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Debt Restructuring and Indenture Amendments: Curing Ambiguities, Navigating Competing Intercreditor Agreements

Lessons From GSO Coastline Credit Partners v. Global A&T Electronic

THURSDAY, SEPTEMBER 22, 2016

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Amendments, Ambiguities, and Intercreditor Agreements

Lessons From
*GSO Coastline Credit Partners et al. v. Global A&T Electronics et al.***

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Competing Goals: Borrowers and Lenders

Borrowers Want Flexibility

- Issue Additional Debt;
- Amend Covenants;
- Extend Maturities

Lenders Want Certainty

- Maintain Priorities;
- Prevent Dilution of Collateral;
- Clear Understandings

Amendments

- **Typical Indentures**
  - Amendment with consent of requisite holders;
  - Amendment of certain economic terms only with consent of each affected holder;
  - Ambiguities and defects may be fixed, rights/powers of the issuer surrendered, and changes made that do not adversely affect holders may be made without consent

Amendments

- **Typical Intercreditor Agreements**
  - Subordination agreements enforceable pursuant to § 510(a) of the Bankruptcy Code.
  - Colloquially, an agreement between creditors that governs their competing rights with respect to a common obligor and its assets
  - Encompasses both payment and lien subordination agreements
  - Governed by New York contract law, generally
  - Entered into with the intent of limiting future disputes among secured lenders by establishing:
    - Relative priorities as regards the liens that secure shared collateral
    - Set of operating rules to govern the parties' rights and remedies

Amending Intercreditor Agreements

- Indentures may give issuer authority to unilaterally amend applicable intercreditor agreements to cure ambiguities, omissions, defects or inconsistencies
- But intercreditor agreement will define how and when its terms control over competing or inconsistent terms of indentures

Recent Case Law: GSO Coastline Credit Partners v. Global A&T Elec. ("GATE")

Harmonizing Intercreditor Agreement And Indentures And Fixing "Ambiguities" Or "Defects"

The Pre-2013 Credit Facilities

- **Senior Facilities (First Priority Obligations)**
  - $625MM senior term loan due October 2014
  - $150MM revolving facility due October 2013
  - Hold a first lien on GATE's assets
- **Junior Facilities (Second Priority Obligations)**
  - Fixed rate loan for $237.5MM due October 2015
  - Floating rate loan for $237.5MM due October 2015
  - Hold a second lien
- **GATE, as well as the holders of the Senior and Junior Facilities are party to an intercreditor agreement, dated as of October 30, 2007 (the "ICA")**

The 2013 Senior Notes

- **February 2013, GATE issues new notes pursuant to an indenture, dated as of February 7, 2013 (the "Indenture")**
  - $625MM of total First Lien notes issued
  - Replaces the October 2014 senior term loan
  - Equal in payment priority to the Second Priority Obligations
  - But secured by a first lien on GATE's assets

The Exchanged Notes

- **September 2013, GATE issues ~ $500MM of additional notes under the Indenture**
  - New notes purport to replace and refinance GATE's Second Lien Notes (the "Exchange")
  - Second Lien Notes cancelled and terminated
  - Designated as additional First Priority Obligations, or "Additional Senior Notes"
  - New notes purport to rank *pari passu* to the February 2013 Senior Notes with respect to GATE's collateral

The ICA Amendment

- **To effectuate the Exchange, GATE amended the ICA without the consent of the holders of the February 2013 senior notes**
  - GATE unilaterally adopted a so-called "Second Intercreditor Amendment Agreement" (the "Second ICA Agreement")
- **The Second ICA Agreement purported to make two principle changes to the ICA**:
  - Changed the definition of "Second Priority Agreement" in the ICA so that any "agreement or instrument [that] expressly provides that it is not intended to be and is not a Second Priority Agreement hereunder" would by definition not be a "Second Priority Agreement"
  - Explicitly designated the Additional Senior Notes as "First Priority Agreements" for purposes of the ICA

How Did GATE Purport To Amend The ICA?

- **As a general matter, lenders and obligors expect that ambiguities, defects, etc. in loan agreements can be amended or fixed without the consent of the holders of the secured notes**
- **Section 4.16(b) of the Indenture**:
  - At the written direction of the Issuer and without the consent of the Holders of the Notes, the Trustee shall from time to time . . . , enter into one or more amendments to any intercreditor agreement to: (i) ***cure any ambiguity, omission, defect or inconsistency*** in any intercreditor agreement; (ii) increase the amount of Indebtedness or the types of Indebtedness covered by any of the intercreditor agreements that may be Incurred by the Issuer . . . [and] . . . (v) make provision for the security securing additional Notes to rank pari passu with the security securing the Notes on the Collateral . . . ."

How Did GATE Purport To Amend The ICA?

- **Section 9.3(b) of the ICA**:
  - Entry in a "supplemental" agreement like the Second ICA Amendment is permissible without the express consent of the Senior Bondholders "to facilitate having additional indebtedness . . . become First Priority Obligations or Second Priority Obligations, as the case may be, under this Agreement . . . provided, that such Additional Debt is permitted to be incurred under the First Priority Agreement and the Second Priority Agreement then extant, and is permitted by said Agreements to be subject to the provisions of this Agreement as First Priority Obligations or Second Priority Obligations, as applicable."
- **What exactly does this provision say?**

How To Reconcile The ICA And Indenture?

- **As explained, Section 4.16 of the Indenture gives the issuer authority to amend the ICA in certain situations**

- **But Section 9.1 of the ICA provides that its provisions govern over those of any "First Priority Document" or "Second Priority Document" (*i.e.*, the Indenture), in the event of a conflict between them**

The Debt Exchange: What Ambiguity Or Inconsistency Did The Exchange Purport To Remedy?

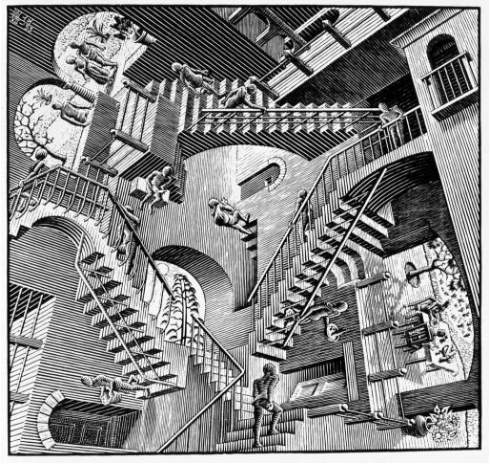
- **Under one reading of the ICA, the Additional Senior Notes would have simultaneously been First Priority Obligations and Second Priority Obligations**
  - The Additional Senior Notes were issued under the Indenture as first lien debt, *i.e.*, First Priority Obligations under the ICA (§1.1)
    - "**First Priority Obligations**" means (a) all principal of and interest . . . and premium (if any) on all loans made pursuant to the First Priority Agreement, (b) all reimbursement obligations (if any) and interest thereon (including without limitation any Post-Petition Interest) with respect to any letter of credit or similar instruments issued pursuant to the First Priority Agreement, (c) all Hedging Obligations, (d) all Cash Management Obligations and (e) all guarantee obligations, fees, expenses and other amounts payable from time to time pursuant to the First Priority Documents, in each case whether or not allowed or allowable in an Insolvency Proceeding.

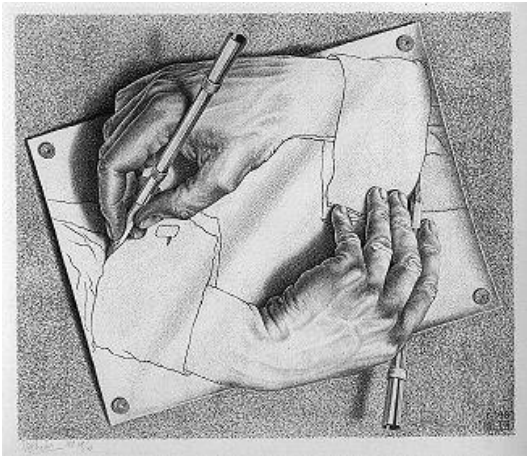
The Debt Exchange: What Ambiguity Or Inconsistency Did The Exchange Purport To Remedy?

- **But the Additional Senior Notes were issued to retire what was originally a junior credit facility, *i.e.*, a Second Priority Obligation**
  - The ICA's definition of "Second Priority Agreement" covers those Agreements in place when the Senior Notes were issued (what the ICA calls "Existing Second Priority Agreements") but also "any other credit agreement, loan agreement, note agreement, promissory note, indenture, or other agreement or instrument evidencing or governing the terms of any indebtedness or other financial accommodation that has been incurred to extend, replace, refinance or refund in whole or in part the indebtedness and other obligations outstanding under each Existing Second Priority Agreement
    . . . ."

The Debt Exchange: What Ambiguity Or Inconsistency Did The Exchange Purport To Remedy?

- **Was this a post hoc ambiguity created by the ICA Amendment itself? In other words, if the latent ambiguity in the original contract is only revealed by an amendment to that contract, and the amendment itself is dependent on the original contract being ambiguous, aren't we going around in circles?**





The New York Supreme Court's Reading

- **Trial Court did not think so**

- **The Court found that under the plain terms of the ICA, the Additional Senior Notes could have been First and Second Priority Obligations simultaneously, "a confusing result"**
  - Under this reading, the Second ICA Agreement passed muster as a unilateral (without the consent of the affected class of holders) amendment to the ICA under Section 4.16 of the Indenture, because it eliminated an "ambiguity" and "inconsistency" within the ICA

The New York Supreme Court's Reading

- **What about the possible tension between the ICA and the Indenture?**
  - Recall, the ICA provides that its provisions govern over those of any "First Priority Document" or "Second Priority Document" (*i.e.*, the Indenture), in the event of a conflict between them

- **The Commercial Division Court did not focus on this provision, and impliedly found no tension between the two contracts**

- **Rather, the Court found that the Exchange was permissible under Section 9.3(b) of the ICA "in situations like this," because the ICA permits the Trustee (as First Priority Representative) to amend without consent to "facilitate having additional indebtedness" "become First Priority Obligations or Second Priority Obligations" under the ICA**

The New York Supreme Court Interprets The ICA And The Indenture

- **What are the implications of the Commercial Division's reading of the documents?**
  - **What do issuers/obligors care about once debt is issued?**
  - **What do lenders care about?**
  - **Is lien priority tantamount? Payment priority?**
  - **Can the issuance of new *pari passu* debt (effectively under-securing then-extant senior debt) be effected through "technical" house-keeping amendments to loan documents?**
  - **Why does this matter when the issuer/obligor remains solvent?**

The Appellate Division's Ruling

- **The result on appeal was night and day**

- **The Appellate Division made three critical findings**
  - First, the Court found explicitly that the ICA controls over the Indenture in the event of conflict, meaning that no unilateral acts purportedly taken pursuant to the Indenture could upset the ICA's original priority scheme
    - *i.e.*, First Priority Obligations had to stay senior, and Second Priority Obligations had to remain subordinated unless a majority of the affected class said otherwise

The Appellate Division's Ruling

- **<u>Second</u>, the Court found that the ICA was neither ambiguous nor inconsistent**
  - This takes the wind out of Section 4.16(i) of the Indenture, which is of no force and effect at this point

- **<u>Third</u>, instead of focusing on the "facilitate additional indebtedness" language of Section 9.3(b) of the ICA, the Appellate Division focused on the language of that Section implicating the ICA's priority scheme**
  - Under this reading of the ICA, any amendment which sought to upset the initial priority scheme was void *ab initio*

The Appellate Division's Ruling

- **Plainly, the Appellate Division believed that the Second ICA Amendment was a substantive change**
  - Is there a way to read the contracts such that changing relative lien priority is not substantive?

- **The Appellate Division's reading doomed the Exchange**
  - All parties and both Courts acknowledged that the intended effect of the Exchange is to amend the lien priority in relation to the secured lenders' common collateral set forth in the ICA
  - As such, there was simply no way to use the Indenture to make a technical amendment to the ICA, the effect of which is to re-set secured lenders' relative lien priorities

Other Illustrative Litigations -- *RadioShack*

- **Dispute between "SCP Lenders" and "ABL Lenders"**
- **Under the applicable ICA, ABL Lenders had a first lien on liquid collateral and second lien on fixed assets; SCP Lenders' lien priority was vice versa**
- **Dispute over proceeds from disposition of liquid collateral that paid over to the ABL Lenders in the bankruptcy, and a pre-petition restructuring to the ABL Lenders' credit agreement done without the consent of the SCP Lenders**
- **Question whether ABL Lenders had the right to unilaterally restructure with RadioShack while preserving a senior lien on the liquid collateral**

Other Illustrative Litigations -- *RadioShack*

- **Dispute turns largely on Chief Judge Shannon's interpretation of Section 9.1 of the ICA, which provided "relatively broad (and commercially standard) rights" to amend the ABL Lenders' loan documents and contained narrow restrictions on those rights which never came into play**

- **The Court rejected SCP Lenders' argument that their position was unfairly changed as a matter of contract or economic expectations**
  - In short, they held junior rights in the liquid collateral before and after the restructuring, and the ICA cannot operate to vault them ahead of the ABL Lenders in entitlement

- **Basically, the other side of the *GATE* coin: seniors are entitled to stay senior through amendment so long as they don't encroach on the rights held by the juniors in their role as subordinated lenders**

Other Illustrative Litigations -- *Momentive*

- **In re MPM Silicones, LLC (*Momentive*)**

- **Despite terms of MPM's pre-petition intercreditor agreement , debtors proposed a chapter 11 plan that distributed all equity along with subscription rights to a $600MM offering to second liens**
- **Senior holders received no cash, but instead received replacement notes bearing sub-market interest rates if they voted against the plan**

Other Illustrative Litigations -- *Momentive*

- **Judge Drain approves plan despite senior holders' objections that (i) the junior was being paid before seniors were paid in full and in cash, and (ii) the seniors' liens were being compromised**
- **The Court calls the governing intercreditor agreement, which was fairly standard, an example of "really bad drafting," but finds that it supports the junior debt's actions**
- **Why?**
  - Certain actions taken in violation of the intercreditor agreement were taken by the junior debt in their role as "unsecured creditors," not secureds, a role that the intercreditor agreement explicitly carved out of its restrictions
  - Senior debt still retained their lien on common collateral
  - Cramdown events were not contemplated by the agreement

Other Illustrative Litigations -- *Musicland*

- **Dispute over whether an ICA could be amended without certain trade creditors' consent to bring new term loan within the priority and protections of an existing revolver**
  - Sheltered new loan under administrative and collateral agent's superior lien
  - After bankruptcy sale, trade creditors were substantially undersecured
- **Amendment added new definitions and rewrote existing ones under the revolving credit agreement**
- **Trade creditors' claim turns on administrative agent's rights under ICA to enter into amendment of revolving credit agreement and thereby extend lien priority to new term loan**

Other Illustrative Litigations -- *Musicland*

- **Bankruptcy Judge Bernstein said that it could**
- **Analysis focused on whether or not the ICA was ambiguous as regards the administrative agent's ability to amend the ICA to bring in a term lender**
- **The Court found that the actual terms of the ICA, a fully integrated New York contract, unambiguously gave the administrative agent the right to amend to cover any type of loan**
  - Critically, the Court rejected trade creditors' argument that it was their **expectation or understanding** that they bargained for a lien that was subordinate only to obligations under Musicland's existing revolving credit facility
  - If that was the case, such language would have been found in the ICA, and it was not
  - Trade creditors consented to "any amendment, modification, etc."

Takeaways

- **Is there a reliable test to distinguish between fixing an ambiguity and making a substantive amendment? Does it all depend on the lens through which the amendment is viewed?**
- ***Musicland* test (condensing New York law): "An agreement is ambiguous if it is capable of more than one meaning when viewed objectively by a reasonably intelligent person who examines the entire contracts and knows the customs, practices, usages and terminology generally understood in the particular trade of business."**
- **Is this a particular enough standard?**
- **What is the intent of a provision like Section 4.16 of the Indenture? What do sophisticated lenders think are appropriate actions for an issuer/obligor or the indenture trustee to take without consent?**

Takeaways

- **When is *post hoc* action taken to "fix" an intercreditor agreement to accommodate the issuer/obligor ever commercially (or legally) justifiable?**

- **Because lenders cannot negotiate indentures (generally), intercreditor agreements must be used to give predictability to relative lien positions, and senior creditors should clearly restrict the junior debt where they have the market leverage to do so**

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