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All for One? Debt Co-Investors Need Not Behave as Musketeers

By Jason Ulezalka and Jonathan W. Young*

The authors review a decision by a Delaware bankruptcy court recognizing the effectiveness of an "uptiering" transaction.

The U.S. Bankruptcy Court for the District of Delaware has delivered an opinion recognizing the effectiveness of an "uptiering" transaction, whereby a subset of an issuer's existing noteholders are issued new notes enjoying a higher priority than that afforded to existing noteholders. The issuer and participating noteholders accomplished this reordering of priority through an amendment to the applicable indenture and intercreditor agreement without the consent (and to the detriment) of the non-participating noteholders. After purchasing a position in the affected notes, and following the issuer's bankruptcy filing, a group of non-participating noteholders filed suit in the bankruptcy court—seeking a determination that the subsequent notes were issued in violation of the applicable terms of the indenture and intercreditor agreement, and that these subsequent notes were actually junior in priority.

In a thorough and closely reasoned opinion, Bankruptcy Judge Craig Goldblatt ruled in favor of the issuer and the subsequent noteholders, and essentially concluded that the uptiering transaction succeeded in elevating the priority of the subsequent note issuance.[1] Following an immediate appeal to the Delaware district court, District Judge Richard Andrews substantially endorsed Judge Goldblatt's conclusion and reasoning in his decision declining to expedite the appeal or to stay Judge Goldblatt's order pending appeal.[2]

Taken together, these recent Delaware decisions represent a ringing endorsement of the uptiering strategies employed in the Trimark, Serta and Boardriders credit facilities, and a sobering reminder that this type of "creditor on creditor violence" is still very much a viable and often used strategy for accessing needed liquidity.

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[1] Bayside Capital Inc. and Cerberus Capital Management, L.P. v. TPC Grp. Inc. (In re TPC Grp. Inc.), Adv. Pro. No. 22-50372 (Bankr. D. Del. July 6, 2022).

[2] Bayside Capital Inc. and Cerberus Capital Management, L.P. v. TPC Grp. Inc. (In re TPC Grp. Inc.), Adv. Pro. No. 22-50372 (D. Del. July 26, 2022).

THE TRANSACTION

In August 2019, TPC Group, Inc. (TPC) issued $930 million of notes bearing interest at 10.5% (the 10.5% Notes) secured by a first-priority lien encumbering substantially all of TPC's assets. Over the course of 2021 and 2022, TPC issued an additional $205 million of notes bearing interest at 10.875% (the 10.875% Notes) secured by those same assets. In connection with the issuance of the 10.875% Notes in 2021, a super-majority of the holders of the 10.5% Notes voted to amend the indenture and intercreditor agreement governing the 10.5% Notes to provide that the lien securing the 10.5% Notes would be subordinate to the lien securing the 10.875% Notes. Importantly, the holders of 10.5% Notes approving these 2021 amendments were the same noteholders being issued the 10.875% Notes.

TPC filed for bankruptcy protection on June 1, 2022 and sought a DIP loan from the holders of the 10.875% Notes. The terms of the proposed DIP loan provided for an additional $85 million of new money to TPC, along with the roll-up of $238 million of 10.875% Note obligations outstanding on the petition date. An ad hoc group of minority holders of the 10.5% Notes filed an adversary proceeding to challenge the aspects of the 2021 transaction by which the 10.5% Notes were purportedly primed by the 10.875% Notes.

On cross motions for summary judgment, the bankruptcy court ruled against the dissenting noteholders, holding that the required majority of holders had properly authorized the subordination of the 10.5% Notes in accordance with the terms of the indenture.

After District Judge Adams denied the motions to expedite and for a stay pending appeal, the parties stipulated to the dismissal of the appeal.

"SACRED RIGHTS"

Both of these Delaware rulings hinged on the question of whether the elevation of priority for the holders of the 10.875% Notes violated the "sacred rights" provisions of the indenture, such that the amendment would have required the affirmative vote of 100% of the affected holders of the 10.5% Notes. The objecting noteholders argued that the sacred rights provisions in the indenture were violated by the 2021 amendments since the 10.5% Notes were subordinated to the 10.875% Notes without the unanimous approval of the holders of the 10.5% Notes.

In furtherance of this position, the objecting noteholders pointed to a sacred right set forth in the indenture that prohibited any amendment to the indenture "dealing with the application of proceeds of Collateral." Relying on this language, the objecting noteholders argued that any amendment to the indenture allowing for additional secured debt to be paid ahead of the 10.5% Notes would "deal with the application of proceeds of Collateral" and be prohibited absent unanimous noteholder approval.

Judge Goldblatt ultimately accepted the more narrow interpretation of this language urged by TPC and the holders of the 10.875% Notes—that the only provision in the indenture "dealing with the application of proceeds of collateral" was the waterfall provision addressing how the proceeds of collateral are required to be distributed by the indenture trustee. The waterfall provision required that, after payment of the trustee's fees, any proceeds of Collateral must be distributed "ratably" among holders of the 10.5% Notes. Judge Goldblatt firmly rejected the attempt to characterize this provision as an anti-subordination restriction, whether sacred or otherwise.

In essence, Judge Goldblatt concluded that the waterfall provision required nothing more than the ratable distribution of monies received by the trustee for the holders of the 10.5% Notes. So long as any monies were distributed to the holders of the 10.5% Notes on a pro rata basis, the terms of the indenture were satisfied. Nothing in this language precluded TPC from issuing new notes at a higher priority than that afforded to the holders of the 10.5% Notes. Judge Goldblatt further emphasized that the indenture did not include express anti-subordination language among its sacred rights. Had the holders of the 10.5% Notes expressly included such language as a sacred right (an approach "sufficiently commonplace" in the market), that provision would have been enforced, and unanimous noteholder consent would have been required to amend the indenture.

THE INDENTURE

The TPC court also assessed the voting provisions in the indenture, which provided for a hierarchy of consents needed for particular amendments:

- Most amendments could be effectuated by a simple majority noteholder vote;
- The release of all or substantially all of the collateral required a super-majority noteholder vote; and
- Amendments dealing with ten "sacred rights" required unanimous consent of all affected noteholders.

According to the court, the "logic of that hierarchy" would suggest that the ten sacred rights would address actions having the potential to be more prejudicial to the interests of individual noteholders than the kinds of actions requiring a majority or super-majority consent. Judge Goldblatt placed great weight on the fact that, under the indenture, the noteholders could release all of their collateral with just a super-majority vote. That being the case, the court found it illogical to read the indenture as requiring unanimous noteholder consent to subordinate the noteholders' lien on the collateral. Why should subordination require unanimous noteholder approval, when the more drastic remedy of an outright release of collateral could be accomplished by super-majority vote?

Judge Goldblatt acknowledged that the objecting noteholders have an understandable complaint, from a commercial perspective, with the fact that they were not offered the opportunity to participate in the 10.875% Notes. However, the court noted that:

> [T]he debtors were free to make their own business decisions in deciding from whom to borrow new money. So while the various 2021 transactions may have violated what the *Trimark* court (perhaps aspirationally) called the "all for one, one for all" spirit of a syndicated loan, the transactions did not violate the letter of the applicable agreements in a manner that gives rise to a claim by the objecting noteholders. There is nothing in the law or the terms of these credit agreements that requires holders of syndicated debt to behave as Musketeers. To the extent such holders want to be protected against self-interested actions by borrowers and other holders, they must include such protections in the terms of their agreements.[3]

CONCLUSION

The opinions by these two Delaware judges highlight the importance of including explicit and precise language in credit agreements and indentures prohibiting uptiering and other non-consensual priming transactions absent the requisite level of consent. As these opinions make clear, to the extent debt investors want lien subordination treated as a sacred right, they must expressly negotiate for the inclusion of such a protection.

We have observed an increased prevalence of anti-subordination language being included in credit agreements and indentures, which we expect comes as a direct response to the slate of well-publicized uptiering and non-consensual priming disputes, including those involving creditors of Trimark, Serta, Boardriders, and now, TPC.

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[3] It is interesting to note that the objecting noteholders acquired their positions between July 2021 and January 2022—months after the initial tranche of 10.875% notes were issued—and at a point in time where all aspects of this capital structure would have been a matter of record.