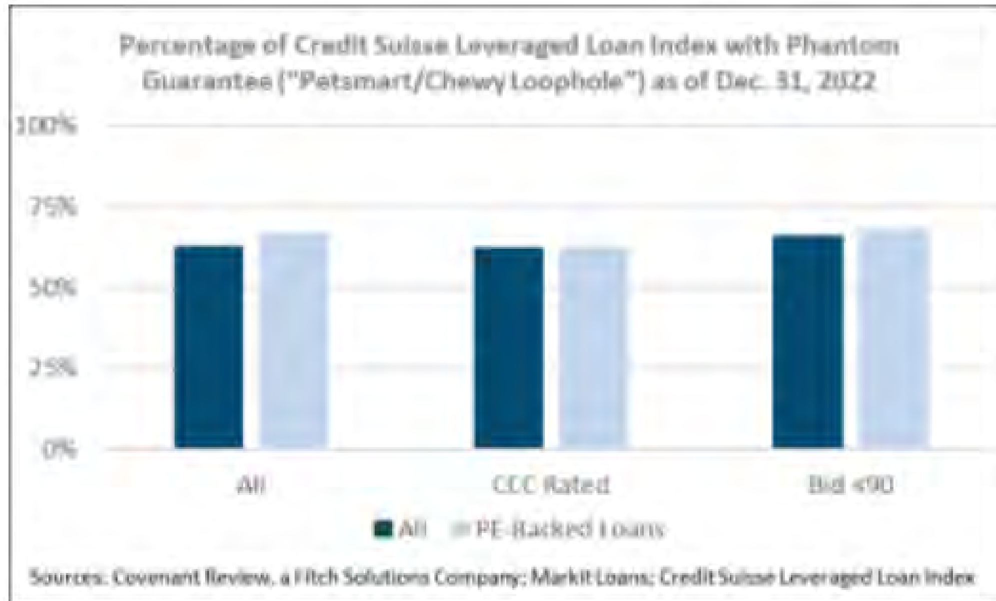


- LSTA published its LMT advisory in March 2021 which was followed by a surge in use of blockers
- But … use of blockers has since declined

Source: Covenant Review, a Fitch Solutions Company

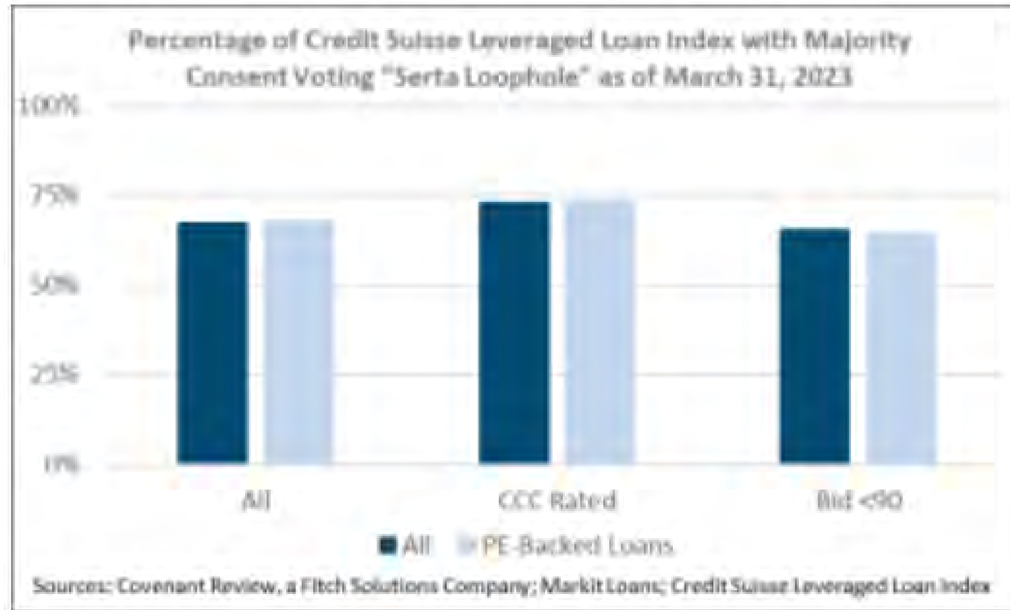
Use of Blockers Increased, Then Declined

The following chart shows, as of December 31, 2022, the percentage of loans in the Credit Suisse Leveraged Loan Index that provides for the automatic release of guarantees provided by entities that become excluded subsidiaries by virtue of ceasing to be wholly-owned (or in other words, loans that do not include any form of Chewy blocker). The data is broken down by all loans vs. PE-backed loans, and all loans vs. CCC rated loans and those bid less than 90.



Serta Protection Usage

The following chart shows, as of March 31, 2023, the percentage of loans in the Credit Suisse Leveraged Loan Index that only require majority lender consent for subordination (i.e., those that do not include Serta protection). The data is broken down by all loans vs. PE-backed loans, and all loans vs. CCC rated loans and those bid less than 90.



ANNEX A: COMPANIES IN THE NEWS

US Litigation (and Bankruptcy) Tracker

Transactions that have resulted in litigation	Transactions where company filed for bankruptcy (or foreign equivalent)
• J. Crew • PetSmart/Chewy • Neiman Marcus • Travelport • Revlon (both pre-filing and post-filing) • *Serta (both pre-filing and post-filing) • Murray Energy • *Boardriders • TriMark • TPC (post-filing) • *Incora • *Mitel • *Bausch Health *Denotes ongoing litigation	• J. Crew • Neiman Marcus • Cirque du Soleil • Revlon • Serta • Murray Energy • McDermott • TPC

UK/European Litigation (and Bankruptcy) Tracker

Transactions that have resulted in litigation	Transactions where company filed for bankruptcy (or foreign equivalent)
*Denotes ongoing litigation	

LSTA LMA Loan Market Association

ANNEX B: SELECT US LIABILITY
MANAGEMENT LITIGATION

SELECT LITIGATION/CASE LAW UPDATES RELATING TO “UPTIERING” PRIMING TRANSACTIONS

Serta

Serta Simmons Bedding LLC, a portfolio company of Advent, had the below capital structure as of June 2020:

- Approximately $2 billion of first lien term loans (the "TLB") maturing November 8, 2023;
- Approximately $450 million of second lien term loans (the "2L") maturing November 8, 2024; and
- An ABL facility with approximately $225 million of revolving commitments maturing November 8, 2021.

On June 8, 2020, Serta announced that it had entered into a transaction support agreement with a majority of lenders in respect of a recapitalization transaction, which provided for the following priming debt (documented outside the existing credit agreements):

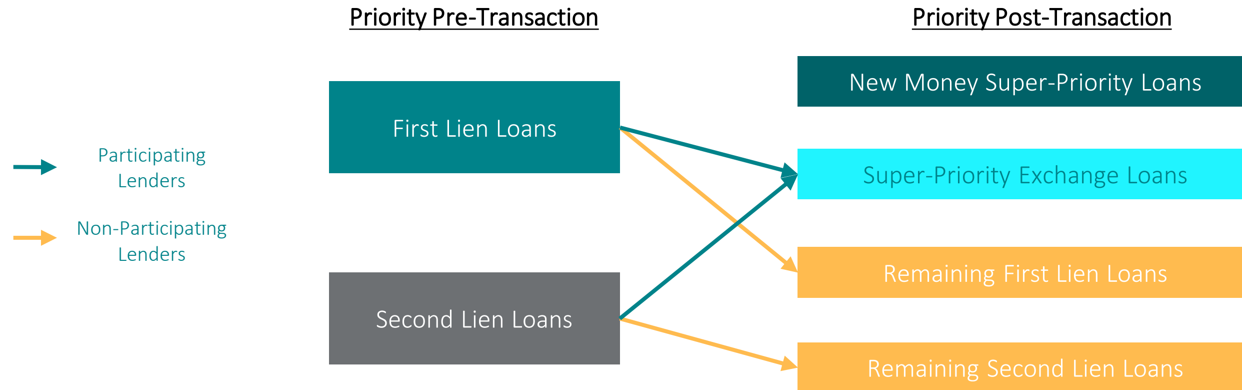
- $200 million of newly funded super-priority, first-out debt ranking ahead of the TLB and 2L;
- $875 million of super-priority, second-out debt issued in exchange for existing TLB and 2L loans held by the consenting majority lenders, ranking ahead of the remaining TLB and 2L; and
- Capacity to incur future super-priority, third-out debt, ranking ahead of the remaining TLB and 2L.

Serta (cont'd)

As a result, approximately $814 million of left-behind "first lien" loans became third/fourth lien loans and approximately $211 million of left-behind "second lien" loans became fourth/fifth lien loans.

Minority first and second lien creditors were not given an opportunity to participate in the new super-priority credit facilities (and did not learn of the transaction until it was publicly announced).

Of critical importance, the existing credit agreements did not expressly require the consent of each (or each affected) lender to subordinate the liens securing their loans.



LSTA LMA Loan Market Association

Serta (cont'd)

On June 11, 2020, certain lenders filed suit seeking a preliminary injunction that would have blocked Serta from implementing this transaction (as illustrated above) on the basis that the transaction violated the pro rata sharing and collateral release provisions (each of which required unanimous consent to amend). That injunction was denied by the court, and the transaction was allowed to proceed.

However, a separate group of lenders filed suit. In March 2022, the court issued an order denying Serta's motion to dismiss the case, thereby allowing those claims to proceed. The key issues raised in that litigation are as follows:

- Whether the exchange of the existing loans into new priming debt was an appropriate use of the "open market purchase" provisions in the existing credit agreement; and
- Whether the transaction, *even if expressly permitted,* breached the implied covenant of good faith and fair dealing.
- From the order on the motion to dismiss: "Plaintiffs further allege that notwithstanding their contractual entitlement to be treated on a pro rata basis with other first-lien lenders, Defendant engaged in furtive negotiations with a select few creditors, manipulated the Agreement to subordinate Plaintiffs' debt without their knowledge, and struck a deal at Plaintiffs' expense."

Serta (cont'd)

Certain of the lenders who unsuccessfully challenged the transaction in 2020 then refiled their lawsuit in New York state court. Unsurprisingly, the plaintiffs echoed similar arguments raised in those other cases, contending (among other things) that:

- The pro rata sharing provisions in the credit agreement enshrine "a bedrock principle ... that the First Lien Lenders share ratably in all payments of principal or interest on their First Lien Term Loans;" and
- The exchange "was not an open market purchase" but rather "a wholly private, exclusionary transaction – an exchange, at a substantial premium to market prices, in which Serta handpicked a group of its lenders (excluding the remainder)."

Serta (cont’d)

While these cases were ongoing, Serta filed for Chapter 11 on January 23, 2023 in the Southern District of Texas. The debtors and the priming lenders then filed motions for summary judgment seeking validation of the uptier transaction.

On March 28, 2023, the bankruptcy court ruled that Serta’s uptier exchange transaction was a valid “open market purchase” under the existing credit agreement, finding in particular that “in looking at what occurred, it’s very clear to me this is what was intended by the agreement” and “it’s what’s intended by the concept of an open market purchase.” The court’s decision was a notable development in the evolving case law regarding these transactions, as it was the first definitive ruling by a judge as to whether a non-pro rata uptier exchange constituted an open market purchase.

The question of whether the transaction violated the implied covenant of good faith and fair dealing is still unresolved in the bankruptcy litigation (with a trial being set to begin May 15, 2023). However, on May 4, 2023, Judge Jones of the bankruptcy court made a discovery ruling reflecting his view that non-priming lenders’ participation in other liability management transactions could be important to the outcome of the good faith and fair dealing claim.

The minority lenders have appealed the bankruptcy court’s ruling to the Fifth Circuit, and the court has agreed to review the decision (although it also denied a motion to expedite the appeal in order to obtain a decision prior to a May 15 confirmation hearing).

Regardless of the outcome in the Serta bankruptcy, state and federal courts in New York have already considered the open market purchase exception to be ambiguous and thus able to survive a motion to dismiss, and those courts are not bound by the bankruptcy court’s (or the Fifth Circuit’s) ruling.

Trimark

In September 2020, TriMark consummated a similar non-pro rata recapitalization executed with a majority of first lien term lenders but not offered to other lenders

The transaction amended a number of provisions in the existing loan documents to permit:

- a $120 million new-money superpriority "first out" term credit facility that ranked ahead of the existing first lien term loan, and
- $307 million superpriority "second out" term notes that ranked ahead of the existing first lien term loan but behind the aforementioned "first out" loan

Both "super senior" tranches were secured by the same collateral that secured the existing first lien debt

Company and participating lenders effectuated the roll-up via the open market purchases provision

Trimark (cont'd)

The result of these transactions was to effectively subordinate the previously first lien debt of the non-participating lenders to the new priming facility and $307 million of previously first lien debt held by the participating lenders

Company and participating lenders also stripped out all covenants from the existing credit facility, including information rights, and strengthened the collective action provision

In August 2021, the **NY Supreme Court allowed the plaintiffs breach of contract claims to proceed** but dismissed the implied covenant of good faith claims

In January 2022, the parties settled the matter, publicly noting that the settlement includes "an exchange of all outstanding First Lien Term Debt on a dollar-for-dollar basis for Tranche B Loans pursuant to the company's Super Senior Credit Agreement. Tranche A Loans outstanding under the Company's Super Senior Credit Agreement will retain their position in the Company's capital structure, senior to the Tranche B Loans."

Boardriders

In April 2018, Boardriders borrowed $450 million of term loans, with $440 million outstanding as of August 2020

In August 2020 Boardriders secretly entered into a non-pro rata recapitalization transaction with a simple majority of lenders providing $135 million of new money alongside a "rollup" of $332 million of existing debt with a newly appointed administrative agent

- The transaction also amended the Credit Agreement to (1) allow for issuance of new superpriority debt and (2) eliminate most of the affirmative and negative covenants

The rollup was in reality a new senior loan, the proceeds of which were used to buy back existing first lien debt via "open market" purchases on a non pro rata basis (and exchanging the new debt obligations for the old ones)

Notably, this transaction was not offered to all lenders

Boardriders (cont'd)

Minority lenders sued in October 2020 arguing, among other things:

- The debt-for-debt exchange did not constitute an "open market purchase"
  - No established market made by one or more third-party broker dealers
  - No competition among the market participants (i.e., the lenders) determines price
  - Company did not retire purchased debt
  - Par purchase price far exceeded market price of 50-60% trading value
  - Purchase was not standalone transaction but part of integrated restructuring
- Exchange was voluntary prepayment that violated the credit agreement's pro rata sharing provisions

Boardriders (cont'd)

In November 2022, the court **denied the motion to dismiss**:

- The court rejected a narrow reading of the sacred rights provisions (notwithstanding that the absence of an express "no subordination" sacred right) as it would "essentially vitiate the equal repayment provisions" of the Credit Agreement and be "contrary to the court's obligation to consider the context of the entire contract and not in insolation [sic] of particular words – or in this case, the absence of particular words". As a result, the court viewed the uptier transaction, in the context of the entirety of the Credit Agreement, as potentially violating the intent of the parties.

- The court also found that the term "open market purchase", undefined in the Credit Agreement, was susceptible to more than one meaning and therefore ambiguous.

Incora

Incora, an aerospace supply chain manager, had the following capital structure prior to its priming transaction:

- $650 million of senior secured notes due 2024;
- $900 million of senior secured notes due 2026;
- $525 million of senior unsecured notes due 2027; and
- a $475 million ABL facility maturing 2024.

In March 2022, Incora completed a recapitalization with PIMCO and Silver Point Capital to provide liquidity relief, which generally consisted of $250 million of new money and an exchange of the existing secured and unsecured notes for new notes due 2026 and 2027, respectively, extending the maturity on over $450 million of notes that would have been due in 2024. They also reduced their interest burden over the next five years by an estimated $90 million.

Under the bond documents, the company needed two-thirds consent of the then-existing senior secured notes and a majority of the unsecured notes to amend the indentures governing its three bond classes.

Incora (cont'd)

Incora executed the transactions through the following process:

- **First:** Incora used their incremental basket capacity and issued fungible add-on notes to favorable holders at par to dilute the voting power of the non-consenting holders.
- **Second:** Upon receiving the necessary votes, PIMCO, Silver Point Capital, and Platinum (the "Sponsor") rolled-up their estimated $1 billion hold of Incora's debt in exchange for higher-priority secured paper.

As a result of these transactions, non-participating noteholders' interests were primed and effectively reduced to an unsecured status in a restructuring event.

In October 2022, a number of Incora's non-participating noteholders filed suit challenging the priming transaction. That litigation is ongoing. Of particular note, the plaintiffs' lawsuit attacks the issuance of new debt to gain the votes needed to effect the transactions. From the complaint: "Defendants executed (or consented to) unauthorized amendments to the Governing Indentures that resulted in the issuance of new notes to certain Favored Noteholders for the specific purpose of diluting Plaintiffs' blocking position in the 2026 Senior Secured Notes and obtaining a feigned supermajority. Those new notes were issued to those Favored Noteholders for no purpose other than to gerrymander a vote of the 2026 Senior Secured Notes, and once that vote occurred, the new notes were exchanged and cancelled on the same day they were issued."

SELECT LITIGATION/CASE LAW UPDATES RELATED TO ASSET DROPDOWNS

J. Crew

In 2016, J. Crew executed a series of transactions in order to transfer certain IP assets outside the existing collateral pool and utilize those IP assets as security in connection with a deleveraging exchange offer.

The Financing Documents:

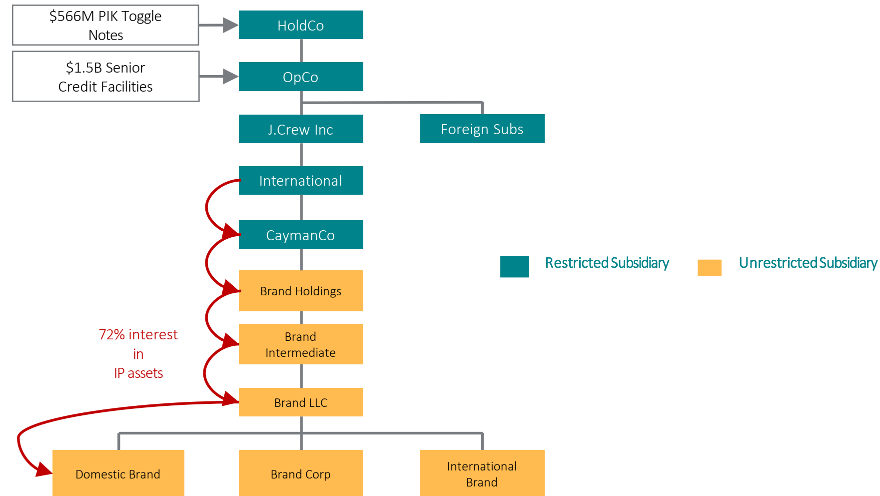
J. Crew was a party to a credit agreement secured in part by assets held by a subsidiary guarantor. That subsidiary guarantor held the IP assets to be transferred. It and certain other non-guarantor subsidiaries were restricted subsidiaries and therefore subject to the restrictions of the company's existing credit agreement. Such Credit Agreement provided:

- a $150 million basket permitting investments in non-guarantor restricted subsidiaries;
- a $100 million general investment basket; and
- the Backdoor Provision (*i.e.*, the investment covenant in the credit agreement also permitted investments of any amount by a non-guarantor restricted subsidiary in an unrestricted subsidiary from certain initial investments in such non-guarantor restricted subsidiary).

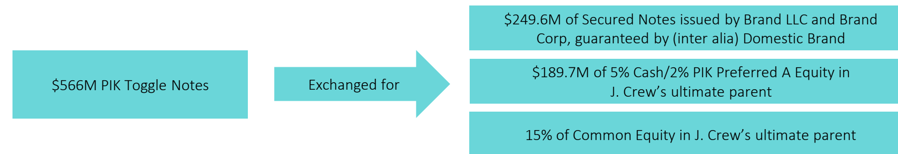
J. Crew (cont'd)

- J. Crew executed the transactions through a multi-step process:
  - **First:** J. Crew used those investment baskets to transfer a 72% interest in IP assets with a claimed value of $250 million from a restricted guarantor subsidiary to a Cayman restricted non-guarantor subsidiary;
  - **Second:** J. Crew utilized the Backdoor Provision to transfer the IP assets from the Cayman subsidiary to an unrestricted subsidiary.
- As a result of these transactions, the IP assets were no longer encumbered by the liens of the credit agreement and were owned (in part) by an unrestricted subsidiary that was not subject to the credit agreement limitations. Accordingly, in 2017 J. Crew concluded the transaction by effecting a private exchange offer pursuant to which $566 million of Senior PIK Toggle Notes due 2019 was exchanged for, among other things, approximately $250 million of Senior Secured Notes due 2021 secured by the IP assets.
- Of note, J. Crew also preemptively filed a lawsuit against the administrative agent in order to obtain a judgment that the dropdown was permitted under the credit agreement. J. Crew then settled this litigation by entering into an amendment to the agreement that (i) provided for the repayment of approx. $150 million in term loans using, among other things, $97 million of new money notes issued by the subsidiary holding the IP assets, (ii) increased the margin and amortization, and (iii) enhanced certain covenant protections for the lenders.
- A more detailed illustration of these transactions is included in the following slide.

J. Crew (cont'd)



Components of Exchange Transactions



PetSmart/Chewy

In 2018, PetSmart effectuated multiple asset transfers that transferred a portion of the value of Chewy.com out of the PetSmart collateral pool securing its existing debt.

The Financing Documents:

- PetSmart had acquired Chewy with the proceeds of two high-yield bond issuances. On completion of the acquisition, Chewy pledged its assets and provided guarantees to secure the new bonds and an existing term loan.
- PetSmart's obligations under the term loan were guaranteed by each of its domestic subsidiaries, other than certain "Excluded Subsidiaries" — which, as is typical, included non-wholly owned subsidiaries.
- The notes provided for the automatic release of guarantees if released in relation to term loan liabilities and further provided that the liens on the assets of such subsidiary would be released when it ceased to be a guarantor of the notes.

Prior to the asset transfers, PetSmart:

- Determined that it had $1.2 billion in both restricted payment and permitted investment baskets under the financing documents; and
- Obtained a valuation opinion that valued Chewy at approximately $4.5 billion.

PetSmart/Chewy (cont'd)

In 2018, PetSmart disclosed multiple asset transfers:

- **First**: PetSmart utilized restricted payment baskets to declare a dividend in the form of 20% of Chewy's outstanding common stock to PetSmart/Chewy's parent, Argos Holdings, Inc.
- **Second**: PetSmart utilized permitted investment baskets to invest 16.5% of the common stock of Chewy into a wholly-owned unrestricted subsidiary of PetSmart.

As a result, Chewy ceased to be a wholly-owned subsidiary of PetSmart. Accordingly, this should have resulted in the release of the guarantees and security under the term loans and notes pursuant to the express terms of the financing documents.

However, these transfers were instead challenged by lenders and resulted in litigation. Specifically, lenders (i) disputed the calculation of available basket capacity, and (ii) argued that the transactions resulted in the company being rendered insolvent. Ultimately PetSmart sought to resolve the litigation to facilitate an IPO of Chewy, and obtained lenders' consent to the transfers by increasing the interest rate, paying a consent fee, and providing lenders with more favorable paydown provisions. The company thereafter completed the spin-off of Chewy via IPO.

Neiman Marcus/MyTheresa

In 2018, Neiman Marcus Group LTD LLC spun off its MyTheresa business to its ultimate parent using an unrestricted subsidiary, thereby transferring approximately $280 million in value to its sponsors.

The Financing Documents:

- Neiman Marcus was party to ABL and term loan credit agreements and had notes outstanding due 2021, each of which was secured by the assets held by certain restricted subsidiaries.
- The financing documents included permitted investment baskets that allowed for the designation of certain subsidiaries as unrestricted subsidiaries.
- The financing documents also permitted the distribution of the capital stock of any unrestricted subsidiaries, without the need to satisfy any conditions (e.g., no event of default or compliance with a leverage ratio test).

Neiman Marcus/MyTheresa (cont'd)

Neiman Marcus executed the transactions through a three-step process:

- **First**: in 2014, Neiman Marcus designated the subsidiary holding the MyTheresa assets as an unrestricted subsidiary under the ABL/term loan credit agreements using capacity under its permitted investments baskets.
- **Second**: in 2017, Neiman Marcus further designated the subsidiaries holding the MyTheresa assets and certain real estate assets as unrestricted subsidiaries under the notes indentures (and the ABL/term loan for the real estate assets).
- **Third**: in 2018, Neiman Marcus distributed the equity interests of MyTheresa as a dividend to Neiman Marcus' parent company, Neiman Marcus Group, Inc.

As a result of these transactions, MyTheresa was no longer a subsidiary of the operating entities but rather a subsidiary of the parent company that was not subject to the restrictions of any debt agreements. This enabled: (i) the MyTheresa operations to be excluded from Neiman Marcus' financial statements, (ii) the assets of MyTheresa to be removed from the reach of creditors, and (iii) the sponsors to have direct control over MyTheresa.

Neiman Marcus ultimately filed for Chapter 11 in 2020. As part of those proceedings, the company settled fraudulent conveyance claims related to these transactions with its unsecured creditors.

Travelport

In May 2020, Travelport Private Holdings III Ltd. executed a series of transactions in order to transfer certain IP assets outside the existing collateral pool of its senior secured debt and subsequently used those assets to support new financing commitments.

The Financing Documents:

- Travelport was a party to a first lien and second lien credit agreement secured in part by assets held by a guarantor subsidiary (the "Guarantor Subsidiary"). The Guarantor Subsidiary held the IP assets to be transferred.
- The financing documents provided for six different baskets with an aggregate $1.27 billion capacity available for transfers of assets into one or more unrestricted subsidiaries, including a $238 million basket for investments in "Similar Businesses."

Travelport (cont'd)

Travelport executed the transactions through a two-step process:

- **First**: Travelport used six baskets to transfer IP assets valued at $1.15 billion (the "IP Assets") from the Guarantor Subsidiary to a newly formed restricted subsidiary (the "IP Subsidiary").
- **Second**: Travelport designated the IP Subsidiary and its newly formed parent company as unrestricted subsidiaries under the financing documents.

Prior to the transfer of the IP Assets, Travelport:

- Appointed one independent director to the newly formed IP Subsidiary, and two independent directors to the board of its primary operating subsidiary (collectively, the "Independent Directors"); and
- Obtained a valuation opinion which valued the IP Assets to be transferred at $1.15 billion.

Travelport (cont’d)

As a result of these transactions, the IP Assets were no longer encumbered by liens and were not subject to credit agreement limitations.

An ad hoc group of Travelport’s first and second lien lenders (acting through the administrative agent) thereafter called Travelport in default, alleging that the transfer breached the credit agreements because the value of the IP Assets exceeded the available investment basket capacity.

On June 5, 2020, Travelport announced that the IP subsidiary had “received commitments for $500 million in financing from Siris Capital Group, LLC and Evergreen Coast Capital Corp.” and “an additional $500 million of available financing capacity.” The financing transactions were approved by the Independent Directors.

Later that same day, Travelport sued its administrative agent in New York state court seeking a declaratory judgment that Travelport was not in default of its first and second lien credit agreements.

Travelport (cont'd)

Subsequent to the filing of Travelport's declaratory relief action, the ad hoc lender group instructed the administrative agent to accelerate all of the first and second lien debt.

On July 13, 2020, Travelport applied for a TRO against the administrative agent and the lenders seeking a stay of enforcement of remedies as a result of the acceleration. Later that month, Travelport and the ad hoc lender group entered into a standstill agreement staying acceleration of the debt.

Travelport and the ad hoc lender group settled the dispute with an agreed recapitalization, which included new money, rollups of the first lien and second lien term loans at discounts, and the unwinding of the IP transfer.

Travelport's debt after the consummation of the recapitalization comprised a priority lien term loan totaling $1.63 billion, including $500 million of new money maturing February 2025, and a first lien term loan totaling $2.05 billion maturing May 2026. The second lien term loan and revolving credit facilities were terminated.

In March 2023, Travelport subsequently executed an uptier debt exchange with holders of the existing first lien loans after having agreed to terms with a majority of those lenders (although participation in the deal was offered to all lenders). The transaction addressed liquidity concerns as the new loans gave the company the option to pay interest margin solely in PIK, while the sponsors simultaneously contributed $200 million of new equity.

Revlon

In 2020, cosmetics company Revlon executed a series of transactions that transferred IP to certain unrestricted subsidiaries and beyond the reach of existing lenders. It then used those assets as collateral for a new priming facility.

The Financing Documents:

Prior to entering into this priming facility Revlon had the following existing debt –

- An approximately $1.7 billion first lien term loan facility (the "2016 Term Facility");
- An approximately $353 million ABL facility (the "ABL Facility");
- A $200 million term loan agented by Ares and issued in 2019 (the "Ares Term Loan"), which was secured by the same collateral package as the 2016 Term Facility (and also benefited from liens on the IP assets of American Crew, which was accomplished via a prior asset dropdown under Revlon's existing debt documents); and
- $950 million of Senior Notes due in 2021 and 2024.

Revlon (cont'd)

Revlon proposed a priming refinancing transaction in March 2020. An ad hoc group of lenders representing required lenders under the 2016 Term Facility objected to this structure and countered with their own competing refinancing structure, which was ultimately adopted.

Revlon executed the transaction through the following process:

- Revlon had previously formed a Cayman Islands subsidiary ("Cayman Holdco") and new domestic unrestricted subsidiaries under that Cayman Holdco (the "Brandcos").
- Revlon transferred its principal IP assets to the Brandcos. This transfer had the effect of moving these assets outside the collateral package benefitting the 2016 Term Facility and ABL Facility.
- Revlon then entered into a new priming facility (the "Priming Facility"). Specifically, Revlon issued first, second, and third lien debt with claims against the transferred IP assets and similar to the Ares Term Loan (which was refinanced in full by the Priming Facility), each tranche has pari passu claims against the collateral package supporting the 2016 Term Facility. As a result, the lenders that participated in the Priming Facility had a senior claim to the IP assets, and the claims of the 2016 Term Facility lenders and ABL Facility to the remaining collateral were diluted by the Priming Facility.

Revlon (cont'd)

- Facilitated by newly established revolver commitments, majority lender consent under the 2016 Term Facility was explicitly obtained to the transfer of the IP assets and attendant debt and lien incurrence as part of the overall transaction. Similarly, lender consent under the ABL Facility was also obtained to expressly permit the incurrence of the relevant debt.

Arguably the most interesting feature of the Priming Facility and the amendment to the 2016 Term Facility is that it permitted an exchange mechanism to roll-up existing debt under the 2016 Term Facility into the new Priming Facility on a basis junior to the new money loans.

Although preferential treatment was given to the lead ad hoc group of lenders, the balance of the lenders under the 2016 Term Facility were all afforded the opportunity to participate in the new money first lien tranche of the Priming Facility. In addition, existing 2016 Term Facility lenders who agreed to extend the maturity of their term loans (which not all lenders could do, since several were CLOs) were afforded the opportunity to roll-up their existing loans into the second-out tranche of the Priming Facility based on their new money commitments.

The non-consenting lenders under the 2016 Term Facility were left with a heavily diluted claim against the remaining assets of Revlon and an indirect (and structurally subordinated) claim against the IP assets via a 66% pledge of the equity of the top Cayman Holdco.

Revlon (cont'd)

- After the Priming Facility closed, certain of the lenders filed suit alleging (among other things) that the resulting arrangements breached sale-leaseback limitations and sought an unwinding of the 2020 transactions. Ultimately, the lawsuit was voluntarily dismissed.
- On June 15, 2022, Revlon filed for Chapter 11 bankruptcy. In October 2022, a majority of the lenders under the 2016 Term Facility filed an adversary complaint renewing efforts to unwind the 2020 transactions. The company subsequently obtained a dismissal of the claims against it based on lack of standing. Shortly thereafter the company, the challenging 2016 term lenders, and lenders under the Priming Facility reached a global settlement which resolved the remaining claims related to the dropdown transactions.

ANNEX B: SELECT UK LIABILITY MANAGEMENT LITIGATION

Asségnagon (2012)

Extreme example of a coercive amendment in which the minority noteholders' redemption rights were reduced from par to a tiny fraction of a euro.

- The power of the majority to bind the minority:
- was not exercised in good faith (compare with NY law's "good faith and fair dealing")
- was not for the benefit of the class of creditors as a whole
- violated the "abuse" principle

Subsequent "Azevedo" case clarified that consent payments are permitted if open to all creditors equally.

Unclear how far a coercive amendment (e.g., covenant strip) can go before considered "abuse" under English law. Will likely be litigated further.

Assénagon (2012)

Key factors for consideration:

- Clear benefit for the whole class (e.g., new money)?
- What is the main motivation of the transaction – e.g., to benefit the issuer, or to punish the minority creditors?
- Positive inducement from borrower/issuer (e.g., consent fee) vs. negative inducement (e.g., stripping of minority's rights)?
- Is the transaction capable of being beneficial to the creditors or is there no conceivable benefit?
- Is there clear minority oppression, such as a significant impairment of the minority's debt?

Speaker Biographies

Elizabeth Tabas Carson
Partner - Sidley Austin LLP

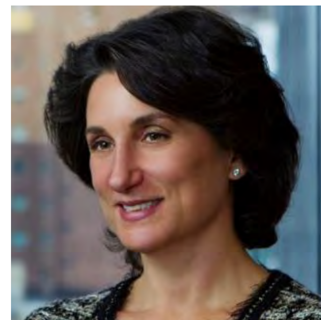
Elizabeth Tabas Carson has extensive experience in structuring and negotiating private financings, secured and unsecured lending transactions, cash flow and asset-based leverage facilities, merger and acquisition financing, mezzanine and second lien financings, debt restructurings and workouts, recapitalizations, SPAC and de-SPAC support transactions, fund financings, private debt, and financings of alternative assets, including structuring complex cross-border financings and liquidity solutions.

Lewis Grimm
Partner - Jones Day

Lewis Grimm has over two decades of leveraged finance experience working on marquee deals in New York, Europe, and Australia. He represents financial institutions, direct and institutional lenders, and corporate borrowers on cutting-edge domestic and cross-border leveraged and investment-grade lending and high yield transactions as well as high-profile restructuring and bankruptcy matters.

Seth Misshula
Head of US Trading and Portfolio Manager - Invesco Senior Secured Management, Inc.

Seth is the Head of US Trading and a Portfolio Manager in Invesco's global private credit group and a member of the Investment Committee. He is responsible for portfolio management as well as the private credit group's trading operations in the US. Seth joined Invesco Senior Secured Management, Inc. in 2005 as a junior portfolio analyst. Over the years his responsibilities grew to include portfolio management and trading and he joined the Investment Committee in 2022.



Jane Summers
Partner - Latham & Watkins LLP

Jane Summers is a partner in the New York office of Latham & Watkins. She is a member of the firm's Finance Department and Banking Practice, where she focuses primarily on representing major financial institutions in leveraged finance transactions, including acquisition financings, cross-border financings, asset-based facilities, and other senior secured lending transactions, as well as in connection with strategic purchases of distressed debt.

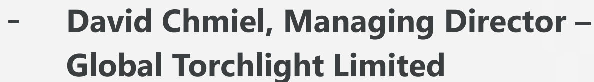
Private Credit Trends

LSTA ADVANCING THE CORPORATE LOAN MARKET | LMA Loan Market Association

Thursday, May 18, 2023

Any Sign of Light on the Horizon? Geopolitics and the Loan Market

Speaker



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Any Sign of Light on the Horizon? Geopolitics and the Loan Market

"War crimes. Sham referendums. Faux annexations. Arbitrary detentions. Show trials. Summary executions. Populations being bussed to 'camps' in another country. Millions put at risk of famine. Hundreds of millions suffering the pressure of increased energy prices, inflation, job losses, and the consequences that follow, whether mentally or physically.

Nuclear threats. Nuclear anxiety. Crazy nuclear debates about whether 'tactical nuclear weapons' can be distinguished from 'strategic nuclear weapons'…

But it gets worse. Because the other challengers to the world order do not stand still."

Admiral Sir Tony Radakin, *Royal United Services Institute*, 14 December 2022

Any Sign of Light on the Horizon? Geopolitics and the Loan Market

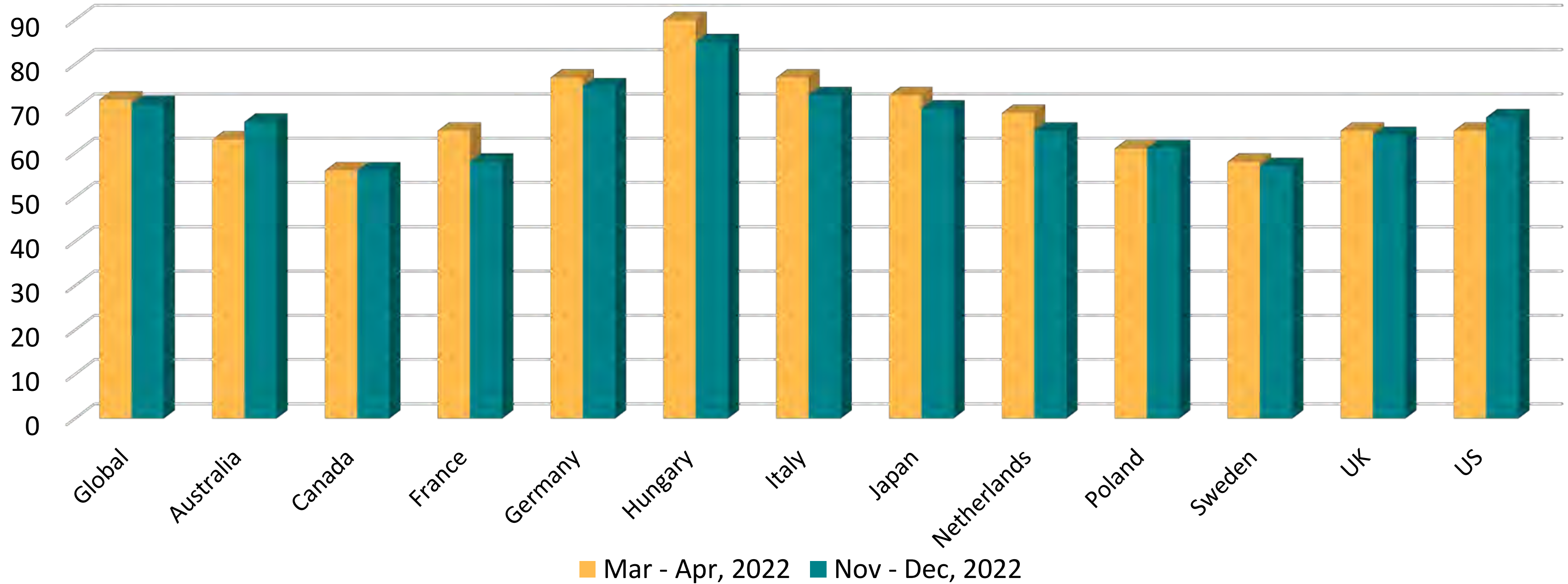
- The War in Ukraine: Where Now? Where in the Future?
- The Geopolitics of the Indo-Pacific
- Is Big Government Here to Stay?

The War in Ukraine

Any Sign of Light on the Horizon? Geopolitics and the Loan Market

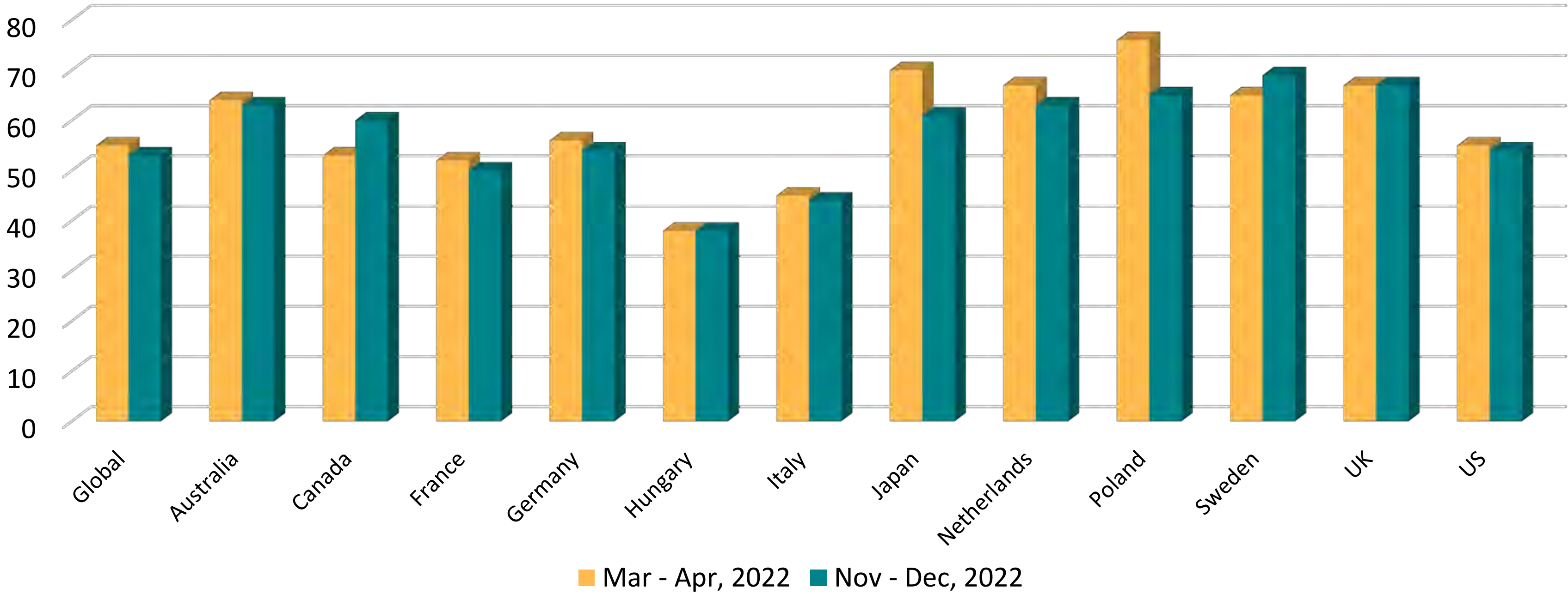
- The War in Ukraine: Where Now? Where in the Future?
  - Gauging Public Opinion One Year On
  - Lessons Learned So Far
  - Some Thoughts on the Future

Any Sign of Light on the Horizon? Geopolitics and the Loan Market



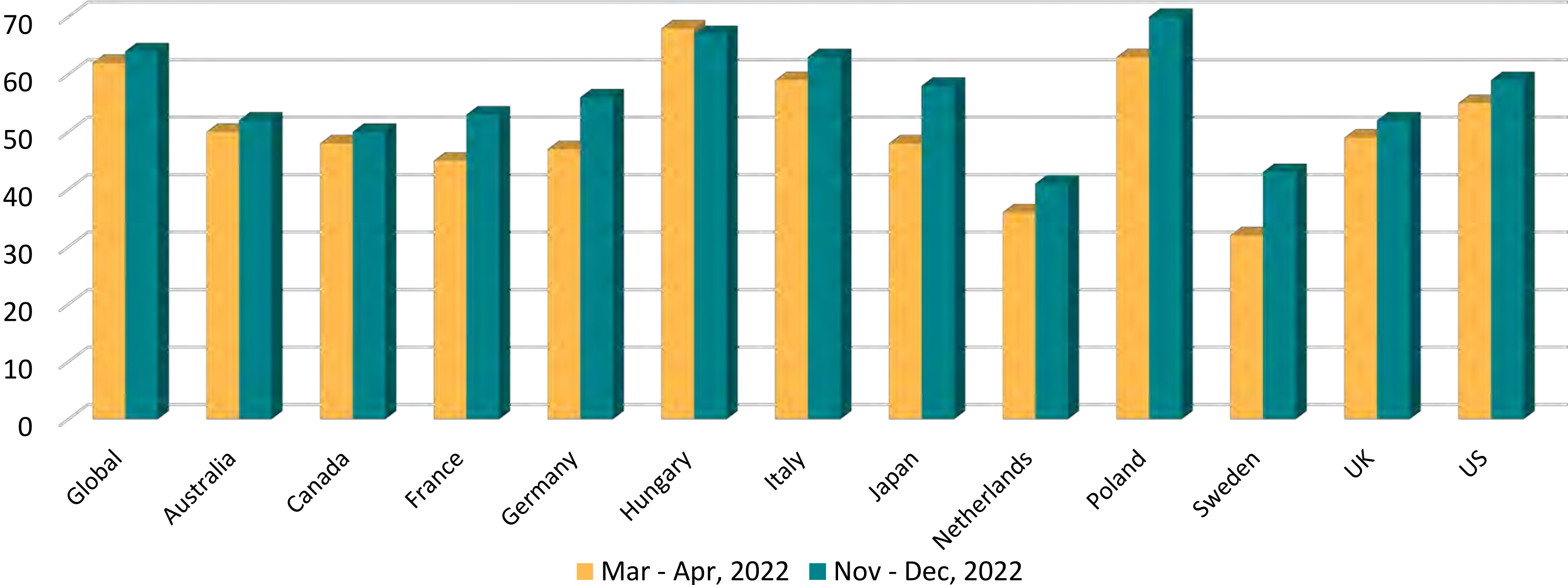
Source: *Ipsos*, January 2023 – % agreeing that their country should avoid getting involved militarily – Global is average of 28 countries polled

Any Sign of Light on the Horizon? Geopolitics and the Loan Market



Source: *Ipsos*, January 2023 – % agreeing that paying more for energy because of sanctions is worthwhile – Global is average of 28 countries polled

Any Sign of Light on the Horizon? Geopolitics and the Loan Market



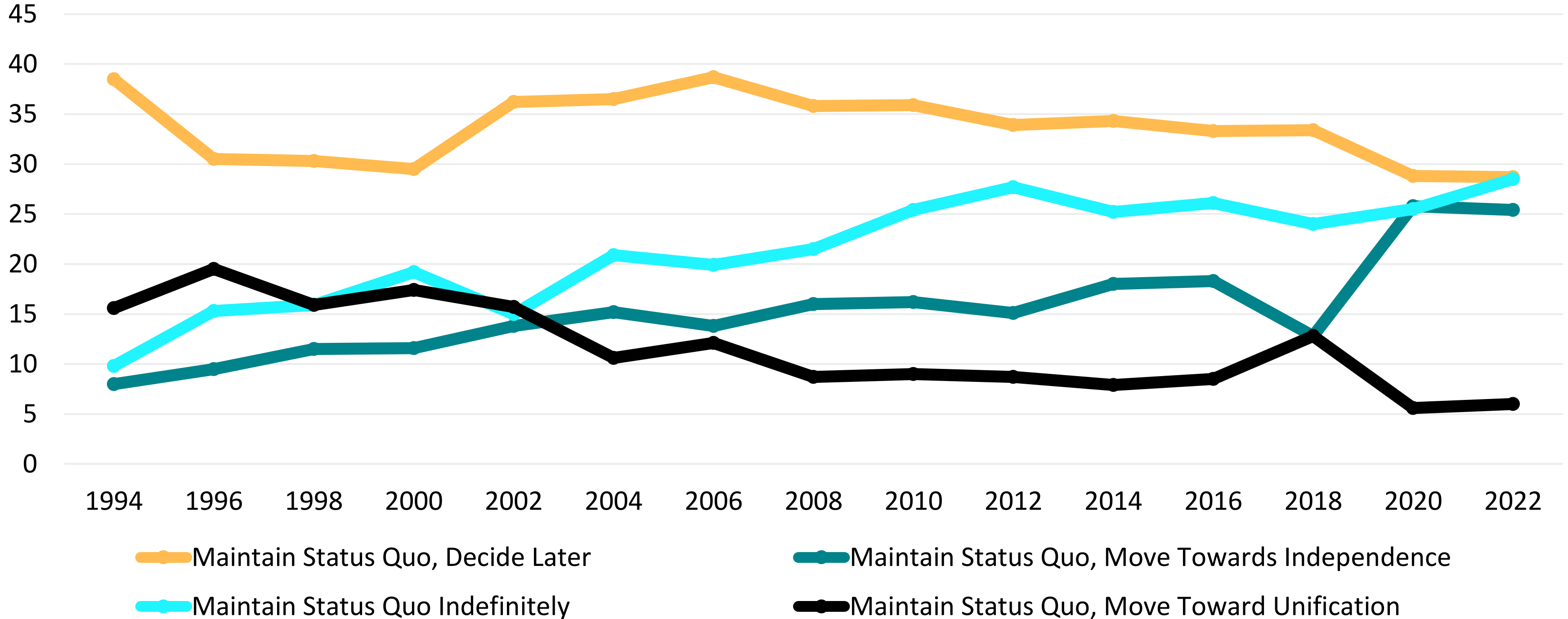
Source: *Ipsos*, January 2023 – % agreeing that the economic climate means their country cannot provide financial support to Ukraine. Global is average of 28 countries polled

The Geopolitics of the Indo-Pacific

Any Sign of Light on the Horizon? Geopolitics and the Loan Market

- The Geopolitics of the Indo-Pacific
  - Taiwan as a Global Flashpoint
  - Decoupling: A Reality or a Fiction?
  - The Role of India

Any Sign of Light on the Horizon? Geopolitics and the Loan Market



Source: Election Study Center, National Chengchi University NB: Not all years and response options shown

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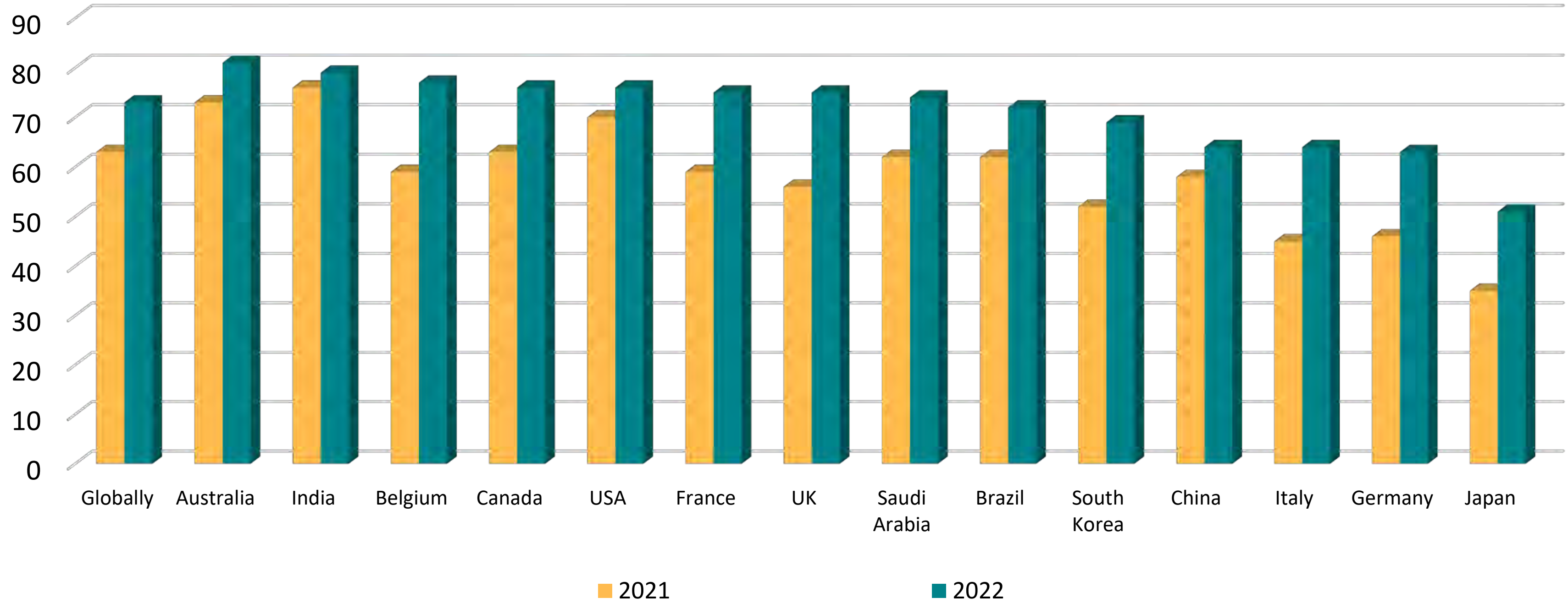
Any Sign of Light on the Horizon? Geopolitics and the Loan Market



Source: *Ipsos Global Advisor for the Halifax International Security Forum;* 23 September – 3 October, 2022

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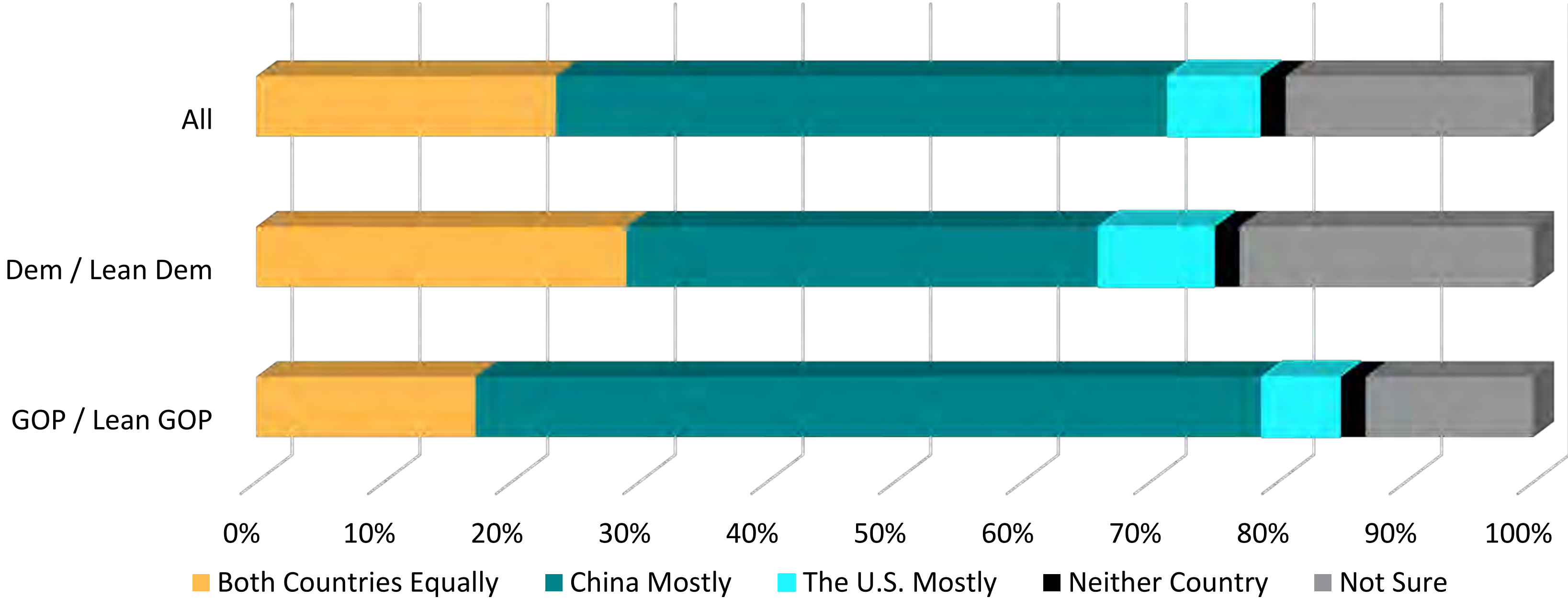
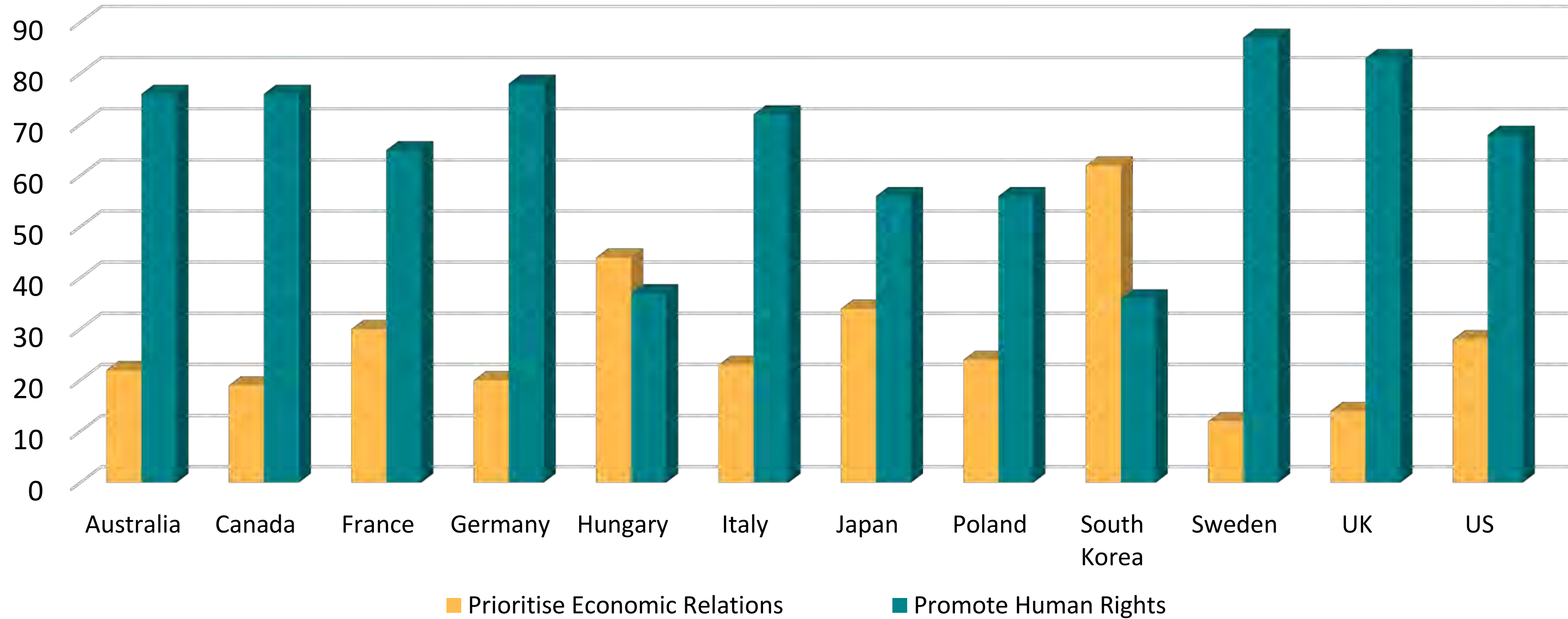


Source: *Pew Research Center*, 20-26 March 2023 Survey of U.S. Adults

Any Sign of Light on the Horizon? Geopolitics and the Loan Market



Source: *Pew Research Center*, Spring 2022 Global Attitudes Survey, No Opinion or No Answer not shown

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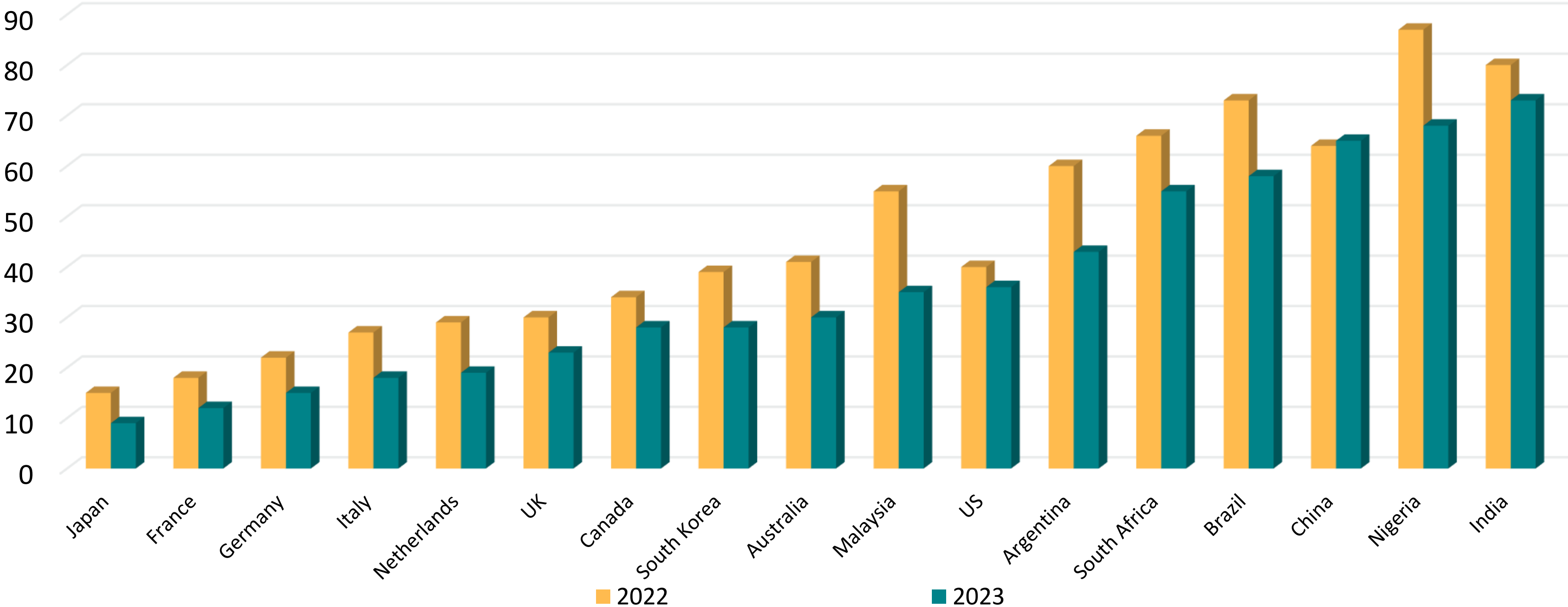
Is Big Government Here to Stay?

Any Sign of Light on the Horizon? Geopolitics and the Loan Market

- Is Big Government Here to Stay?
  - Inflation and Economic Insecurity
  - The Politics of ESG
  - How to Pay For It All?

Any Sign of Light on the Horizon? Geopolitics and the Loan Market



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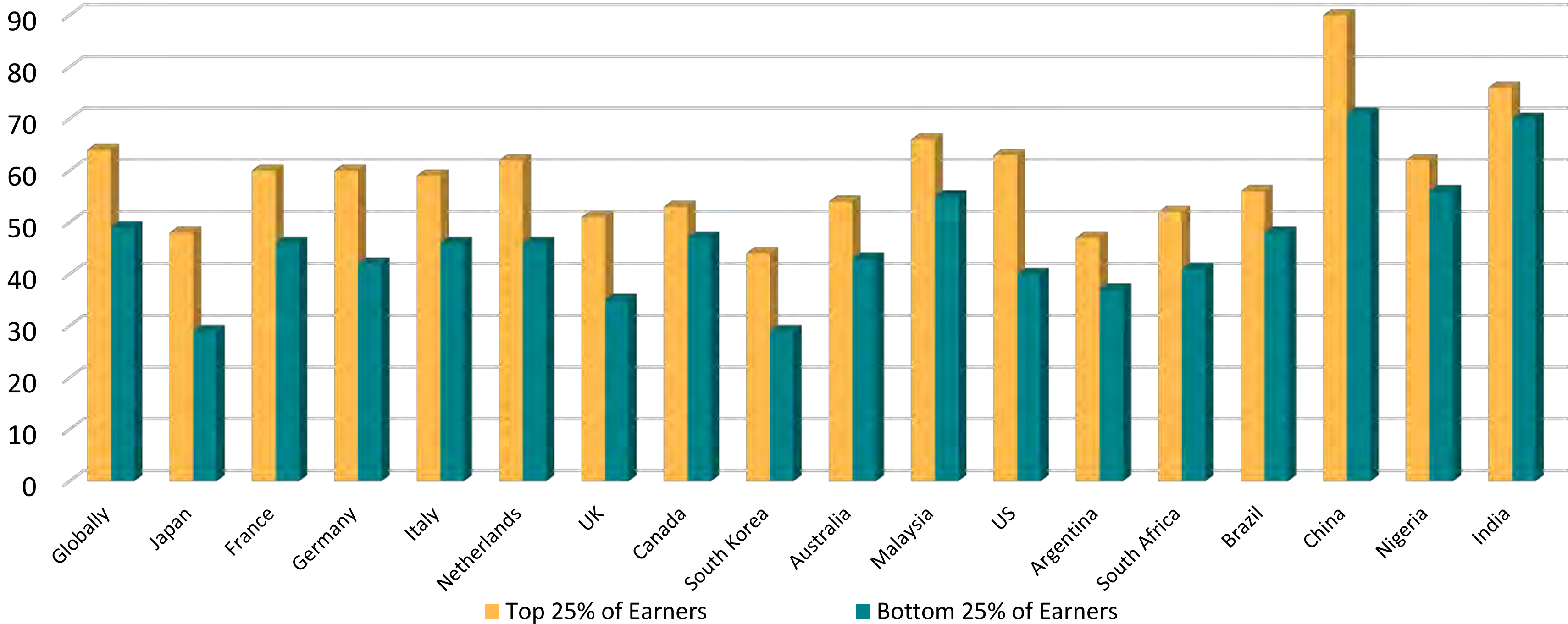
Source: *Edelman Trust Barometer*, 2023 – All time low for all but South Africa and China in 2023

Any Sign of Light on the Horizon? Geopolitics and the Loan Market



Source: *Edelman Trust Barometer*, 2023

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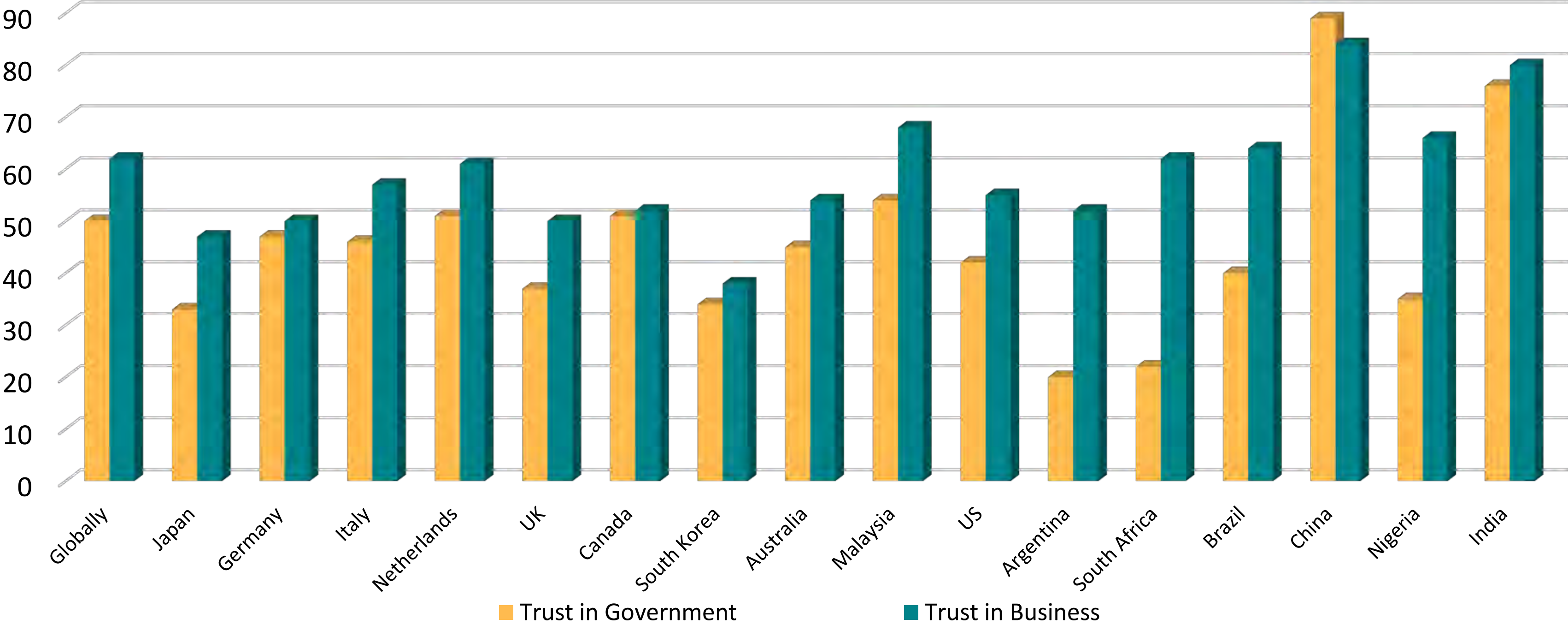

Source: *Edelman Trust Barometer*, 2023

Any Sign of Light on the Horizon? Geopolitics and the Loan Market

- Is Big Government Here to Stay?
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  - How to Pay For It All?

Any Sign of Light on the Horizon? Geopolitics and the Loan Market

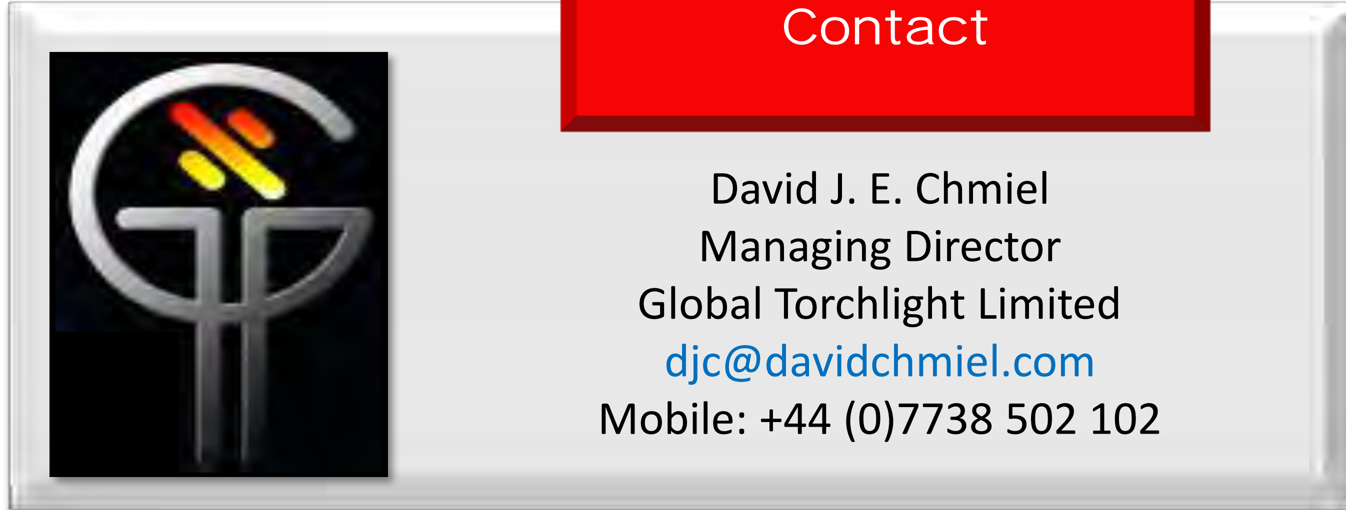
"It is more important for the United States to get night landing rights for our naval carrier pilots in Japan than it is for us to save the machine tool industry in the United States."

Defense Secretary Caspar Weinberger, 1984

"You can certainly feel the government support here. ...Making profits and going public with [initial public offerings] as quickly as possible are not the priority of the project, but building the country's own chips and realizing the Chinese dream are."

Unnamed Chinese microchip executive, *Nikkei Asia*, 18 March 2020

Any Sign of Light on the Horizon? Geopolitics and the Loan Market



LSTA AND LMA NEW YORK CONFERENCE

Sustainable Finance: Maintaining Integrity

Speakers

- **Sukhvir Basran, Partner – London – Cadwalader, Wickersham & Taft LLP**
- **Gemma Lawrence-Pardew, Head of Sustainability, Director - Legal – LMA**
- **Robert Lewis, Partner – Sidley Austin LLP**
- **Tess Virmani, DGC & EVP - Public Policy, Head of ESG – LSTA**

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Thursday, May 18, 2023

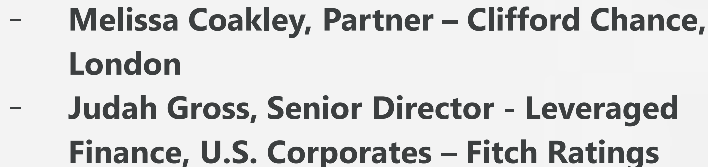
LSTA AND LMA NEW YORK CONFERENCE

Recoveries and Default Risk

Moderator

- Monique Mulcare, Counsel – Mayer Brown LLP

Speakers



- Melissa Coakley, Partner – Clifford Chance, London
- Judah Gross, Senior Director - Leveraged Finance, U.S. Corporates – Fitch Ratings

LSTA ADVANCING THE CORPORATE LOAN MARKET | LMA Loan Market Association

Thursday, May 18, 2023

Presentation Overview

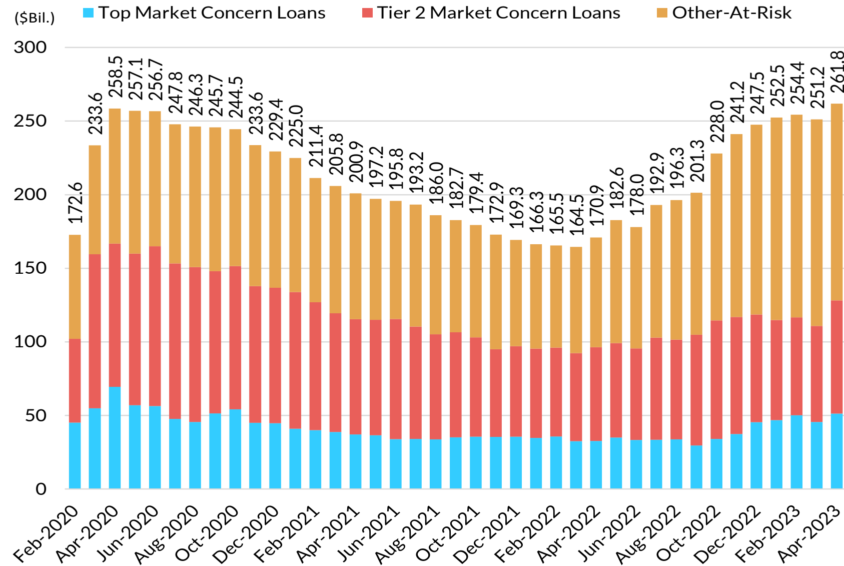
- Setting the Table - Overview of Defaults and Recoveries
- What are we seeing?
  - Perspectives from the US and Europe

Setting the Table - Overview of
Defaults and Recoveries

Overview: Increased Default Forecast

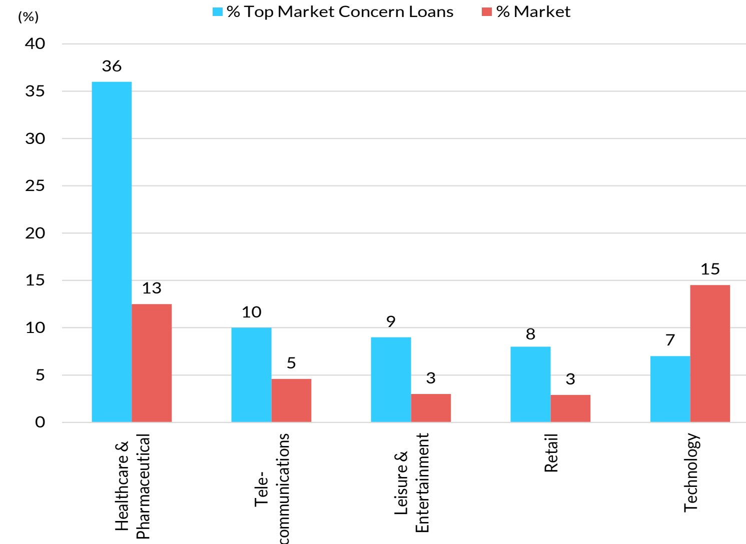
- Sectors to Watch: Healthcare, Leisure & Entertainment, and TMT

Market Concern Loans List Amounts Outstanding



Source: Fitch U.S. Leveraged Loan Default Index

Top Market Concern Sector – Loans



Source: Fitch U.S. Leveraged Loan Default Index

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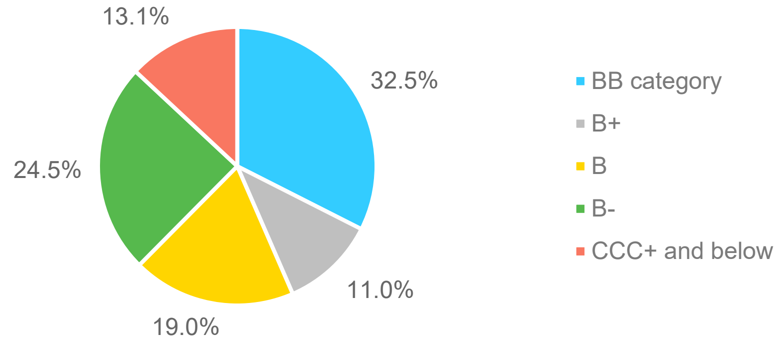
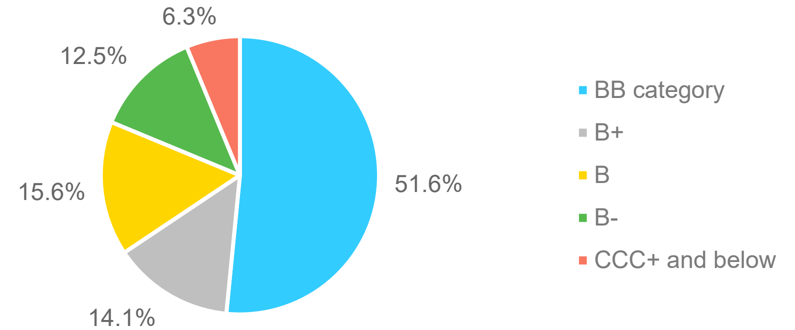
Defaults: Fitch Rated Portfolio – Shift to 'CCC'





Recoveries: Expected and Observed

- **Recovery Expectations**
  - Number of BSL 1L instruments estimated to recover 90%+ of par (*i.e.*, ‘RR1’) fell below the 50% threshold in 2022 (from 53% to 47%)
  - All sectors (except media & entertainment and energy) experienced a downward shift in recovery expectations in 2022

- **Observed Recoveries**
  - Solid 1L recoveries historically, with average recovery rate of 76% and the median was 95%
  - Loan size tends to influence recoveries with smaller term loans achieving better recoveries than larger issues
  - 2023 focus was on LMTs with Serta decision materially impacting 1L recoveries

Overview: Impact of LMTs on Defaults

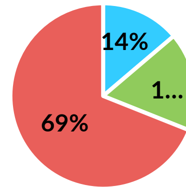
Fitch examined the performance of 30 LMTs, that were publicly disclosed between 2014 and 2023. All 30 LMTs involved distressed issuers with ratings at, or below, ‘CCC+’ at the time.

- 17 were deemed DDEs
- 7 subsequently filed Ch. 11 or executed DDEs

Benefits to issuer credit profiles remain elusive

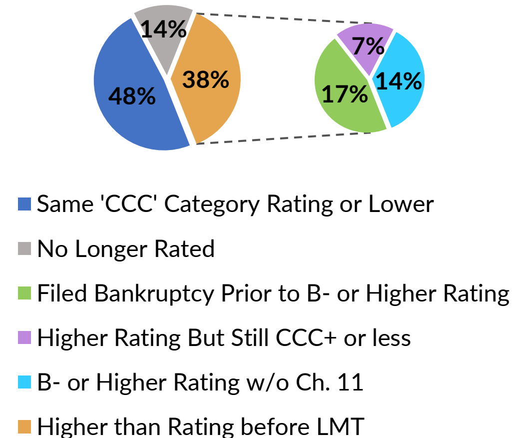
- 14 issuers are rated today at same ‘CCC’ level or lower
- 2 have higher ratings but still in ‘CCC’ range
- 5 migrated to ‘B’ range through Ch. 11
- Only 4 reached ‘B’ range without Ch. 11
- 9 are higher than rating before LMT

Rating Migration



- B- or Higher Rating w/o Ch. 11
- B- or Higher Rating w/ Ch. 11
- CCC+ or Lower or Unrated

Post LMT Rating Migration



What are we seeing?
Perspectives from the US and Europe

What are we seeing?

- Impact of Private Credit
- Influence of LMTs in the U.S.
- Crystal Ball View on Restructurings
- Legislative Developments

What are we seeing? Impact of Private Credit

The U.S. Perspective:

- Private Credit has grown quickly and steadily with $1.4 trillion assets under management (AUM) globally. If this trend continues private credit will grow to $2.3 trillion AUM.
- Private Credit—
  - During the Pandemic, Private Credit, working with management teams and sponsors, solved liquidity issues and provided covenant relief.
  - Direct lending by Private Credit has put stress on banks that previously had collected fees as intermediaries and dealmakers.

The European Perspective:

- Deloitte tracker reported 345 European private credit deals in the second half of 2022 – 97 in France, 92 in the UK, only 47 in Germany.
- Deal activity down 16% compared to prior year due to slowing M&A activity and macro economic issues linked to inflation
- Typically, a behind closed doors consensual restructuring/ work out approach
  - signs of changes?
  - key drivers?

What are we seeing? Influence of LMTs

The U.S. Perspective:

- Liability Management Transactions (LMTs) are out-of-court first attempts to stave off bankruptcy

- In the loan market, LMTs come in two predominant flavors:

  - **Drop-downs** – Examples of Drop-Downs – J. Crew and Revlon

  - **Uptiers** – Examples of Uptiers – Revlon, Serta Simmons, Trimark and Boardriders

- LMTs have spawned sprawling contentious litigation and with mixed results.

The European Perspective:

- Less prevalent vs. US

- On the rise?

- Predictions – likely areas for development post-*Keter*

What are we seeing? Influence of LMTs cont'd

The U.S. Perspective:

- More importantly, as mentioned by Judah, these LMTs have only deferred bankruptcy for a short period
- The net effect of the LMTs may be that (i) debtors are structurally unable to reorganize or (ii) there will be reduced recoveries for all stakeholders.
- For example, in *Serta*,
  - the Uptiered consenting lenders can only expect to recover between 74% to 75%
  - the Non-consenting lenders expected recovery is less than 3%. At 3%, a scorched-earth litigation can only enhance their recovery.

The European Perspective:

- Risks to lenders in a covenant light environment if restructuring on the cards
  - New money is king
  - Timed out for use of alternative processes?
  - Greater insolvency risk

What are we seeing? Crystal Ball View on Restructurings

The U.S. Perspective:

- Canary in the Coal Mine?
  - American Bankruptcy Institute and Epiq Bankruptcy have reported that, between April 2022 and April 2023, small businesses using subchapter V have increased 81% and chapter 11 filings have increased 32%.
  - Despite these percentage increases, the actual number of cases filed still remains relatively low and total filings dropped 9% year over year.
- Company fundamentals and realistic/conservate valuations are even more important

The European Perspective:

- Restructuring market has been relatively quiet across Europe in the post-COVID period
- About to change?
- Uptick in defaults – core drivers
- European deal themes
- Auditor influence

The U.S. Perspective: Crystal Ball View on Restructurings

- *ESL Investments, Inc. v. Sears Holdings Corp.* (*In re Sears Holdings Corp.*), 51 F.4th 53 (2d Cir. 2022), cert. denied sub nom. *Cyrus Capital Partners, L.P. v. Sears Holdings Corp.*, No. 22-765 (U.S. Mar. 20, 2023)

- Key Holdings: Given that the continued operation of Sears, as a retailer, was an open question when it filed for bankruptcy, the Second Circuit upheld bankruptcy courts':
  - valuing inventory collateral at its "net orderly liquidation value," rather than book value, going-out-of-business sale value, or forced liquidation value
  - valuing the non-borrowing base inventory at zero
  - giving full face value to undrawn letters of credit

- The bankruptcy court's determinations were upheld largely because the junior lenders did not provide the bankruptcy court with a reasonable alternative valuation methodology. The ultimate recoveries of the junior lenders were materially reduced as a result of this failure.

What are we seeing? Legislative Developments

The U.S. Perspective:

- Legislative Developments, the few that there are, are focused consumer issues.
- H.R. 1017, **Bankruptcy Venue Reform Act**, which requires that Chapter 11 bankruptcy proceedings take place where the principal place of business or principal assets of the corporation are located, has been reintroduced by Congressmen Ken Buck (R-CO-04) and Zoe Lofgren (D-CA-18).

The European Perspective:

- New rescue and rehabilitation legislation implemented in France, Netherlands and Germany over the past couple of years
- Spain and Italy recently also introduced their new restructuring laws
  - All implementing the **2019 European Harmonisation Directive** relating to Restructuring and Insolvency
  - Inspired by Chapter 11 – cross class cramdown, DIP financing, debtor led
  - Precedents
  - Impact

Questions?

Thank you!

Bio: Melissa Coakley

Melissa Coakley is a Partner in Clifford Chance's Global Restructuring and Insolvency Group, based in London, with 18 years experience working on a range of cross border consensual and non-consensual restructurings, work outs and formal insolvencies, acting across the stakeholder spectrum. Melissa also maintains a focus on the Middle East, having spent five years on secondment to the Clifford Chance Dubai office during the Dubai financial crisis

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Bio: Judah J. Gross

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Senior Director, Fitch Ratings
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Judah Gross is a Senior Director in Fitch's U.S. Leveraged Finance group where he focuses on restructuring and recovery matters as well as leveraged loan and high-yield documentation analysis and structure. Prior to joining Fitch in 2018, Judah practiced as an attorney in the financial restructuring group at Stroock & Stroock & Lavan LLP where he represented lenders and high-yield bondholders in in-court and out-of-court restructurings.

Bio: Monique J. Mulcare

Monique J. Mulcare

Counsel, Mayer Brown LLP

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+1 212 506 2181

Monique Mulcare is a Counsel in Mayer Brown's Global Restructuring Practice. Monique represents senior secured creditors and strategic investors in major cases in a variety of industries in both US and international jurisdictions in recovering distressed assets. Monique has extensive experience in workouts and in-court and out-of-court restructurings. Monique also advises a range of parties on netting-related safe harbor and bankruptcy-related intellectual property issues.

Monique is an active participant on the Loan Syndications and Trading Association's (LSTA) Trade Practices and Forms Committee.