Vinson&Elkins

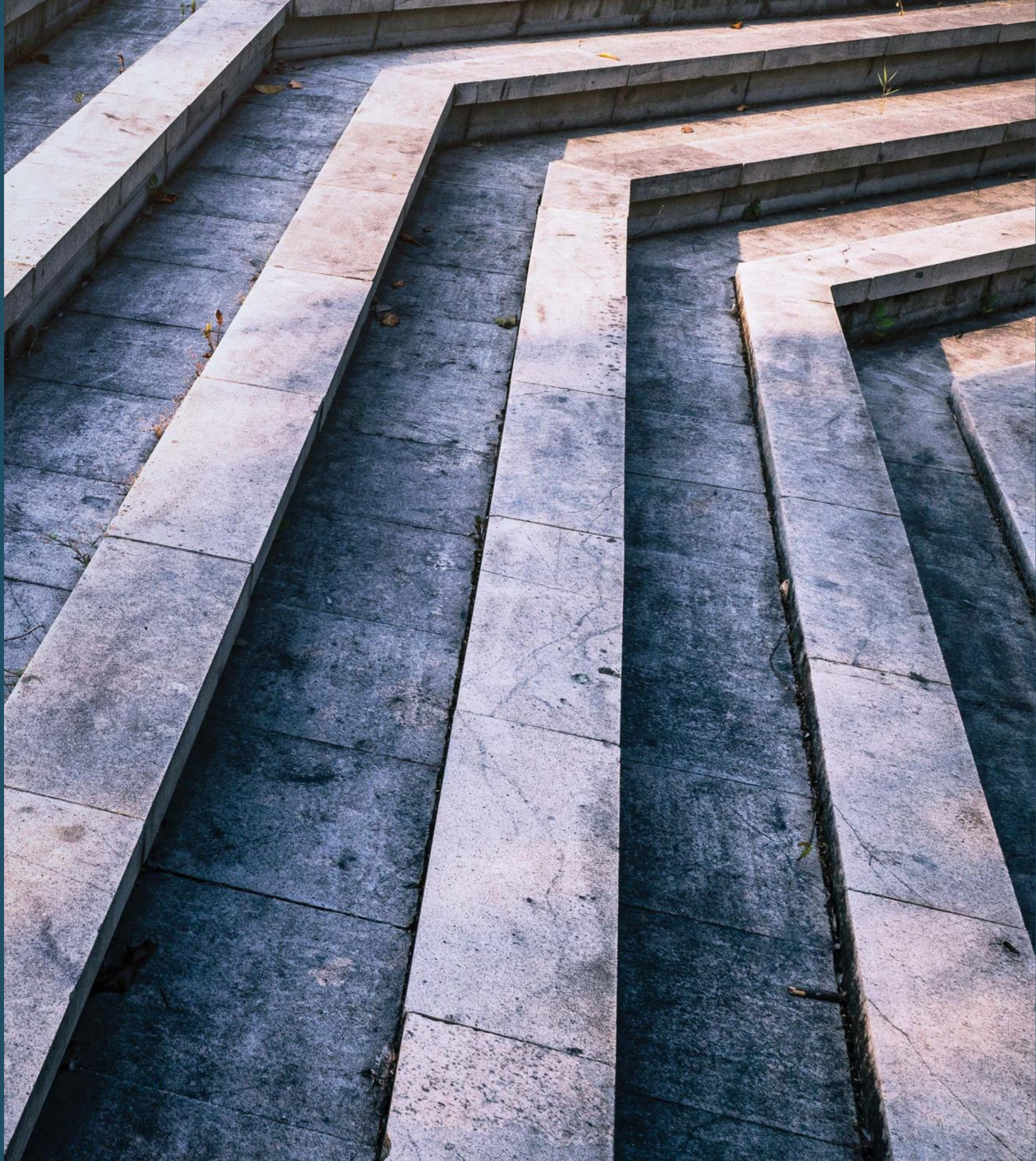
# Navigating

# Lender–on–Lender Violence

An Overview of Liability Management Transactions and Market Trends

**Presented by David Meyer, George Howard, and Lauren Kanzer**

April 27, 2023



# Agenda

- Overview of Liability Management Transactions
- Uptier Transactions
  - Serta Simmons Case Study
- Drop-Down Transactions
  - Revlon Case Study
- Cooperation Agreements
- Transaction Takeaways

# Liability Management Transactions – The Who, What, Where, When, and Why?

- Companies facing financial distress, liquidity constraints, or maturity walls may have a variety of transaction opportunities available to address their funded debt obligations
- A recent liability management transaction trend involves the company and a subset of favored lenders engaging in transactions or credit document amendments to enhance the company's liquidity and improve that lender's position in the creditor stack—but often to the detriment of the other lenders in the same tranche
- These transactions have spurred violent courtroom brawls across the United States, as the excluded group of lenders sue the favored lender group, the company, and often the sponsors, seeking to void the transactions as unauthorized and violative of sacrosanct lender rights (*e.g.*, sacred rights related to priority of payment / waterfall, pro rata sharing, etc.)

**Who?** Companies facing distress and a subset of lenders

**What?** Liquidity-enhancing transaction with a majority of lenders to the detriment of other minority lenders

**Where?** Often in the existing credit documents, utilizing majority lender consent to allow priming or moving of assets

**When?** Recent phenomenon beginning around 2017

**Why?** Alternative out-of-court means for company to raise additional liquidity

# Types of Liability Management Transactions

**Creative thinking and proactive efforts at early signs of potential distress can help companies preserve value, maximize optionality, and potentially avoid the need for a chapter 11 filing and give lenders opportunities to improve their position**

- A company typically has a variety of tools to manage distress, though its options may be limited by the company's specific situation and the terms of its funded debt documents
- Two commonly employed types of liability management transactions are "drop-down" and "uptier" transactions

| Type of Transaction | Description | Examples |
|---|---|---|
| **Uptier Transactions** | • Company enhances its liquidity by issuing super senior secured debt to the participating lenders (and possibly a sponsor)—which may be partially in exchange for new money and partially in exchange of existing secured indebtedness—after lifting any restrictions on such new super senior secured debt by majority vote of the existing secured lenders<br>• Transaction includes a risk of litigation and its associated costs as non-participating / minority lenders may seek relief from the courts | • Serta Simmons Bedding, LLC<br>• TMK Hawk Parent, Corp. (Trimark)<br>• Boardriders, Inc.<br>• Wesco Aircraft Holdings Inc. (d/b/a Incora) |
| **Drop-Down Transactions** | • Company enhances its liquidity by moving assets into an "unrestricted subsidiary" (*i.e.*, a subsidiary that is not subject to the liens and claims of existing secured lenders) and then raising a new financing secured by those assets | • J.Crew Group, Inc.<br>• PetSmart, Inc. & Chewy, Inc.<br>• Travelport Worldwide Ltd.<br>• Revlon, Inc. |

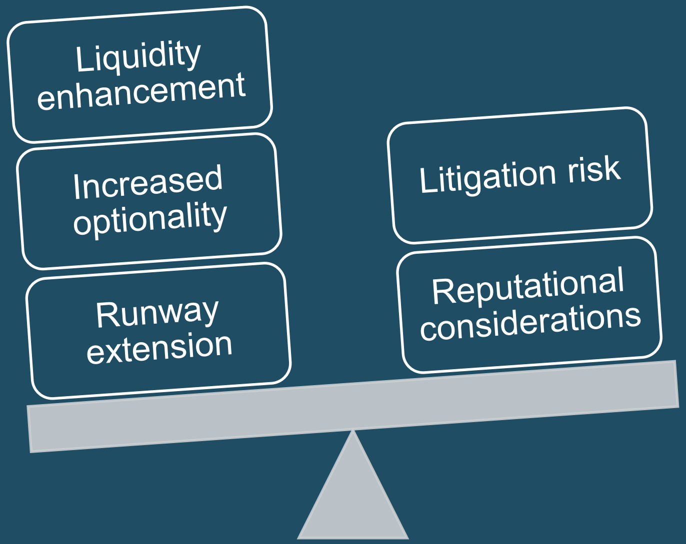
# Uptier Transactions

# Overview and Considerations

**Uptier transactions enhance a company's liquidity but come with significant litigation risk**

- An uptier transaction is a form of priming transaction that typically provides a company with a new-money liquidity infusion from a subset of its lenders and/or sponsors
  - Uptier transactions typically involve modifying credit agreements to allow a borrower to issue super-priority debt with existing collateral to a subset of lenders—the participating lenders—followed by a debt-for-debt exchange of existing debt for new super-priority debt
  - The lenders who did not participate in the transaction—the minority lenders—are often left with what they view as a less attractive debt instrument that is junior to newly issued and/or exchanged debt
- The benefits of an uptier transaction must be weighed against the risk of uncertain litigation costs and outcomes
  - Minority or non-participating lenders have commenced lawsuits against companies, participating lenders, and sponsors, sometimes in multiple jurisdictions
  - Bankruptcy litigation surrounding these transactions continues to develop, but the early signs are favorable for companies and participating lenders

**Parties must weigh the benefits of uptier transactions against the potential risk**



# Select Uptier Transactions

| Company | Year | Related Litigation | Status |
|---|---|---|---|
| Murray | 2018 | Bankruptcy S.D. Ohio (Nov. 2019 – March 2022) | Murray Energy and non-participating lenders settled |
| Serta Simmons | 2020 | NY State and District Courts and S.D. Texas Bankruptcy Court (Jun. 2020 – present) | Bankruptcy court affirmed the Serta Transaction's validity as a matter of law; Fifth Circuit agreed to review |
| TriMark | 2020 | NY State Court (Nov. 2020 – Jan. 2022) | TriMark and non-participating lenders settled |
| Boardriders | 2020 | NY State Court (Oct. 2020 – present) | Boardriders and non-participating lenders agreed to negotiate a settlement subject to Boardriders' expected sale of assets to Authentic Brands |
| TPC Group | 2021 | Del. Bankruptcy Court (June 2022 – Nov. 2022) | Bankruptcy court granted summary judgment in favor of TPC and majority noteholders, affirming the transaction's validity |
| Incora | 2022 | NY State Court (Oct. 2022 – present) | Complaint filed Oct. 31, 2022; litigation is ongoing |
| Mitel | 2022 | NY State Court (Mar. 2023 – present) | Complaint filed Mar. 14, 2023; litigation is ongoing |

# Case Study: Serta Simmons

# Serta Simmons Bedding, LLC – Relevant Background

An LBO in 2012, the bankruptcies and closures of its major distribution channels (Mattress Firm and Sears) and increasing competition strained Serta's liquidity in the lead-up to an uptier priming transaction (the "***Serta Transaction***") in June 2020

## General Business Background

- Serta Simmons Bedding, LLC ("***Serta***") is one of the largest producers of mattresses in the United States
- In August 2012, private equity firm Advent International Corporation ("***Advent***") purchased a majority interest in Serta, reportedly valuing the company at ~$3 billion
- A $670 million debt-financed sponsor dividend was paid in 2016

## Key Events Preceding the Serta Transaction

| | |
|---|---|
| **Business Performance** | - Meaningful declines in business performance in 4Q19, with EBITDA and revenue both down<br>- 1Q20 business performance continued to decline, with EBITDA down to $22mm vs. $45mm in the prior year period<br>- Technical defaults from delayed financials and failure to file a compliance certificate in May 2020 |
| **Ratings Downgrades** | - Issuer credit rating downgraded to CCC from CCC+ by S&P Global Ratings in December 2019<br>- Corporate rating downgraded to Caa3 from Caa1 by Moody's in March 2020 |
| **Debt Trading Prices** | - First lien debt traded down from 60.75/63.25 on February 14, 2020 to 49.3/52.3 on March 25, 2020<br>- Second lien debt traded down from 29.045/32.341 on February 14, 2020 to 23.75/29.375 on March 25, 2020 |
| **Lender Groups** | - Company engagement of financial advisor first publicly reported in March 2020, followed quickly by reporting that the majority lender group was working with legal counsel<br>- Market rumors suggested a group of distressed investors proposed a J-Crew style drop-down transaction, which Serta rejected in favor of the uptier transaction proposed by the majority lender group |

# Serta Simmons Bedding, LLC – Pre-Transaction Capital Structure

Before the Serta Transaction, Serta's capital structure included two tranches of debt

| Pre-Transaction Capital Structure | | |
|---|---|---|
| First Lien Term Loan | $1.88 billion | November 2023 |
| Second Lien Term Loan | $424 million | November 2024 |
| **Total Debt** | **$2.3 billion** | |

# Serta Simmons Bedding, LLC – Post-Transaction Capital Structure

## New Superpriority Debt

- New Money Tranche: $200 million of newly funded superpriority "first out" debt ranking ahead of the existing first lien term loans
- Exchange Tranche: $875 million of superpriority "second out" debt ranking ahead of the existing first lien term loans in exchange for certain existing first lien term loans and existing second lien term loans:
    - Exchange ratio of $74 of new superpriority "second out" debt for each $100 of existing first lien term loans; and
    - Exchange ratio of $39 of new superpriority "second out" debt for each $100 of existing second lien term loans
- An additional basket for superpriority "third out" debt that would rank ahead of the existing first lien term loans that could be used for future exchanges of existing first lien term loans and existing second lien term loans
- Provided the flexibility to use certain assets for future liquidity enhancing and/or liability management transactions

## Post-Transaction Capital Structure

| Instrument | Pre-transaction | Post-transaction | Maturity |
|---|---|---|---|
| Superpriority First Lien First-Out Term Loan | – | $200 million | August 2023 |
| Superpriority First Lien Second-Out Term Loan | – | $875 million | August 2023 |
| Superpriority First Lien Third-Out Term Loan | – | Up to an unspecified amount | – |
| First Lien Term Loan | $1.88 billion | $814 million | November 2023* |
| Second Lien Term Loan | $424 million | $211 million | November 2024* |
| **Total Debt** | **$2.3 billion** | **$2.1 billion** | |

* The Serta Transaction did not modify the maturity dates for the existing first and second lien term loans.

# Serta Simmons Bedding, LLC – Implementation of Serta Transaction

The Serta Transaction was implemented by various amendments to the existing first lien credit agreement, which were approved by a majority of lenders just before they exchanged their existing first and second lien holdings for the new superpriority debt

| Amendments to Existing Debt Documents* |
|---|
| - Modified the definition of "Incremental Equivalent Debt" permitted under the existing credit agreement to include "Indebtedness" issued under the new superpriority facility, "which may be senior, *pari passu* or junior in right of payment and/or with respect to security with the Obligations"<br>- Authorized the agent to enter into a new intercreditor agreement establishing the senior payment priority of the new superpriority debt<br>- Added a new provision to the existing credit agreement outlining the circumstances triggering mandatory prepayments of the first lien term loans to affirm that the new superpriority debt had rights of payment senior to the existing first lien term loan<br>- Removed the provision in the credit agreement that previously designated the subordination of the first lien term loans as an event of default |

* Because Serta is not a public company, its debt documents not subject to litigation are not readily available for review. As such, while Serta's filings in its chapter 11 cases (discussed below) note that the second lien credit agreement was amended in 2020 in connection with the Serta Transaction, because there has been no litigation surrounding the second lien credit agreement, it is unclear what those amendments were or whether they mirrored the amendments made to the first lien credit agreement

# Serta Simmons Bedding, LLC – Litigation Timeline

**The announcement of the Serta Transaction kicked off a series of litigation battles in New York state and federal courts**

| Date | Event |
|---|---|
| Mar. 2020 | – Reporting that Serta and its lenders had engaged advisors |
| June 8, 2020 | – Serta announces its entry into a transaction support agreement with certain lenders for the Serta Transaction |
| June 11, 2020 | – Serta rejects alternative transaction proposal from Apollo, Angelo Gordon and Gamut Capital (the "***Objecting Lenders***")<br>– Objecting Lenders file a complaint in New York state court requesting a preliminary injunction to block the Serta Transaction |
| June 20, 2020 | – New York state judge declines to issue a temporary restraining order after finding that the credit agreement "seems to permit" the Serta Transaction |
| July 2, 2020 | – Affiliates of LCM Asset Management ("***LCM***") commence a lawsuit (the "***LCM Lawsuit***") in the U.S. District Court for the Southern District of New York ("***SDNY***") against Serta and the participating lenders for violating certain provisions of the credit agreement and breaching the implied covenant of good faith and fair dealing |
| Mar. 10, 2021 | – The LCM Lawsuit is dismissed for lack of subject matter jurisdiction (LCM lacked diversity with certain participating lender defendants) |
| May 4, 2021 | – LCM files a new complaint in SDNY against Serta (and not the participating lenders) to resolve the jurisdictional issue (the "***Second LCM Lawsuit***") |
| Mar. 29, 2022 | – Serta's motion to dismiss (the "***MTD***") the Second LCM Lawsuit is denied |
| Nov. 3, 2022 | – Objecting Lenders file a second complaint in New York state court to void the Serta Transaction (the "***Second Objecting Lenders Lawsuit***") |
| Jan. 24, 2023 | – Serta commences chapter 11 cases in the U.S. Bankruptcy Court for the Southern District of Texas and concurrently files an adversary proceeding seeking a declaratory judgment that the Serta Transaction was valid |
| Mar. 28, 2023 | – Bankruptcy Court for the Southern District of Texas upheld validity of Serta Transaction as a matter of law (the "***Validity Order***") |
| Apr. 26, 2023 | – Fifth Circuit Court of Appeals agreed to review the Validity Order |

# Serta Simmons Bedding, LLC – Summary of SDNY Motion to Dismiss Ruling

## The SDNY ruling on Serta's MTD addressed the following key arguments*

| Theme | LCM Position | Company Position | Court Ruling |
|---|---|---|---|
| **No-Action Clause** | ✓ Only applies to actions to realize upon collateral or enforce guaranties, and, therefore, not applicable to lawsuit that sought neither remedy | × Barred lawsuit because related to allegation that transaction released collateral | - Must be strictly construed; only applies to actions to realize upon collateral or enforce guaranties, and, therefore, not applicable to lawsuit that sought damages and injunctive relief related to an allegedly improper transaction |
| **"Open Market" Transaction** | ✓ Serta Transaction was negotiated in secret, and, therefore, the exchange of existing first lien debt for new senior debt was not an "open market" transaction<br>× Credit agreement contained two other provisions specific to exchange transactions, neither of which sanctioned the Serta Transaction | × "Open market" means the price a willing buyer and willing seller can obtain in an arm's-length transaction, and the priming transaction was negotiated at arms' length<br>✓ Existence of specific provisions governing exchange transactions did not prohibit company from invoking another provision of the credit agreement to retire debt in an open market transaction | - The term "open market" as used in the credit agreement was ambiguous, and the court was unable to conclude at the MTD stage that the Serta Transaction qualified as an "open market" transaction<br>- Existence of specific provisions governing exchange transactions did not prohibit company from invoking another provision of the credit agreement that permitted the retirement of debt in an open market transaction |
| ***Pro Rata* Sharing Provisions** | × Court should consider the practical effect of the amendments to the credit agreement which elevated the ability of certain first lien lenders to be paid ahead of others | ✓ Each of the amendments to the credit agreement were expressly permitted with the consent of a majority of lenders<br>✓ No changes were made to the *pro rata* sharing provisions (or other sacred rights) | - The specific amendments that were made to the credit agreement did not require unanimous lender consent and were properly approved by a majority of lenders<br>- The *pro rata* sharing provision only applied to debt within the same "class," and remained unaltered even though the first lien debt was made subordinate to a new class of debt<br>- Anti-subordination was not a "sacred right" under the credit agreement that required unanimous lender consent |
| **Damages** | ✓ Damages were caused by being subordinated to over $1 billion in new senior debt | × No damages since old first lien debt traded up in value after the announcement of the priming transaction | - Enough facts were alleged to demonstrate damages from subordination to a significant amount of new debt; did not need to specify how actual damages would be quantified at MTD stage |
| **Good Faith and Fair Dealing** | ✓ Implied covenant claim not duplicative because based on different facts—*i.e.*, if transaction was permissible, it should have been offered to all lenders *pro rata*<br>✓ Minority lenders denied the fruits of their bargain by being subordinated to $1 billion of superpriority loans | × Implied covenant claim must fail because the Serta Transaction was permitted under the terms of the credit agreement<br>× Should be dismissed as duplicative because it arises from same facts as breach of contract claims and seeks identical damages | - When there is a bona fide dispute over whether a contract covers the contested issue, claim for breach of implied covenant of good faith and fair dealing may be brought in the alternative<br>- Sufficient facts were pled to support claim; "one could reasonably conclude from Plaintiffs' allegations that [the company] systemically combed through the credit agreement tweaking every provision that seemingly prevented it from issuing a senior tranche of debt, thereby transforming a previously impermissible transaction into a permissible one" |

* This high-level summary is for discussion purposes only and is not intended to represent a comprehensive analysis of every argument and position taken by the parties or the court.

# Serta Simmons Bedding, LLC – Chapter 11 Cases

- On January 23, 2023, Serta and certain of its affiliates commenced pre-negotiated chapter 11 cases in the United States Bankruptcy Court for the Southern District of Texas (the "***Bankruptcy Court***")
- Serta commenced its chapter 11 cases with a restructuring support agreement ("***RSA***"), whereby the company will equitize a portion of the outstanding debt, shed almost $1.6 billion in liabilities and exit with approximately $300 million on its balance sheet at emergence from the chapter 11 cases*
- The RSA is supported by the lenders who participated in the Serta Transaction. Lenders objecting to the Serta Transaction are not parties to the RSA
  - Approximately 81% of Serta's first lien, first-out priority term loan lenders and approximately 77% of its first lien, second-out priority term loan lenders are parties to the RSA
- Under Serta's proposed plan of reorganization and the RSA:
  - the first lien, first-out priority term loan lenders will share in approximately $195 million in new term loans on account of their paper;
  - the first lien, second-out priority term loan lenders will receive approximately 100% of the equity in the reorganized company, subject to the vote by the non-participating/objecting lenders and dilution by the MIP, and $105 million in take-back term loans;
  - the non-participating/objecting lenders recovery is subject to a death-trap
    - if the lenders vote to accept the plan, each lender will receive its *pro rata* share of 4% of the equity in the reorganized company subject to dilution by the MIP, or
    - if the lenders vote to reject the plan, each lender will receive its *pro rata* share of 1% of the equity in the reorganized company subject to dilution by the MIP

* Documents filed in connection with Serta's chapter 11 cases note that the second lien term loan was paid in full in the time between the Serta Transaction and the chapter 11 cases

# Serta Simmons Bedding, LLC – Adversary Proceedings

- Concurrently with the filing of the chapter 11 cases, Serta commenced two adversary proceedings and proposed a schedule of dates and deadlines that tie the resolution of the adversary proceedings to the plan confirmation process
  1. The first adversary proceeding (the "***Stay Adversary Proceeding***") sought to extend the protections of the automatic stay to all non-Serta defendants (*i.e.*, the participating lenders) and stay all pending Serta Transaction litigation
  2. The second adversary proceeding (the "***Transaction Validity Adversary Proceeding***") sought a declaratory judgment that the Serta Transaction was valid under the terms of the first lien term loan, which effectively brought all pending Serta Transaction litigation before the Bankruptcy Court

# Serta Simmons Bedding, LLC – The Stay Adversary Proceeding

- In the Stay Adversary Proceeding, the Objecting Lenders argued that the automatic stay should not be extended to halt pending litigation against the participating lenders because their damages claims against the participating lenders are not claims that were “core” to Serta’s pending chapter 11 cases, so the dispute should be resolved outside of the Bankruptcy Court, consistent with the credit agreement’s forum selection clause
  - Serta and the participating lenders argued that if the claims against the Objecting Lenders are not resolved in the chapter 11 case and the Objecting Lenders prevail, Serta “could end up right back in chapter 11” due to the resulting indemnification claims
  - Additionally, Serta noted that its proposed plan is contingent on resolution of the claims against the Objecting Lenders prior to confirmation
- At a hearing on March 13, 2023, the Bankruptcy Court agreed with Serta and extended the automatic stay finding it critical that the Bankruptcy Court decide these issues that are so intertwined to the plan and claims adjudication processes
  - The Bankruptcy Court found that the Objecting Lenders’ claims against the participating lenders are “really claims being asserted against the debtor,” and that the “entire litigation,” at its “core,” is about “the debtors’ conduct.”
  - However, the Bankruptcy Court preserved the Objecting Lenders’ ability to request reconsideration of the stay, noting that it could “conceive of a set of circumstances that would change [its] stance,” but did not provide any additional detail

# Serta Simmons Bedding, LLC – The Transaction Validity Adversary Proceeding

- In the Transaction Validity Adversary Proceeding, Serta sought a declaratory judgment that the Serta Transaction was unambiguously authorized by Serta's first lien credit agreement, effectively bringing the non-bankruptcy Serta Transaction litigation to the Bankruptcy Court
  - The Bankruptcy Cort noted that determining whether the Serta Transaction was an open market purchase was a "threshold" question of law that should be decided on summary judgment, adding that it did not find the provision "ambiguous at all"
- Accordingly, Serta and the participating lenders filed motions for summary judgment, which were met by LCM and the Objecting Lenders' responses, with all parties reiterating their previous arguments
  - **Objecting Lenders Argument:** the Serta Transaction (i) was not an open market purchase, (ii) violated their sacred rights to *pro rata* treatment, (iii) required their consent because it "released all or substantially all" of the loan's collateral; and (iv) violated Serta's implied covenant of good faith and fair dealing because the subordination of the Objecting Lenders deprived them of their benefit of the bargain
  - **Serta and Participating Lenders' Argument:** (i) the Objecting Lenders, as "sophisticated players," understood and priced in risk related to Serta's potential liability management transactions; (ii) the open market purchase provision did not require Serta to offer the transaction to all lenders; (iii) the Objecting Lenders conflate pro rata rights with anti-subordination; and (iv) the Serta Transaction did not release any collateral or guarantee value
- In a bench ruling on March 28, 2023, the Bankruptcy Court granted Serta's motion for summary judgment in part, holding that the Serta Transaction fits squarely within the open market purchase provision of the first lien credit agreement
  - The Bankruptcy Court also denied summary judgment on the Objecting Lenders' and LCM's counterclaim for breach of the implied covenants of good faith and fair dealing, but noted that he would allow the Objecting Lenders and LCM to amend the counterclaim

# Serta Simmons Bedding, LLC – Appeal to Fifth Circuit and Upcoming Trial

- On April 11, 2023, the Objecting Lenders and LCM filed a petition with the Fifth Circuit Court of Appeals seeking a direct and expedited review of the Bankruptcy Court's ruling that the Serta Transaction qualified as an "open market purchase" as a matter of law
  - The Objecting Lenders and LCM have requested that the Fifth Circuit issue a decision by May 8, 2023—the initial date set for the confirmation hearing (now set for May 15, 2023)—arguing that preconfirmation review is imperative because Serta's proposed plan is itself conditioned on the favorable (to Serta) resolution of the adversary
  - Serta disagreed, arguing that there is no emergency that warrants an expedited review schedule because the Fifth Circuit may render its decision after confirmation, as it has done in several other cases
- On April 26, 2023, the Fifth Circuit agreed to review the Bankruptcy Court's order affirming the validity of the Serta Transaction, but it denied the Objecting Lenders' request to expedite its review
- Regardless of when the Fifth Circuit renders its decision, the Bankruptcy Court is scheduled to hold Serta's confirmation hearing and the trial in the Transaction Validity Adversary Proceeding on May 15, 2023
- At the trial, the Bankruptcy Court will consider the evidence and arguments on the claims that survived Serta's motion for summary judgment, including, among other things, the Objecting Lenders' and LCM's counterclaim for breach of the implied covenant of good faith and fair dealing

# Drop-Down Transactions

# Overview and Considerations

**A drop-down transaction does not always explicitly require the consent of the majority of a company's lenders and can be achieved simply by utilizing existing terms in a company's credit documents**

- A drop-down transaction allows a company to enhance its liquidity by moving assets into an "unrestricted subsidiary" (i.e., a subsidiary that is not subject to the liens and claims of existing secured lenders) and then raise a new financing secured by those assets
  - Often times the transferred assets will be leased back to the transferring company for use so that business operations are not impacted
- Drop-down transactions may be attractive when certain protections against leakage do not appear in a company's credit documents, such as:
  - no limit on transfer of "crown jewel" assets to non-loan party subsidiaries;
  - no caps on ability to invest in non-loan parties;
  - no leverage tests for designation/creation of unrestricted subsidiaries are required;
  - automatic lien release mechanisms when collateral has been transferred to affiliates; and
  - loose sale leaseback provisions
- Benefits of a drop-down transaction include liquidity enhancement, increased optionality, and runway extension, all of which must be weighed against uncertain litigation costs and outcomes
- Drop-down transactions often involve related litigation brought by dissenting lenders, but recent bankruptcy litigation such as Revlon, Inc. (discussed below) implies that the end-results may outweigh the risks associated with these types of transactions

# Select Drop-Down Transactions

| Company | Year | Related Litigation | Status |
|---|---|---|---|
| J.Crew | 2017 | NY State Court<br>(Feb. 2017 – June 2017) | J.Crew and non-participating lenders settled |
| PetSmart / Chewy | 2017 | NY State Court<br>(June 2020 – Sept. 2020) | PetSmart and non-partcicipating lenders settled |
| Travelport | 2020 | NY State Court<br>(May 2020 – Sept. 2020) | Travelport and non-participating lenders settled |
| Revlon | 2020 | NY State Court<br>(Aug. 2020 – Feb. 2023) | Revlon and non-participating lenders settled |

# Case Study: Revlon

# Revlon, Inc.

- In August 2019 and May 2020, Revlon, Inc. ("***Revlon***" or the "***Company***"), a multinational company that owns cosmetics, skin care, and fragrance brands, executed two separate drop-down transactions by transferring intellectual property assets (the "***IP Assets***") to unrestricted subsidiaries under the existing credit documents and issuing new debt on the unencumbered collateral
- MacAndrews & Forbes Group, LLC ("***MacAndrews & Forbes***") beneficially owned over 87% of Revlon's publicly traded shares, and the board consisted of 6 sponsor employees/appointees and 7 independent directors
- The Company had outstanding funded debt obligations of approximately $3 billion, which included:
  - $1.75 billion under a $1.8 billion term loan by and between Revlon, Inc. and Revlon Consumer Products Corporation ("***RCPC***") as borrowers, Citibank N.A. ("***Citibank***") as Administrative Agent and Collateral Agent, and certain of Revlon's subsidiaries as guarantors (the "***2016 Term Loan***")
  - $394.9 million under a $400 million asset-based revolver (the "***ABL Facility***")
  - $500 million in 5.75% senior unsecured notes due 2021 (the "***2021 Notes***")
  - $450 million in 6.25% senior unsecured notes due 2024 (the "***2024 Notes***")
- The 2016 Term Loan had a scheduled maturity of September 2023 but was subject to a springing maturity of November 2020 if the 2021 Notes were outstanding on November 16, 2020, and Revlon's liquidity was less than the sum of $200 million plus the then-outstanding amount of 2021 Notes
  - Revlon's $400 million ABL Facility was also subject to the same springing maturity
- The 2016 Term Loan did not limit transfers of the IP Assets, did not require any formal valuation for transfers of the IP Assets to affiliates, and had significant amounts of investment capacity to move the IP Assets outside of the collateral pool

# Revlon, Inc. (cont'd)

- In August 2019, the Company took advantage of the gaps in the 2016 Term Loan and transferred the IP Assets to certain foreign unrestricted subsidiaries of RCPC (collectively "***BrandCo***"), which were then used as collateral for a new $200 million term loan provided by Ares Management LLC ("***Ares***") (the "***2019 Term Loan***"), and leased back to the Company (the "***2019 Transaction***")
  - The 2019 Term Loan had a maturity date of 2022 and was secured by a first-priority lien on the IP Assets and was *pari passu* to the 2016 Term Loan
  - The 2019 Term Loan included a tighter covenant package with, among other things, a senior debt maintenance covenant, an absolute cap on such debt, and a minimum EBITDA covenant
  - The 2019 Term Loan also included a general prohibition on BrandCo's operating activities
- Despite the 2019 Transaction, in late 2019 and into early 2020, Revlon faced a significant risk related to the maturing 2021 Notes and the springing maturity of the 2016 Term Loan
- As such, Revlon began exploring financing alternatives with the lenders under the 2016 Term Loan (the "***2016 Term Lenders***"), whereby the Company would use the IP Assets at BrandCo as collateral, refinance the 2016 Term Loan participating lenders, and grant *pari passu* liens on the remainder of the 2016 Term Loan collateral
- However, in mid-March 2020, a group of 2016 Term Lenders opposing the transaction (the "***Dissenting Lenders***") entered into a cooperation agreement seeking to block any necessary amendments to the 2016 Term Loan
- To circumvent the Dissenting Lenders, in connection with the 2020 Transaction (defined below), Revlon and a group of 2016 Term Lenders (the "***Participating Lenders***") arranged for an increased $65 million revolver loan under the 2016 Term Loan that would dilute the position of the Dissenting Lenders and make the Participating Lenders the required lenders under the 2016 Term Loan capable of amending the 2016 Term Loan
  - The revolver commitments disappeared 15 days after being issued due to the commitments under the 2020 Facilities (defined below)

# Revlon, Inc. (cont'd)

- In May 2020, Revlon took advantage of the same exact gaps in the 2016 Term Loan again and transferred the remaining IP Assets to BrandCo, which were then used as collateral for a $910 million first lien facility, a $950 million second lien facility, and a $3 million third lien facility (the "***2020 Facilities***") provided by the Participating Lenders, and leased back to the Company (the "***2020 Transaction***" and, together with the 2019 Transaction, the "***Revlon Transactions***")
  - The 2020 Facilities were subject to a springing maturity and would mature on the earlier of (i) June 30, 2025, and (ii) May 2, 2024, if greater than $100 million in 2024 Notes remained outstanding
  - The 2020 Facilities were secured by liens on the IP Assets and were *pari passu* to the 2016 Term Loan
  - Proceeds of the 2020 Facilities were used to refinance the 2019 Term Loan and repay the 2021 Notes
  - Participating Lenders were permitted to convert their respective 2016 Term Loan
- Following the 2020 Transaction, the Dissenting Lenders sent a Notice of Event of Default to UMB Bank ("***UMB***"), which was acting as Citibank's successor under the 2016 Term Loan
- At the Dissenting Lenders' direction, UMB filed suit against Revlon in New York state court, alleging (a) improper siphoning of collateral away from the 2016 Term Lenders; (b) improper manipulation of the voting provisions in the 2016 Term Loan; and (c) an acceleration of the 2016 Term Loan debt due to an alleged event of default
- The Dissenting Lenders withdrew the suit before service had been executed or substantive motions had been filed because they were mistakenly repaid in full by a nearly $1 billion payment made accidentally by Citibank in connection with the 2020 Facilities

# Revlon, Inc. (cont'd)

- On June 15, 2022, Revlon and certain affiliates (collectively, the "***Debtors***") filed for chapter 11 bankruptcy protection in the United States Bankruptcy Court for the Southern District of New York (the "***Bankruptcy Court***") supported by a restructuring support agreement (the "***RSA***") with the Participating Lenders
- On October 31, 2022, the Dissenting Lenders filed an adversary proceeding against the Debtors and the Participating Lenders seeking to unwind the 2020 Transaction because:
  - they did not consent to the amendment of the 2016 Term Loan;
  - the transfer of the IP Assets violated certain sale and lease back provisions in the 2016 Term Loan;
  - the Participating Lenders received a windfall; and
  - the transfer divested the Dissenting Lenders of their collateral
- In response, Revlon and the Participating Lenders argued that the Dissenting Lenders lacked standing to bring these claims as such claims were derivative causes of action the belonged to the Debtors' bankruptcy estates, and even if the Dissenting Lenders could bring such claims, the terms of the 2016 Term Loan allowed the Debtors to take the actions used to effectuate the 2020 Transaction
- On February 15, 2023, siding with the Debtors and the Participating Lenders, the Bankruptcy Court dismissed the adversary proceeding on the grounds that the claims asserted were derivative of fraudulent transfer claims and potential similar estate claims, which can only be brought by the Debtors' bankruptcy estates
  - The Dissenting Lenders also argued that the Bankruptcy Court's dismissal of their avoidance claims as derivative of estate claims did not require dismissal of their monetary damages claims against the Participating Lenders

# Revlon, Inc. (cont'd)

- On February 21, 2023, the Debtors, the Participating Lenders, and the Dissenting Lenders announced a global settlement whereby each Dissenting Lender would receive its *pro rata* share of (i) 18% of the equity in the reorganized company, subject to dilution by the MIP, or (ii) $56 million in cash
- Revlon's plan was confirmed on April 3, 2023 and is expected to go effective next month

# Cooperation Agreements

# Cooperation Agreements

**In recent years, lender groups have begun to coordinate earlier via cooperation agreements at the first indication of financial stress**

- A cooperation agreement is an increasingly popular tool whereby a company's lenders will bind similar creditor parties together in credit negotiations to achieve a desired outcome
  - Cooperation agreements may be among a majority or minority of lenders
- Prior to pursuing any transaction, a company should be aware of any existing cooperation agreements among its lenders
  - If a lender group is unorganized, the company may decide to act quickly in order to keep the lender group fractured
- From a lender's perspective, entering into a cooperation agreement with a majority of lenders is often a helpful tool to generate negotiating leverage and obtain favorable outcomes
  - Individual lenders can often get a decent understanding of how their interests may align with other lenders based on where value breaks, but they may be unaware of how the structural aspects of each lender in the group may affect the path the group decides to pursue (depending upon whether a CLO, fund, insurance company, other direct lender, investor base, etc.)
  - In addition to creating leverage from size, using cooperation agreements may also reduce professional fees as each lender in the group typically only incurs fees proportionate to its relative holdings percentage
  - Despite these benefits, lenders should keep in mind that the collective nature of cooperation agreements is also a limitation on the individualized treatment and consideration by the advisors (*e.g.*, the legal advisor's mandate is to act in the best interest for the lender group as a whole, not any individual lender)

# Cooperation Agreements

## Lenders have used cooperation agreements in the following recent transactions

| Company | Cooperation |
|---|---|
| J.Crew Group, Inc. | • **Cooperation Agreement Parties:** A majority of J.Crew's 2016 term loan lenders<br>• In June 2017, it was first reported that certain of J.Crew's term loan lenders were in the process of signing a cooperation agreement that would require a commitment from more than 50% of the term loan lenders that they would not provide a waiver consenting to any exchange transaction |
| Revlon Consumer Products Corp. | • **Cooperation Agreement Parties:** 50% of Revlon's 2016 term loans<br>• In early 2020, a majority of Revlon's 2016 term loan lenders signed a cooperation agreement attempting to prevent a series of new financing transactions that would strip the collateral from the 2016 term loan facility |
| Wesco Aircraft Holdings, Inc. (d/b/a Incora) | • **Cooperation Agreement Parties:** Approximately 33% of Incora's senior secured noteholders<br>• In February 2022, a group of Incora's noteholders assembled a blocking position and signed a cooperation agreement whereby they agreed not to join in any non-pro-rata deal potentially proposed by Incora's majority lenders |
| Carvana Co. | • **Cooperation Agreement Parties:** 70% of Carvana's unsecured lenders<br>• In December 2022, as Carvana's stock plunged nearly 97% and its bonds have traded down to 50, lenders signed a cooperation agreement to present a united front in negotiations around new financing or a debt restructuring |
| Brand Industrial Services, Inc. (d/b/a BrandSafway) | • **Cooperation Agreement Parties:** 74% of BrandSafway's term loan lenders, and 61% of the company's total lenders<br>• In November 2022, given near-term maturities and BrandSafway's 9X leverage, lenders organized under a cooperation agreement to organize in the face of any refinancings or restructuring negotiations |

# Cooperation Agreements: PWM Property Management – Overview

**PWM provides a cautionary tale of when a cooperation agreement goes too far and violates the Bankruptcy Code**

- PWM Property Management (“***PWM***”) owns commercial office towers in New York City and Chicago and was heavily impacted by the Covid-19 outbreak and the quarantines and work-from-home policies in its wake
- On October 31, 2021, PWM filed for Chapter 11 protection in the Bankruptcy Court for the District of Delaware, reporting $1 billion to $10 billion in both assets and liabilities
- In bankruptcy, PWM immediately moved to reject the property management agreement with S.L. Green Management Corp. (“***SLG***”), the property manager for its New York City office tower
  - SLG is a forty-nine percent (49%) preferred equity holder in the Debtor and further holds fifty percent (50%) of the mezzanine C loans
- In support of rejection, PWM argued that, after losing its largest tenant (Major League Baseball), SLG failed to bring in a new tenant or to take any other steps to make the building competitive in the New York market.
  - If SLG did not find a replacement tenant by October 31, 2021, it would trigger a “Tenant Trigger Event” under the office tower’s mortgage documents
  - The Tenant Trigger Event would allow the mortgage service to sweep certain excess cash flows, which would leave PWM unable to pay SLG their required quarterly dividend payments for their equity contribution

# Cooperation Agreements: PWM Property Management – The Agreement

**The creditors entered a cooperation agreement that largely prevented their consideration of other plans**

- The mezzanine lenders (including SGL) entered into a cooperation agreement pursuant to which the creditors agreed to only support the plan of adjustment that would be prepared by the group
  - The creditors were largely prohibited from considering, supporting, or discussing any other plan
- In response to PWM's motion to extend the exclusivity period, SGL and the mezzanine lenders objected and filed their plan of adjustment under seal "to prevent any perceived violations of [PWM's exclusivity]"
- PWM objected, arguing that filing the plan violated PWM's exclusivity period, notwithstanding that it was filed under seal, and further that the *entrance into the cooperation agreement constituted improper solicitation* under section 1125(b) of the Bankruptcy Code because it prohibited the parties from consenting to any transaction other than the group's plan of adjustment
- In response, the creditors argued, among other things, that they did not violate PWM's exclusivity because the plan of adjustment was filed under seal, which only allowed the court, PWM, and the U.S. trustee to see the plan, and that they did not violate section 1125(b) of the Bankruptcy Code by *entering into the cooperation agreement because courts support creditor negotiations during the debtors' exclusive period.*
  - The creditors added that the cooperation agreement expressly provides in a disclaimer that the plan of adjustment is subject to higher or better offers, so the cooperation agreement and plan of adjustment cannot constitute an improper solicitation or a post-petition lock up agreement

# Cooperation Agreements: PWM Property Management – The Court's Ruling

## Cooperation agreements may constitute improper solicitation in violation of the Bankruptcy Code

- At the hearing on exclusivity, the bankruptcy court noted displeasure with PWM's progress, but nonetheless granted PWM's extension
- The bankruptcy court also held that the creditor group violated PWM's exclusivity period by filing the plan of adjustment, adding:
  - sealing the proposed plan of adjustment did not constitute proper protection because filing on the public docket itself was improper
  - sealing the proposed plan of adjustment pursuant to section 107 of the Bankruptcy Code is improper in the first instance because the plan of adjustment does not contain "trade secrets, confidential research, development, or commercial information," as section 107 requires
- Importantly, the bankruptcy court also held that the creditors' entry into the cooperation agreement violated section 1125 of the Bankruptcy Code
  - while creditors may discuss acceptable terms before a debtor files a plan, by filing their plan with the court, the creditors solicited votes prior to approval of a disclosure statement
  - filing the plan on the docket, even without disclosing the content, was enough to "whet the appetite of interested parties," and
  - the cooperation agreement's disclaimer that it was not soliciting votes was wholly irrelevant

# Transaction Takeaways

# Transaction Takeaways

1. Early action and assessment of alternatives can provide an early mover advantage for creditors willing to transact and allow a distressed company to avoid a chapter 11 filing with its attendant disruption and costs
2. Do not be afraid to go bespoke—transactions can be combined and processed in unique ways that preserve value
3. Thorough analysis of and creative thinking around a company's credit documents, creditor constituencies, and operational and strategic advantages can produce innovative solutions
4. Litigation risk but weighed against time, options, and runway
5. As these transactions become more popular, reputational harm seems limited thus far
6. As evidenced by *Serta* and *Revlon*, bankruptcy courts are more than willing to wade in and quickly resolve any lingering disputes associated with these transactions
7. As case law, particularly bankruptcy law, continues to evolve in favor of companies pursuing these transactions, the perceived downsides (*e.g.*, litigation surrounding the debt documents, fiduciary duty claims, fraudulent transfer claims and tortious interference) seemingly diminish as the end results are still favorable to the company

# THANK YOU

www.velaw.com

@VinsonandElkins

@VinsonElkins

**Austin**
T +1.512.542.8400

**Dallas**
T +1.214.220.7700

**Dubai**
T +971.4.330.1800

**Houston**
T +1.713.758.2222

**London**
T +44.20.7065.6000

**Los Angeles**
T +1.213.527.6400

**New York**
T +1.212.237.0000

**Richmond**
T +1.804.327.6300

**Riyadh**
T +966.11.250.0800

**San Francisco**
T +1.415.979.6900

**Tokyo**
T +81.3.3282.0450

**Washington**
T +1.202.639.6500