The latest developments in liability management

Simpson Thacher partner **Nick Baker** and associate **Jonathan Mitnick**, both in New York, together with associate **Dasha Bechade** in London, take us through the latest trends in 'creditor on creditor violence' to emerge so far this year in the US and Europe – and how the two geographies are diverging.

Aggressive and creative liability management exercises (LMEs) have been used across a number of high-profile situations in the United States for the better part of a decade, whereas they are still a rarity in the European market.

Recent developments indicate that the market for these types of transactions in the United States and Europe might be headed in slightly different directions.

Interestingly, it is the Europeans who are exhibiting more aggression. Where European companies and investors are showing increasing willingness to dip their toes into the water, their US counterparts may be inclined to row back slightly from the most aggressive manoeuvres.

While the LME market in the United States has been quite robust, certain recent LME transactions have been the subject of renewed scrutiny. Two recent decisions by United States bankruptcy judges held that the LME at issue did in fact breach the credit documents.

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Robertshaw

Robertshaw, a US company that sells controls for commercial and residential appliances, encountered financial difficulties and a looming debt maturity that led it to enter into an uptier transaction with an ad hoc group of lenders (including Invesco) in May 2023.

The ad hoc group provided new loans and exchanged their existing loans into a new super priority credit facility.

After this transaction, Robertshaw's liquidity problems persisted. Meanwhile, alliances among the ad hoc group shifted. Invesco accumulated enough of the new super priority loans to deliver the necessary consent to provide new financing to the company and amend the credit agreements to, among other things, commence a bankruptcy proceeding to sell its assets, with Invesco acting as the stalking horse bidder.

In December 2023, after learning of these developments, the other members of the ad hoc group formulated their own plan to wrest control from Invesco.

Along with the company's private equity sponsor, they loaned new money to a Robertshaw affiliate that, they argued, was not covered by the credit agreement's debt and lien covenants, and that money was in turn distributed to Robertshaw. Robertshaw used this cash to repay a portion, but not all, of the new super priority facility.

As a result, Invesco's aggregate holdings in the super priority facility dipped and the other members of the ad hoc group voted to implement amendments to the credit agreement to increase the super priority facility.

Robertshaw immediately then borrowed under the increased super priority facility using the proceeds to refinance the affiliate loan.

While creditor influence and control shifted from Invesco to the other members of the ad hoc group, the company's fate did not change. Robertshaw filed for bankruptcy in Houston in February 2024, and the parties immediately commenced litigation over the December 2023 LME, with Invesco claiming the amendment and repayment of its loans violated the credit agreement, including a so-called "Incora blocker" (see below) which prohibited lenders from amending the credit agreement to issue new loans for the purpose of influencing voter thresholds.

Bankruptcy Judge Christopher M. Lopez ruled that Robertshaw violated the credit agreement because 100 per cent of the loan proceeds from the Robertshaw affiliate should have been applied to prepay the super priority facility, and instead Robertshaw had applied a portion of the loan elsewhere.

However, Lopez dismissed Invesco's breach of contract claims against the other lenders as well as Invesco's tortious interference claim against all parties, finding that everyone had acted in their economic interests.

Rather than use its equitable powers to reinstate Invesco to its status prior to the December 2023 LME, the court held that Invesco's recourse is to assert a proof of claim for money damages against Robertshaw in its bankruptcy.

It also ruled that the proof of claim cannot assert indirect or consequential damages, as those are waived under the credit agreement. As a result, Invesco's recovery may be much smaller than if the court had used its equitable powers, as it did in Wesco/Incora discussed below.

Wesco/Incora

Wesco is an aircraft parts supplier and supply chain management services provider that was purchased by a private equity sponsor in a leveraged buyout in 2019 and merged with another company to form Incora. The LBO was partially financed by two classes of secured notes, due 2024 and 2026.

In March 2022, Wesco entered into an LME with a group of noteholders, who at that time held a supermajority position in the 2024 secured notes and a majority, but not a supermajority, of the 2026 secured notes.

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As first step in the transaction, Wesco amended the 2026 indenture, with majority consent, to allow it to issue additional 2026 secured notes.

Second, it issued new 2026 notes to the group, thereby giving them a supermajority position.

Third, with the consent of the group, given their newly-acquired supermajority position, the company uptiered the group's 2024 and 2026 holdings, including the newly-issued 2026 notes, into a new first-lien position and released the liens and stripped the covenants of the original 2024 and 2026 indentures, leaving the non-participating noteholders with now-unsecured notes.

Critically, all of these steps occurred sequentially but substantially simultaneously, and each amendment was conditioned on the effectiveness of the subsequent amendments.

Two groups of non-participating lenders sued Wesco, the sponsor, and the participating noteholders, and the suit ended up in front of Bankruptcy Judge Marvin Isgur after Wesco filed for bankruptcy in Houston in June 2023.

In an oral opinion on 10 July 2024, Judge Isgur held that the first amendment to allow additional notes to be issued violated the terms of the 2026 indenture.

The 2026 indenture prohibited, without supermajority consent, any action that "had the effect" of releasing liens. Because the second amendment followed as an "automatic sequence" from the first amendment allowing the issuance of additional 2026 notes, the first amendment "had the effect" of a lien release and was prohibited by the 2026 indenture without supermajority consent, which the group did not have until after the issuance of new notes permitted by the first amendment.

Regarding the remedy, Judge Isgur forcefully rejected the notion that the excluded noteholders would only get an unsecured claim for money damages against the debtor.

Instead, he declared that he would use the court's equitable powers to refashion Wesco's capital structure and restore the excluded noteholders' liens on the property as if the amendments had never occurred. The status of new 2026 notes financing is undecided.

"No rubber stamp from the courts"

Despite the prevalence and variety of aggressive up-tier and priming transactions in the US market, these decisions show that each LME will be analysed on its specific facts and contractual language.

> United States bankruptcy courts, even ones that are sophisticated and sympathetic to the debtor's needs, will not simply rubber stamp LMEs when the borrowers end up in Chapter 11.

However, these decisions also underscore that, particularly in bankruptcy, litigants challenging LMEs must not only prevail on legal grounds, but also as to the appropriate remedy.

On the opposite end of the spectrum, the market for aggressive LMEs in Europe is still relatively nascent. European companies have been more reluctant than their American counterparts to engage in aggressive LMEs for a combination of reasons including, but not limited to, the perception of a smaller European market and therefore the need to preserve relationships and reputations and the various obstacles, such as directors' duties, lender liability regimes and equitable subordination risk, that arise when a variety of complicated jurisdictions are involved.

Nevertheless, recent transactions, such as the Hunkemoller uptier transaction, indicate that US style LME transactions are gradually being seen as a viable tool in the European company and sponsor toolbox.

Hunkemoller

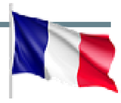
In late June 2024, Dutch lingerie maker, Hunkemoller, owned by private equity sponsors, announced that it had agreed an uptiering transaction with a bondholder holding over 60 per cent of its senior secured notes due 2027.

As part of the transaction, the bondholder agreed to provide new financing pari passu with an existing super senior RCF, in exchange for its 2027 notes being elevated in the payment waterfall. This left a stub of the 2027 notes and a pre-existing bridge facility in a junior position.

The transaction was achieved with the bondholder providing the simple majority consent required to change the priority of payments under the note documents. This is one of the first of such reported transactions implemented by a sponsor-owned company in Europe. There are reports that the noteholders of the stub may look to litigate.

In the first part of 2024, two of the most prolific high yield issuers in the European market shocked their creditors by announcing unprecedented and aggressive approaches to managing their sizable liabilities, arguably paving the way for the Hunkemoller transaction.

Altice France



In March 2024, the embattled French mobile and communications company, Altice France, issued an ultimatum to the creditors of its roughly 24 billion euro of debt that either they participate in discounted transactions (in other words, effectively agree to a haircut) to delever the group or the proceeds from the sale of unrestricted assets would be stripped from the creditors.

The company is able to achieve this by using its extremely flexible debt documents, negotiated in a world where Altice France was considered a "safe bet" by European high yield investors, to designate key subsidiaries as "unrestricted" and therefore outside the scope of the debt covenants.

As recently as late May 2024, Altice France has continued to use these permissions under its credit documents, although nothing has yet happened beyond the designation of certain valuable subsidiaries as "unrestricted".

The mischief is that the company is threatening to exercise the resulting flexibility to extract value rather than repay its hefty senior debt obligations in order to coerce creditors into agreeing to take haircuts.

Ardagh

Around the same time Altice France was making waves with its proposal to creditors, Ardagh, an Irish metal and packaging company, announced that it had completed a priming transaction with Apollo providing around 1 billion euro in new secured debt to a group company sitting outside the restricted group.

The proceeds were on-lent to the issuer of the group's existing debt and used to redeem the group's senior secured notes due in April 2025.

The Apollo debt is reportedly secured by, amongst others things, a lien over the proceeds loan to the issuer. As a consequence of the transaction, the group's pre-existing secured debt is now both structurally subordinated in respect of certain valuable subsidiaries and pari passu to Apollo's debt by virtue of a secured claim over a proceeds loan to the issuer. A feature of the deal also permits Apollo, which

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was reportedly not a creditor prior to the transaction, to purchase the pre-existing junior notes on the open market and swap those for additional portions of the new secured debt.

Conclusion

The Altice France and Ardagh manoeuvres have resulted in European creditors seeking, for the first time ever, to enter into US-style co-operation agreements to try to defend themselves from debtors seeking to pit creditors against each other.

By late April 2024, both Altice creditors and Ardagh creditors had reportedly entered in respective cooperation agreements, again borrowing from the US market playbook where these have become common. It remains to be seen how successful these cooperation efforts will be and whether this develops into a longer term trend in the European market.

Where previously there was a great deal of care given to maintaining good will with creditors and ensuring continued access to capital markets, the recent manoeuvres employed by Altice, Ardagh, and now sponsor-backed Hunkemoller, indicate that, at least in certain instances, European companies and sponsors feel that a new approach to LMEs will bring more reward than risk at this stage.

However, it is worth noting that the transactions in Europe are still largely untested in the court systems across the various European jurisdictions so there will certainly be further developments to look forward to as these matters play out.

In contrast, the US market for LMEs after a long period of largely unchecked aggressive growth, may be looking to moderate itself going forward. In particular, the Wesco decision, which equitably refashioned the borrower's capital structure, may convince companies and sponsors to adopt a more measured approach to LMEs in the US market.

This article featuring Simpson Thacher first appeared in the August edition of Global Turnaround magazine. Global Turnaround is the leading source of market intelligence for the restructuring and bankruptcy industry and is read in over 70 countries. To find out more, go to www.globalturnaround.com