

## Delaware Chancery Court Upends Realogy Debt Exchange

*December 22, 2008*

### EXECUTIVE OVERVIEW

Realogy Corporation, an affiliate of Apollo Management, terminated its invitations to holders of its outstanding unsecured high yield notes to exchange those notes for second lien term loans under an available tranche of its senior secured credit facility after Vice Chancellor Lamb of the Delaware Chancery Court found that the second lien term loans did not constitute “Permitted Refinancing Indebtedness” under Realogy’s senior secured credit facility and, consequently, the second liens securing such loans would not constitute “Permitted Liens” under Realogy’s senior notes indentures.

### BACKGROUND

In April 2007, an affiliate of Apollo Management acquired Realogy, a provider of real estate and relocation services that operates under brands such as Century 21, Coldwell Banker, ERA and Sotheby’s International Realty. In connection with the acquisition, Realogy issued three tranches of debt securities:

- \$875.0 million aggregate principal amount of 12.375% Senior Subordinated Notes due 2015 (“Senior Subordinated Notes”);
- \$1.7 billion aggregate principal amount of 10.50% Senior Notes due 2014 (“Senior Cash Notes”); and
- \$550.0 million<sup>1</sup> aggregate principal amount of 11.00%/11.75% Senior Toggle Notes due 2014 (“Senior Toggle Notes” and, together with the Senior Subordinated Notes and Senior Cash Notes, the “Existing Notes”).

On November 13, 2008, Realogy commenced issuing invitations (the “Invitations”) for commitments of up to \$500.0 million aggregate principal amount of new second lien incremental term loans under the accordion feature of its existing senior secured credit facility. The second lien incremental term loans were to be:

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<sup>1</sup> Pursuant to Realogy’s election to pay interest in-kind, on October 15, 2008, the aggregate principal amount of the Senior Toggle Notes has increased by \$32.2 million.

- guaranteed by all of Realogy's subsidiaries that guarantee its first lien obligations under the existing senior secured credit facility (and that guarantee its unsecured bonds subject to the Invitations); and
- secured on a second-priority lien basis by substantially all of Realogy's and the guarantors' assets to the extent such assets secure Realogy's first lien obligations under its senior secured credit facility.

Participating holders were to fund their commitments for second lien incremental term loans by delivering their Existing Notes to Realogy in response to the Invitations. Commitments made pursuant to the Invitations were to be accepted based on a waterfall (which sought to maximize the benefit of the transaction to Realogy), by according the highest acceptance priority to the Senior Subordinated Notes (the tranche of notes with the highest cash interest expense) and the lowest acceptance priority to the Senior Toggle Notes (the least expensive element of the capital structure among the Existing Notes, in terms of cash outlay, since Realogy has elected to pay interest on the Senior Toggle Notes with additional notes), with the Senior Cash Notes having the middle priority. Pursuant to the terms of the Invitations, Realogy limited the amount of commitments that were to be funded by Senior Subordinated Notes to \$125.0 million to comply with its senior notes indentures and the amount of commitments funded by Senior Toggle Notes to \$175.0 million.

#### **SENIOR TOGGLE NOTES LITIGATION**

- On November 26, 2008, The Bank of New York Mellon, the Trustee under the Senior Toggle Notes Indenture, and High River Limited Partnership, a holder of Senior Toggle Notes ("High River" and, together with the Trustee, the "Plaintiffs"), filed a complaint in the Delaware Chancery Court seeking a declaratory judgment that the Invitations and the incurrence of the second lien incremental term loans would breach the Senior Toggle Notes Indenture (the "Contract Claims").
- In addition, High River sought a declaratory judgment and injunctive relief against the completion of the transactions would constitute fraudulent transfers by Realogy of its assets (the "Fraudulent Transfer Claims"). Realogy joined the Plaintiffs in their request for an expedited proceeding on the Contract Claims, which was granted, and the parties agreed to stay the Fraudulent Transfer Claims. On December 9, 2008, the Plaintiffs and Realogy each filed a motion for summary judgment on the Contract Claims. A hearing on the motions was held on December 15, 2008.
- On December 18, 2008, the Chancery Court held in favor of the Plaintiffs on their motion for summary judgment on the Contract Claims. The Chancery Court found the Plaintiffs' argument that the second lien term loans could not be "loans" under the senior secured credit facility due to the non-cash nature of the exchange to be unconvincing. However, the Chancery Court found that the refinancing of the Senior Toggle Notes and the Senior Cash Notes with second lien term loans does not constitute Permitted Refinancing Indebtedness

under the senior secured credit facility and, consequently, absent an equal and ratable lien for the benefit of the Senior Toggle Notes and the Senior Cash Notes, would violate the senior notes indentures.

- In reaching this conclusion, the Chancery Court found that a flat prohibition on granting greater security to Permitted Refinancing Indebtedness than the debt to be refinanced in such defined term could not be nullified by a proviso thereto which states that “other guarantees and security may be added to the extent then permitted under Article VI (the negative covenants).” Realogy had interpreted the proviso to permit the Senior Toggle Notes and Senior Cash Notes to be refinanced by the “accordion” tranche of the senior secured credit facility since such debt and related liens were permitted under Article VI.
- In response to the decision, Realogy terminated the Invitations on December 19, 2008. Realogy has indicated that it will seek other means to restructure its outstanding debt.

#### OBSERVATIONS

- The definition of Permitted Refinancing Indebtedness in Realogy’s senior secured credit facility is not common and issuers and their advisers should not read the decision as a deterrent to economically rational exchanges if the relevant provisions of an issuer’s debt instruments support such an approach.
- The decision does not preclude Realogy from conducting a smaller exchange of the Existing Notes for second lien term loans (\$150.0 million of commitments) under a quantitative carveout in the credit agreement.
- During the hearing, Vice Chancellor Lamb appeared reluctant to interpret the credit agreement provisions in an action brought by the Trustee and the holders of the Senior Toggle Notes without any participation by the senior lenders. The Vice Chancellor was concerned that his decision, if in favor of the Plaintiffs, could be nullified by an amendment to the senior credit agreement and, if in favor of Realogy, could prejudice the lenders. In a footnote, the Chancery Court wrote: “The court notes the irony contained in the present situation. The Trustee, a non-party to the Credit Agreement, is suing to enforce a document whose terms are not for the Trustee’s benefit. Moreover, those terms can be amended to remedy the prohibitions the Trustee relies on at any time, without the consent of the Trustee or the Senior Toggle Noteholders. Thus, as to the Trustee and the Senior Toggle Noteholders, it is little more than fortunate happenstance that they are able to find a provision in the Credit Agreement on which to rely to block the proposed transaction. Nevertheless, the court must construe the agreements as they stand, not as they might be.”

By reaching its decision, the Chancery Court avoided prejudicing the rights of a party not before the court (i.e., the bank group) and invited Realogy to seek an amendment to clarify the definition of Permitted Refinancing Indebtedness.

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