
Momentive: Intercreditor Agreement Issues

Presented by

Damian S. Schaible
Kenneth J. Steinberg

Davis Polk

Davis Polk & Wardwell LLP

Presenters



Damian S. Schaible

Mr. Schaible is a partner in the Insolvency and Restructuring Group of Davis Polk & Wardwell LLP. He has worked on a wide range of corporate restructurings and bankruptcies, representing debtors, creditors, agent banks, lenders, asset purchasers and other strategic parties.

Mr. Schaible has played a key role in a number of high-profile restructurings in recent years, including representing the debtors in Delta Air Lines', Frontier Airlines', Pinnacle Airlines' and Patriot Coal's successful chapter 11 cases, representing the agent for the prepetition senior lenders in the Tribune, Cengage, MediaNews Group and C-BASS cases, and representing the DIP Agent in the Exide and NewPage cases. Mr. Schaible also regularly advises investors with respect to distressed and non-distressed debt and equity investments, including representing a number of banks and investors in connection with distressed bank recapitalizations.

Mr. Schaible served as the Chair of the Committee on Bankruptcy and Corporate Reorganization of the New York City Bar Association, and he is on the Board of Directors of the American Bankruptcy Institute.



Kenneth J. Steinberg

Mr. Steinberg is a partner in the Credit Group of Davis Polk & Wardwell. He represents financial institutions and borrowers on a variety of credit transactions, including leveraged acquisition financings and asset-based financings. In addition, he has substantial experience in both in-court and out-of-court restructuring and financing transactions, including debtor-in-possession financing and bankruptcy exit financings, representing both senior secured lenders and borrowers.

Mr. Steinberg graduated summa cum laude from Fordham Law School, where served on the Fordham Law Review. He also holds an MBA in finance from Columbia Business School.

Background

Make-Whole Dispute

- First lien and 1.5 lien noteholders claimed a roughly \$200 million make-whole, arguing that it was due upon any refinancing
- Momentive argued that the make-whole was only due upon an *elective* prepayment before maturity, not a repayment after a bankruptcy acceleration

Plan Treatment Toggle

- To attempt to resolve the make-whole disputes, the company offered “deathtrap” plan consideration:
 - A. Accept the Plan, waive any make-whole claims, and receive payment in cash in full on the effective date, from the proceeds of committed exit facilities
 - B. Reject the Plan, preserve the right to assert make-whole claims, but receive replacement notes with a principal amount equal to the allowed claim after litigation of the make-whole and a “present value equal to the amount of the allowed claim”
- There was no disagreement that the rates on the replacement notes were below market
- After the first and 1.5 lien holders rejected the plan, litigation of the make-whole was consolidated with plan confirmation. The bankruptcy court confirmed the plan over the senior lien noteholders’ objections and held that they were not entitled to a make-whole

Basics of the Intercreditor Dispute

Relevant Agreement

- The Intercreditor Agreement (ICA) between the 1st and 1.5 lien noteholders and the 2nd lien noteholders included several key agreements by the 2nd lien noteholders, including:
 - To turn over any collateral or proceeds of collateral received through exercise of remedies before the senior lien holders were paid in full in cash
 - To let the senior lien holders control the exercise of remedies against the collateral by not exercising rights or remedies before the senior lien holders are paid in full in cash
 - Not to challenge the liens of the senior lien holders or their exercise of remedies

Complaint

- In July 2014, the senior lien creditors filed state court actions against the 2nd lien noteholders, alleging that:
 - Receipt by the 2nd lien noteholders of distributions under the proposed plan before the senior lien creditors had been paid in full violated the ICA and were subject to turnover
 - By supporting a plan that crammed up the senior lien creditors and intervening in the make-whole dispute, the 2nd lien noteholders had violated the ICA's strictures on exercise of remedies or objecting to relief sought by the senior lien creditors
- As a remedy, the senior lien creditors sought damages and turnover of all distributions, including plan distributions, backstop fees and other fees, until the senior creditors were paid in full

ICA Dispute – Pre Confirmation Developments

Removal to Federal Court and Plan Carveout

- In advance of plan confirmation, the 2nd lien noteholders successfully removed the suit to federal court and had it remanded to the Bankruptcy Court
- Although the proposed plan of reorganization initially attempted to terminate creditors' rights under the ICA, after the senior lien creditors objected these releases were removed
- The confirmed plan expressly carved out claims under the ICA from the plan releases, and provided that the Bankruptcy Court would retain jurisdiction over the pending disputes

Scheduling and Plan Confirmation

- The senior lien creditors did not pose their ICA arguments as plan objections in part due to case law holding that a plan need not comply with an applicable intercreditor agreement, so long as all parties' rights under the agreement are preserved
- Briefing on the ICA dispute was postponed during the confirmation process, with motions to dismiss and responsive papers scheduled to be submitted after the confirmation hearing

Motion to Dismiss

- The 2nd lien noteholders' primary response to both theories raised by the senior lien creditors was that the ICA narrowly concerned the common collateral
 - This argument emphasizes the difference between lien subordination and payment subordination, arguing that none of the challenged actions related to the collateral, rendering them all permissible
 - With respect to all distributions, the 2nd lien noteholders argued that they did not constitute proceeds of the collateral, as all collateral would be retained by the company and would continue to secure the replacement 1st and 1.5 lien notes
- Additionally, the 2nd lien noteholders argued that upon plan effectiveness, the senior lien creditors would have been paid in full as a matter of law, and thus entitled to no further payments
- Further emphasizing the limitation of the ICA to the common collateral, the 2nd lien noteholders argued that distributions were only subject to turnover to the extent they were received “as secured creditors,” and that all distributions could have been obtained regardless of their secured or unsecured status
- Lastly, the 2nd lien noteholders pointed to a customary provision preserving their right to act as unsecured creditors, arguing that all challenged actions taken in the case were taken in that capacity

The Court's Ruling

Narrow Construction of the ICA

- After lengthy oral argument, the court observed that “[t]he ICA is very clearly an intercreditor agreement pertaining to the parties’ collateral rights. That is the overall context of the agreement and it is in that context that the claims should be evaluated”
- The court also adopted the view that waivers of creditors’ rights must be “clear beyond peradventure,” citing the *Boston Generating* case

Intervention in the Case

- The court held that in supporting the debtors’ plan and otherwise intervening in the case, the 2nd lien noteholders had not interfered with the senior lien creditors’ rights in the collateral and thus had not violated the ICA
- With respect to the make-whole dispute, the court noted that nothing in the ICA barred the 2nd lien noteholders from disputing the amount of the senior lien claims, and that the agreement did not contain broader “silent second lien” provisions found in other ICAs

The Court's Ruling (*cont'd*)

Distributions Not Subject to Turnover

- Turning to the distributions received by the 2nd lien noteholders, the court first found that the equity in the reorganized debtor distributed to 2nd lien noteholders did not constitute proceeds of common collateral and thus was not subject to turnover
 - The court reasoned on this point that the equity was distributed in exchange for the 2nd lien noteholders' liens, NOT for the assets encumbered by those liens
 - The court also found that distribution of the equity in no way diminished the collateral, and thus could not be viewed as proceeds of that collateral
- With respect to the cash distributions received, although cash was indeed common collateral, the court found that it had not been distributed to the 2nd lien noteholders "in connection with the exercise of any right or remedy relating to Common Collateral" and thus was also not subject to turnover

Payment in Full Not Relevant

- Notably, although the parties devoted substantial time to the question of whether the senior lien creditors had in fact been "paid in full" that issue was not ultimately relevant, given the court's finding that the challenged distributions were permissible regardless of whether the senior lien debt had been paid

Implications and Takeaways

Limits of Lien Subordination

- Given the strict limitation of the agreement to the common collateral, junior lien creditors were able to both attack the senior lien creditors' rights in bankruptcy and receive substantial distributions before payment in full of the senior creditors
- As compared to full payment subordination, lien subordination does not assure payment in full before value flows to junior creditors, and can create significant uncertainty and litigation risk as to the division of distributable value between collateral and non-collateral value

Provisions to Consider

- Turnover of distributions received in respect of the junior lien creditor's secured claim, regardless of source or form, as opposed to only distributions of collateral or proceeds thereof
- Prohibition on supporting a plan that is not supported by the first lien noteholders and does not pay them in cash in full
- More narrowly tailored carveout preserving the rights of junior lien holders to act as unsecured creditors, to avoid undoing more specific protections
 - While the court did not rest its decision on this provision, it did comment that preserving unsecured creditor rights might "trump" more specific prohibitions

Implications and Takeaways (*cont'd*)

Payment in Full Didn't Matter

- In the wake of the court's cramdown ruling, there was significant argument and analysis of whether the debt crammed down would be "deemed discharged" or otherwise held to no longer be outstanding for purposes of the ICA as a matter of law, notwithstanding clear language requiring "payment in full in cash"
- Although the 2nd lien noteholders did take the view that the debt ceased to exist upon plan effectiveness, the court was sympathetic to the senior lien creditors on the point, asking of the "payment in full in cash" provision: "How much more explicit can you get?"
- That this question wasn't relevant underscores the fundamental narrowness of lien subordination. Unlike payment subordination, the junior lien creditor does not ensure full payment of the senior lien creditor, and so long as the collateral is respected, the junior lien creditor can receive substantial distributions and has significant leeway in fighting for recoveries

Biographies

Damian S. Schaible

PARTNER



New York Office

212 450 4580 tel

212 701 5580 fax

damian.schaible@davispolk.com

Mr. Schaible is a partner in Davis Polk's Insolvency and Restructuring Group. Since joining the firm in 2002, he has worked on a wide range of corporate restructurings and bankruptcies, representing debtors, creditors, agent banks, lenders, asset purchasers and other strategic parties.

Mr. Schaible served as the Chair of the Committee on Bankruptcy and Corporate Reorganization of the New York City Bar Association and is on the Board of Directors of the American Bankruptcy Institute.

WORK HIGHLIGHTS

- Counsel to Capital Z Partners as an investor in the \$175 million recapitalization of Anchor Bancorp Wisconsin Inc. through a Chapter 11 filing of its parent
- Counsel to J.P. Morgan, as agent for, and lender under, the approximately \$3.9 billion pre-petition senior secured credit facility in the Chapter 11 cases of Cengage Learning, Inc. and certain of its affiliates
- Counsel to Citibank as agent and lender in connection with the potential restructuring and the successful refinancing of a \$160 million senior secured credit facility for Oxford Mining Company, LLC
- Counsel to Hon. Warren Winkler, Chief Justice of Ontario, as mediator in the bankruptcy proceedings of Nortel Networks Inc. and its affiliates
- Counsel to J.P. Morgan as agent and arranger in connection with a \$500 million debtor-in-possession financing for Exide Technologies in Exide's Chapter 11 case
- Counsel to Strategic Growth Bancorp in connection with its acquisition and recapitalization of Mile High Banks through a Chapter 11 filing of Mile High's parent
- Counsel to Pinnacle Airlines and its affiliates in connection with their Chapter 11 cases

Damian S. Schaible (cont.)

PARTNER

- Counsel to Patriot Coal Corporation and its affiliates in connection with their Chapter 11 cases
- Counsel to J.P. Morgan as agent for the prepetition senior lenders in the successful Chapter 11 cases of The Tribune Company, where the lenders were owed more than \$8.5 billion and received more than 98% of the stock of reorganized Tribune, in addition to cash distributions
- Counsel to J.P. Morgan as agent and arranger in connection with a \$600 million debtor-in-possession financing for NewPage Corporation in NewPage's Chapter 11 cases
- Counsel to Bank of America as agent for the prepetition lenders in connection with Affiliated Media, Inc.'s restructuring and prepackaged Chapter 11 case; the lenders were owed approximately \$590 million
- Counsel to Delta Air Lines in its Chapter 11 restructuring
- Counsel to Frontier Airlines in its Chapter 11 restructuring
- Counsel to J.P. Morgan as agent for a \$1.855 billion senior credit facility in connection with C-BASS's out-of-court restructuring and Chapter 11 cases
- Representing numerous major financial institutions in connection with Dodd-Frank Resolution Planning
- Regularly advises banks and potential investors in connection with bank holding company restructurings

RECOGNITION

Mr. Schaible is recognized as a leader in his field, including being:

- Named a "Rising Star" – *IFLR1000: The Guide to the World's Leading Financial Law Firms*
- Named a "Rising Star in Bankruptcy" – *Law360 2014*
- Leading Lawyer, New York: Bankruptcy/Restructuring – *Chambers USA 2012-2014*
- Named a "Rising Star" – *New York Law Journal 2013*
- Named a "Rising Star" – *New York Super Lawyers 2012*
- Named one of the "40 Under 40" – *The M&A Advisor*
- Recommended in Corporate Restructuring – *The Legal 500 U.S. 2011*
- Selected as an "Outstanding Young Restructuring Lawyer of 2010" – *Turnarounds & Workouts*

Damian S. Schaible (cont.)

PARTNER

OF NOTE

- Contributing Author, *Collier Bankruptcy Practice Guide*

CURRENT MEMBERSHIPS

- Chapter 11 Lawyers' Advisory Committee for the Eastern District of New York Bankruptcy Court
- Chair, Advisory Committee Working Group on Intercreditor Agreements; American Bankruptcy Institute Commission to Study the Reform of Chapter 11
- Board of Directors, American Bankruptcy Institute
- Board of Directors, Lighthouse International Film Festival
- Board of Directors, A House on Beekman
- Member, Council on Foreign Relations

PAST MEMBERSHIPS

- Chair, Committee on Bankruptcy and Corporate Reorganization, New York City Bar Association
- Chair, Courts Subcommittee, Committee on Bankruptcy and Corporate Reorganization, New York City Bar
- Co-Chair, Secured Credit Committee, American Bankruptcy Institute
- Newsletter Editor, Secured Credit Committee, American Bankruptcy Institute
- Member, Technical (organizing) Committee, INSOL International's 2013 Global Congress

PROFESSIONAL HISTORY

- Partner, 2009-present
- Associate, 2002-2009
- Law Clerk, Hon. Danny J. Boggs, U.S. Court of Appeals, Sixth Circuit, 2001-2002

Damian S. Schaible (cont.)

PARTNER

ADMISSIONS

- State of New York
- U.S. Court of Appeals, Second Circuit
- U.S. Court of Appeals, Sixth Circuit
- U.S. District Court, Colorado
- U.S. District Court, E.D. Michigan
- U.S. District Court, E.D. New York
- U.S. District Court, S.D. New York
- U.S. District Court, W.D. Wisconsin

EDUCATION

- B.A., Political Science, College of the Holy Cross, 1998
 - *magna cum laude*
 - Phi Beta Kappa
- J.D., New York University School of Law, 2001
 - *magna cum laude*
 - Order of the Coif
 - Notes Editor, *The New York University Law Review*

Kenneth J. Steinberg

PARTNER



New York Office

212 450 4566 tel

212 701 5566 fax

kenneth.steinberg@davispolk.com

Mr. Steinberg is a partner in Davis Polk's Corporate Department, practicing in the Credit Group. He represents financial institutions and borrowers on a variety of credit transactions, including leveraged acquisition financings and asset-based financings. In addition, he has substantial experience in both in-court and out-of-court restructuring and financing transactions, including debtor-in-possession financing and bankruptcy exit financings, representing both senior secured lenders and borrowers.

WORK HIGHLIGHTS

Recent Representations

- J.P. Morgan as administrative agent in connection with \$500 million of debtor-in-possession term and asset-based revolving credit facilities for Exide Technologies
- Citigroup as administrative agent in connection with \$950 million of debtor-in-possession term and asset-based revolving credit facilities for Eastman Kodak Company
- Citigroup as administrative agent in connection with \$1.1 billion of debtor-in-possession term and asset-based revolving credit facilities for Federal-Mogul Corporation and subsequent \$3.5 billion of bankruptcy exit term and asset-based revolving credit facilities
- J.P. Morgan as administrative agent in connection with \$885 million of senior secured term and asset-based revolving credit facilities for Tower Automotive in connection with its acquisition by affiliates of Cerberus Capital Management pursuant to Section 363 of the Bankruptcy Code
- Goldman Sachs as arranger in connection with \$765 million of senior secured first and second lien facilities for Pro Mach Group, Inc. in connection with its acquisition by affiliates of AEA Investors
- Delta Air Lines, Inc. in connection with its \$2.5 billion of first- and second-lien bankruptcy exit term and revolving credit facilities and subsequent refinancing thereof
- Delta Air Lines, Inc. in connection with its offerings of \$750 million of first-lien secured notes and \$650 million of junior-lien secured notes, and concurrent \$750 million of senior secured credit facilities

Kenneth J. Steinberg (cont.)

PARTNER

- Bank of America, N.A. in connection with the out-of-court restructuring of \$630 million of senior secured credit facilities for the Fontainebleau Miami hotel
- Credit Suisse Securities (USA) LLC as administrative agent in connection with \$655 million of senior secured first and second lien credit facilities for Siemens Water Technologies in connection with its acquisition by affiliates of AEA Investors
- The Federal Reserve Bank of New York in connection with the term asset-backed securities loan facility (“TALF”)
- Citigroup as administrative agent in connection with a \$270 million debtor-in-possession accounts receivable securitization facility for AbitibiBowater, Inc. and subsequent \$600 million bankruptcy exit asset-based revolving credit facility
- Credit Suisse Securities (USA) LLC in connection with an \$820 million senior secured term loan facility for Gymboree Corporation in connection with its acquisition by affiliates of Bain Capital
- Bank of America, N.A. in connection with \$320 million of senior secured term and revolving credit facilities for PRIMEDIA INC. in connection with its acquisition by affiliates of Texas Pacific Group
- Cantor Fitzgerald Securities as administrative agent in connection with \$35 million of debtor-in-possession term loan facilities for Sbarro, Inc. and subsequent \$137.3 million of rollover and new money exit term loan facilities

PROFESSIONAL HISTORY

- Partner, 2012-present
- Associate, 2005-2012

ADMISSIONS

- State of New York

EDUCATION

- B.S., Finance and Accounting, University of Pennsylvania, The Wharton School, 1987
 - *summa cum laude*

Kenneth J. Steinberg (cont.)

PARTNER

- M.B.A., Finance, Columbia Business School, 1992
 - Dean's List
- J.D., Fordham University School of Law, 2005
 - Dean's List
 - *summa cum laude*
 - Staff Member, *Fordham Law Review*