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Unhappy Lenders Challenge Aggressive Debt Exchanges

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Takeaways

- Loan agreement provisions allowing borrowers to repurchase their loans to take advantage of steep debt discounts and restructure their debt became popular in the wake of the financial crisis. The meaning of some common terms in those clauses is now being tested in courts.
- Court decisions so far have varied, but more are expected soon, potentially providing clarity to both lenders and borrowers.
- The disputes, and the prospect that borrowers might be allowed to offer favorable terms to subsets of existing lenders, may prompt additional changes in standard loan agreements.

Most syndicated term loan B credit facilities allow the borrower or its affiliates to purchase loans from lenders on a non-pro rata basis if those transactions are made through either an "open market purchase" or a "Dutch auction."

Such provisions became popular during the Great Recession, when many syndicated loans traded at a discount to par. Before that, borrowers generally could not take advantage of discounted loan prices because most credit agreements either prohibited them from taking assignment of their loans or treated such purchases as a voluntary prepayment required to be allocated pro rata to all lenders.

If, instead, a borrower is permitted to use the "open market purchase" and "Dutch auction" mechanisms provided in many credit agreements to repurchase or exchange loans with a subset of its lenders, it can gain negotiating leverage with the remaining lenders in a restructuring. Borrowers can induce participation in the exchange by offering more favorable terms in the new debt, possibly subordinating the debt held by the nonparticipating lenders, and sometimes also stripping some covenants from the existing loan documents, reducing protections for lenders that do not participate. Those lenders, who often do not receive the repurchase or exchange offer, or were required to commit substantial capital to participate, may view the partial exchanges as coercive.

Absent provisions authorizing limited debt purchases, prepayments must generally be made on a pro rata basis to all lenders at par or, in some cases, a premium. Also, credit agreements often treat the pro rata sharing of payments as a "sacred right," requiring unanimous lender consent, rather than majority, to modify. Debt buybacks through open market purchases or Dutch auctions are exceptions to the pro rata sharing requirement and restrictions on loan assignments to the borrower.

Recently, the meanings of "open market purchase" and "Dutch auction," as those terms are used in the assignment provisions of credit agreements, have been contested in state and federal courts. In those cases, borrowers used these processes to "repurchase" loans from some lenders on a non-pro rata basis in exchange for new superpriority or other favorable debt.

As these can be powerful tools for distressed borrowers, strengthening their hands in dealing with remaining lenders, the decisions in these cases may significantly impact borrowers considering out-of-court restructurings.

Serta Simmons: Challenged but Permitted to Close

On June 8, 2020, Serta Simmons announced its intent to repurchase hundreds of millions of dollars of term loans held by a majority of its first- and second-lien lenders in exchange for new superpriority loans with priority over the

existing first- and second-lien debt. A group of nonparticipating lenders sought a preliminary injunction in state court to block the transaction, arguing, in part, that the proposed transaction impermissibly amended the pro rata sharing clause of the existing loan documents.

The court denied the motion, finding the credit agreement "seem[ed] to permit[] the debt-to-debt exchange on a non-pro rata basis as part of an open market transaction." It concluded that, since the amendments did "not affect [plaintiffs'] so-called 'sacred rights' under the Credit Agreement, plaintiffs' consent [did] not appear to be required," and the transaction could go forward.

A second group of nonparticipating lenders brought suit in federal court, arguing the exchange was not an "open market" transaction because the purchase of existing debt (1) did not retire existing loans; instead it exchanged existing loans for new loans; (2) was not priced at market value; and (3) was arranged privately rather than negotiated in an open market. Ultimately, the court dismissed the case on jurisdictional grounds and did not resolve the issue.

TriMark: Resolved Outside of Court

In September 2020, TriMark issued superpriority loans composed of new money "first out" (Tranche A) loans and "second out" (Tranche B) loans exchanged, through an open market purchase, for a portion of existing loans held by a majority of its first-lien lenders. Some of the nonparticipating lenders sued the borrower, its private equity sponsors and several participating lenders, alleging, as the second group of nonparticipating lenders did in *Serta Simmons*, the transaction was not an "open market purchase" because it (1) did not retire debt; it instead implemented a debt-for-debt exchange; (2) was not priced at market value, but above the existing loans' trading value; and (3) was negotiated privately, rather than in the "open market" on an arm's length basis.

The court denied, in part, the defendants' motion to dismiss, finding the original credit agreement could be reasonably read to require the plaintiff lenders' consent for the amendments. One amendment modified the definition of an "open market purchase" to include transactions "below or above par for cash, securities, or any other consideration with one or more lenders that are not made available for participation to all lenders."

On January 7, 2022, TriMark announced that it reached a consensual resolution of the dispute with the nonparticipating lenders. According to a press release, TriMark will exchange "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 …, senior to the Tranche B Loans." TriMark expects to complete the transaction by January 31, 2022, after which the court would dismiss the pending litigation.

Boardriders: Challenge Pending

In August 2020, Boardriders contracted with a majority of its first-lien lenders to exchange their existing loans for new superpriority loans. The minority lenders, who did not receive an offer to participate, sought to unwind the transaction. They alleged, similarly to the other challenges described above, the transaction was not an "open market purchase" because it (1) was a debt-for-debt exchange rather than a debt retirement; (2) was priced not at market value, but above the trading value of the existing first-lien loans; and (3) was not a stand-alone transaction, but part of a broader reorganization diverting value from nonparticipating lenders to those participating. As of press time, the defendants' motion to dismiss was pending.

Murray Energy: Heading Toward an Evidentiary Trial

In 2018, Murray Energy Holdings used a modified Dutch auction to exchange new superpriority debt for existing debt held by a majority of its lenders under a 2015 agreement. In Murray's subsequent Chapter 11 case, the agent for the nonparticipating 2015 lenders sought a declaratory judgment that the 2018 transaction was invalid. Among other reasons, the agent argued the mechanism through which Murray repurchased the participating lenders' debt did not qualify as a "modified Dutch auction."

On November 8, 2021, the court denied cross-motions for summary judgment due to conflicting expert testimony on whether the transaction was in fact a modified Dutch auction "as that term is commonly understood in the finance industry." The court said it was unable to determine without a trial "whether a modified Dutch auction requires a range of offer prices or a minimum discount at which the debt will be repurchased," or "whether: (1) the negotiations leading up to the [2018 auction] fulfilled any requirement of a range or minimum discount; (2) the negotiations leading up to the transaction can fulfill the requirement of bidding; and (3) the par-value bid precludes a finding that the [2018 auction] was a modified Dutch auction."

Conclusion

Following the *Serta Simmons* transaction, lenders began insisting that credit agreements include so-called "anti-Serta" provisions to better protect against priming efforts by borrowers and sponsors. That trend, however, appears to be losing steam. A November 2021 *Xtract Research* survey of credit agreements in the large sponsor market in the second and third quarters of 2021 found that agreements with "anti-Serta" provisions decreased 9% between those quarters.

Assuming that the parties in *Boardriders* and *Murray Energy* do not follow the path of *TriMark* and reach out-of-court settlements, the resolution of those cases should help clarify the meaning of an "open market purchase" or "Dutch auction."