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Bankruptcy Court Rejects Challenge to Pre-Bankruptcy Uptier Transactions

There have been several so-called "uptier" transactions over the last several years, where lenders have provided "rescue financing" to a distressed company senior in priority to existing debt. While there has been significant commentary about whether such financings are contractually permitted, there have been few decisions analyzing challenges to such transactions.[1] In *Bayside Capital Inc. v. TPC Group Inc. (In re TPC Group Inc.)*,[2] the United States Bankruptcy Court for the District of Delaware (Goldblatt, J.) recently held that pre-petition transactions where certain, but not all, bondholders provided new financing and received liens senior to those on existing debt that were not prohibited by the applicable indenture or other related agreements.[3]

Background

Uptier transactions can take many forms, but in general, they involve some or all existing lenders' agreeing to provide new financing to a borrower (often facing some form of distress) in exchange for such new funds (and sometimes prior loans) being treated as a super-priority and thereby subordinating existing debt. These transactions are often effectuated without the consent of all of the lenders, and the non-participating minority lenders sometimes assert that such transactions are not permitted under the terms of the applicable credit agreement or indenture and that any purported subordination is not enforceable. The borrower and the participating lenders, on the other hand, typically take the position that such uptiering is not explicitly prohibited by the applicable documentation and that the transaction itself does not implicate any "sacred rights" that require the consent of all lenders.

In 2019, TPC Group Inc. ("TPC") issued $930 million of senior secured notes (the "Original Notes") under an indenture (the "Indenture") that were secured by a first lien on fixed assets and a second lien (junior to an asset-based loan facility) on current assets. TPC subsequently had liquidity issues and entered into discussions with certain noteholders holding more than 67% of the Original Notes (the "Majority Holders"), resulting in the issuance of more than $200 million of new notes to the Majority Holders in 2021 and 2022 (the "New Notes") secured by the same collateral as the Original Notes. In connection with these transactions, TPC and the Majority Holders also entered into a new intercreditor agreement that subordinated the Original Notes to the New Notes. To effectuate this uptiering of the New Notes, TPC obtained consents from the Majority Holders, but it did not offer the opportunity to participate in the transactions to all noteholders.[4]

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[1] For example, in the well-publicized Serta, 2022 WL 953109 (SDNY Mar. 29, 2022), and Trimark, 2021 WL 3671541 (N.Y. Sup. Ct. Aug. 16, 2021), cases, minority lenders were allowed to pursue various claims against majority lenders to challenge similar transactions.

[2] 2022 WL 2498751 (Bankr. Del. July 6, 2022).

[3] *Id.* at *12.

[4] *Id.* at *2-5. The supplemental indenture for the New Notes includes express anti-subordination language. *Id.* at 11.

Despite this new financing, TPC was unable to avoid bankruptcy. In connection with proposed debtor-in-possession (DIP) financing in its Chapter 11 case, among other matters, the court considered on an expedited basis a challenge to the uptier transactions brought by holders of approximately 10% of the Original Notes (the "Objecting Noteholders"). One of the primary issues considered by the court was whether the uptier transactions were permissible under the terms of the Indenture (*i.e.*, whether the New Notes were senior to the Original Notes).[5]

Legal Analysis

As an initial matter, the court rejected arguments that the Objecting Noteholders did not have standing to challenge the uptier transactions as the result of the "no-action clause" contained in the Indenture, purportedly prohibiting individual holders from taking action to enforce the terms of the Indenture and requiring at least 25% of such holders to request any such action be taken by the trustee under the Indenture. Observing that "caselaw expresses a strong skepticism towards reading a no-action clause to preclude enforcement of rights that an agreement expressly grants to individual holders[,]"[6] the court found that to prohibit the Objecting Noteholders from challenging the uptier transactions would in effect render meaningless any sacred rights in the Indenture for the benefit of individual holders.[7]

The court then analyzed whether the uptier transactions violated provisions of the Indenture that would have given individual noteholders the right to consent to any changes related to how proceeds of collateral would be applied in a way that adversely affected such holders.[8] Rejecting the Objecting Noteholders' argument that putting any debt ahead of them would implicate such a sacred right, the court concluded that such restrictions were intended to "protect[] the holders' rights to ratable treatment and should not be read as an anti-subordination provision in disguise."[9] Noting that releasing collateral under the Indenture requires only a 67% vote and that "[s]ubordination of a lien to that of another lender is a *less* drastic intrusion on the rights of an individual holder than releasing all of the collateral," the court concluded that it "would not make sense to … permit a two-thirds majority to take a *more* drastic action but give every holder the right to block the *less* extreme measure" and that, therefore, the uptiering transactions did not require unanimous consent.[10] On that basis, the court declined to invalidate the uptiering transaction.

Finally, although not relevant to its central holding, the court responded to criticisms that not all noteholders were invited to participate in the uptier transactions. While acknowledging that, "to the extent the [Objecting Noteholders] have anything to complain about …, that complaint is more that … [they] were not offered the opportunity to participate[,]" the court concluded that the uptiering "did not violate the letter of the applicable agreements in a manner that gives rise to a claim by the [Objecting Noteholders]."[11]

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[5] *Id.* at *5-6. The plaintiffs have appealed the court's ruling and also sought to have the decision stayed pending appeal. The requested stay was denied by the court but ultimately granted on a temporary basis by the United States District Court for the District of Delaware. As a result of that stay, TPC has not sought final approval of its DIP financing.

[6] *Id.* at *8.

[7] *Id.* at *8-9.

[8] *Id.* at *9-12.

[9] *Id.* at *12.

[10] *Id.* at *12-13.

[11] *Id*. at *13.

Conclusion

It should be abundantly clear that the validity of any uptiering or similar transaction will hinge largely on the language of the underlying agreements and the substance of such transaction. While the *TPC* decision may provide a potential reference point for structuring uptier transactions (depending on the result of the pending appeals), the court also provided advice for lenders that would like to avoid a similar result: if "holders want to be protected against self-interested actions by borrowers and other holders, [then] they must include such protections in the terms of their agreements."[12] The most obvious way to do so, of course, would be to include as strong as possible anti-subordination language in the underlying credit agreement or indenture.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email authors Joel H. Levitin (partner) at 212.701.3700 or jlevitin@cahill.com; or Richard A. Stieglitz Jr. (partner) at 212.701.3393 or rstieglitz@cahill.com; or email publications@cahill.com.

[12] *Id.* at *12.