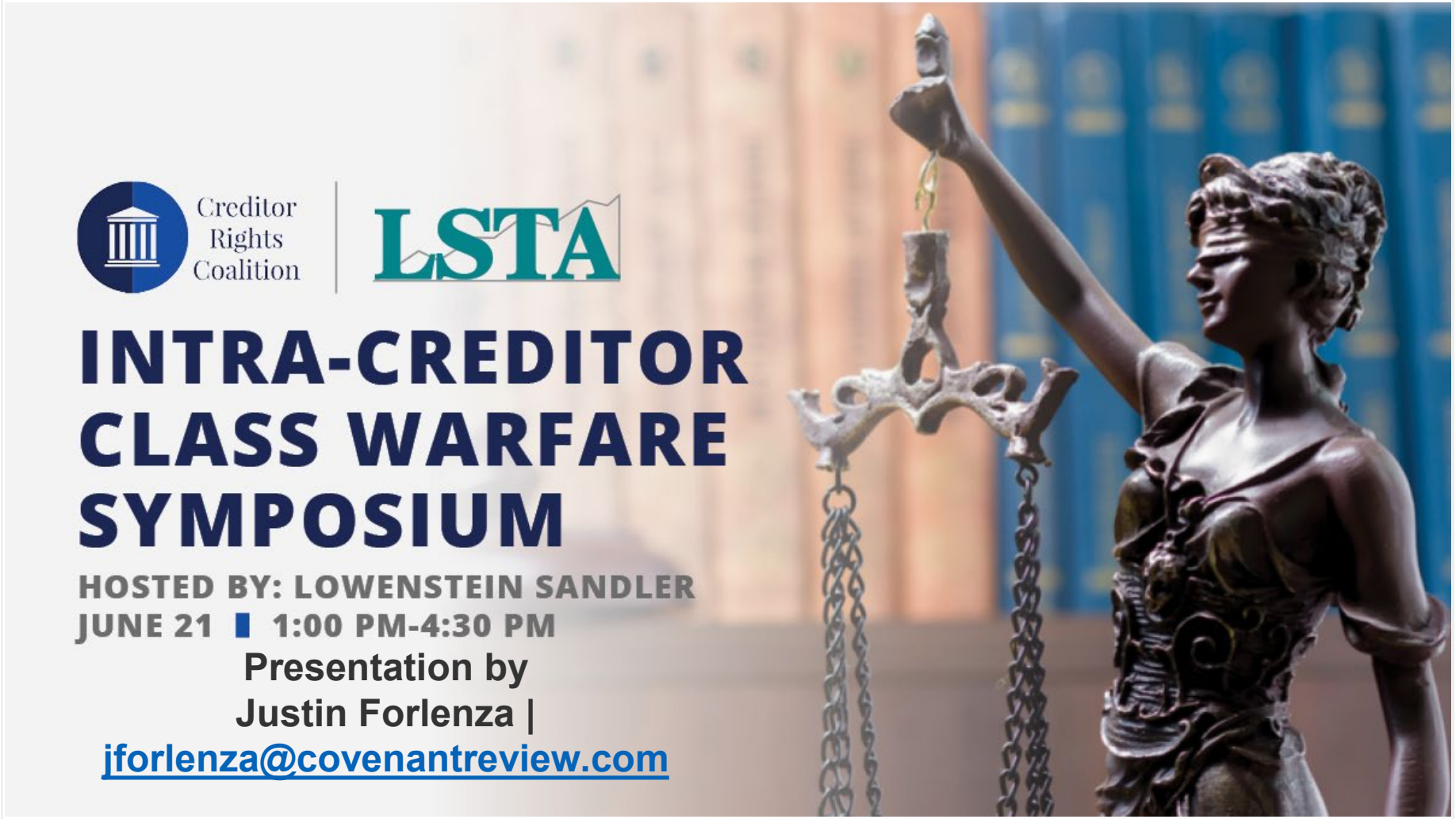
Panel 3: Where do we go from here?



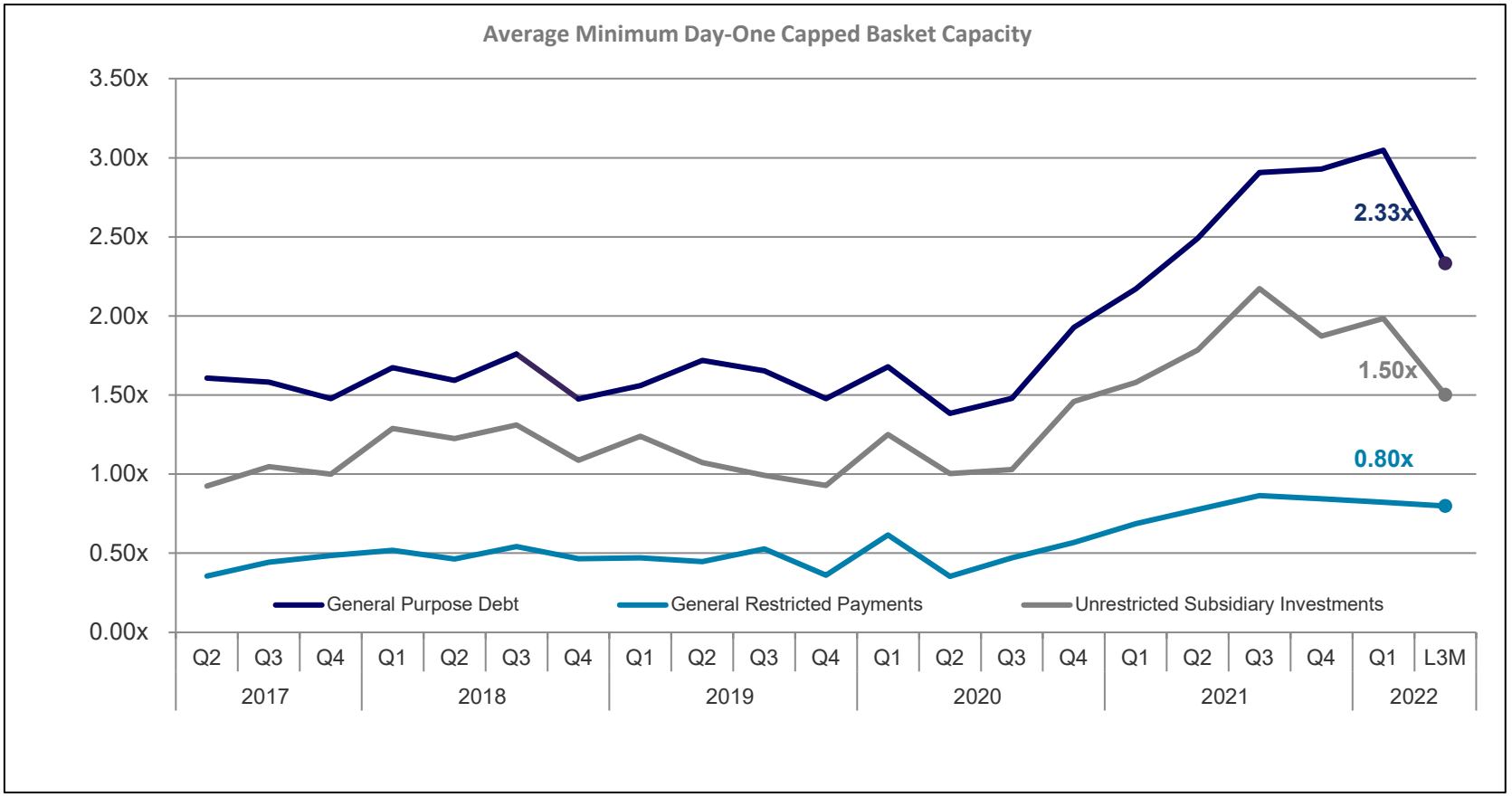
Liability Management Transactions: Potential Responses

- **J. Crew / Drop-Down Financings:**
  - Elimination of “trapdoor” baskets
  - Inclusion of “J. Crew blocker” provisions
  - Caps on investments in unrestricted subsidiaries (rare) or overall reduction in investment capacity
  - Additional ratio tests for designation of unrestricted subsidiaries (also rare)

- **Uptiering:**
  - Affected or 100% lender consent for subordination amendments.
    - Subject to exceptions for transactions offered ratably to existing lenders, DIP financings, among other items
  - Open market purchases required to be made for cash
  - Affected or 100% lender consent for pro rata sharing / pro rata payment / waterfall amendments

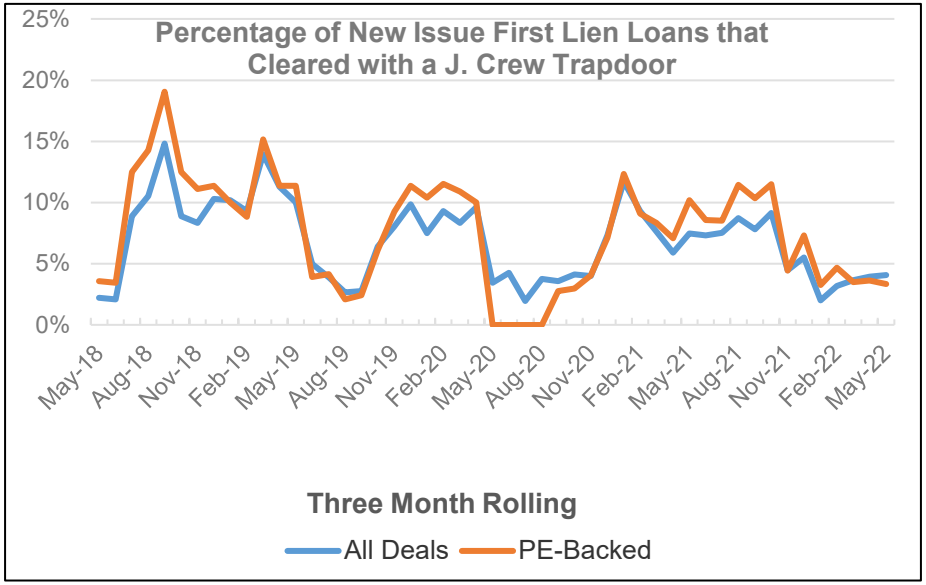
Drop-Down Financing Protections: Unrestricted Subsidiary Investments Capacity

Overall, the trend has been toward greater day one unrestricted subsidiary investment capacity over time, though there has been a retrenchment as of late due to market conditions



Drop-Down Financing Protections

- **J. Crew trapdoor baskets: Per Covenant Review data, the prevalence of first lien loans issued with the "trapdoor" has generally decreased over time**



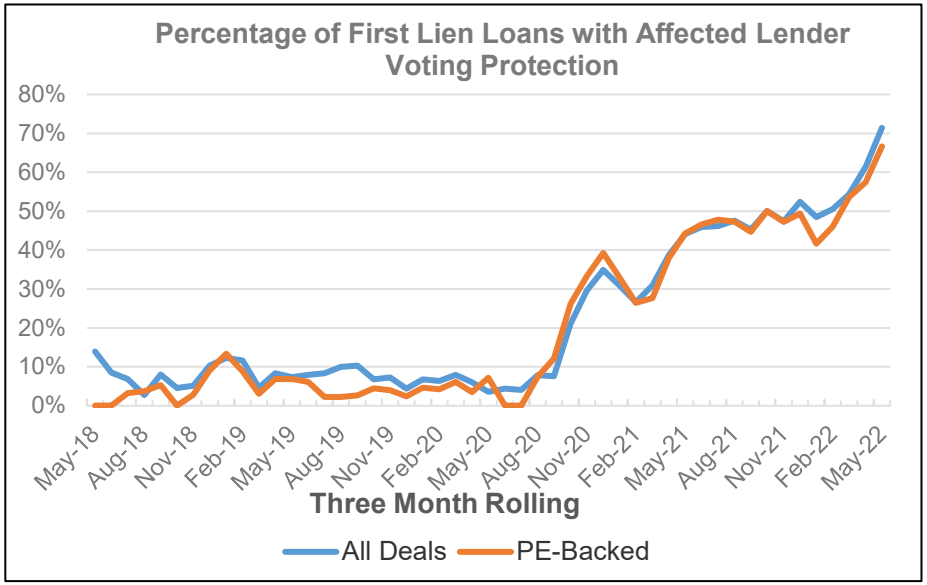
- **J. Crew blockers: An analysis by Covenant Review of loans issued in the L3M period ending May of 2022 found the following:**
  - **61.8% of all loans included a form of J. Crew blocker**
  - **60.8% of sponsor-backed loans included a form of J. Crew blocker**
- **Note however that these provisions vary in drafting and can be flawed**

Source: Covenant Review, a Fitch Solutions service

Uptiering Transactions: Contractual Protections

- After the initial Serta ruling, market focus shifted to subordination amendment protections.
- This has trended upward over time; currently, roughly 2/3rd of loans include heightened amendment standards for amendments to subordinate to other obligations:

- Open Market Purchases: may be limited to cash transactions (very rare)
  - Conversely: Some agreements expressly allow for open market and privately negotiated non-pro rata buybacks



Source: Covenant Review, a Fitch Solutions service

Uptiering Transactions: Potential Judicial Intervention?

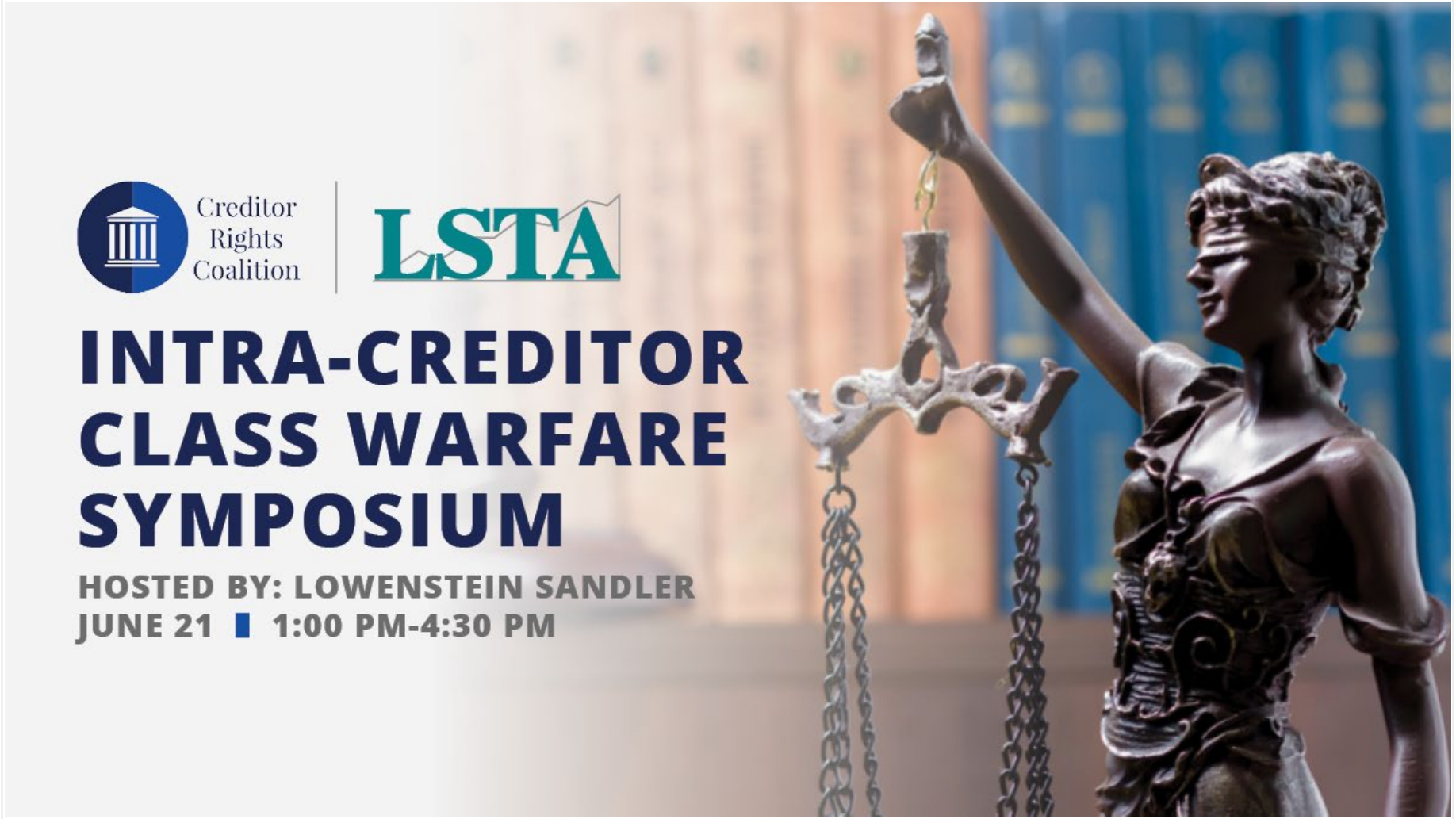
- If judges can find a textual hook, are they inclined to protect minority lenders?

- Subsequent court rulings have *somewhat* favored non-participating lenders:
  - Trimark: Breach of contract and validity of amendment claims survived motion to dismiss; parties then settled.
  - Serta: SDNY allowed breach of contract regarding open market purchase interpretation and breach of implied covenant of good faith and fair dealing claims to survive to trial.

- Interpretation of “Open Market Purchase” in uptiering context may provide some lender protections.

Other Solutions

- Lender cooperation agreements?
- “Parting Kiss” risk: Requirement that lenders continue to have skin in the game post-amendments
- Payments for consent covenants in loans: Requirement that consideration for amendments be offered to and paid to all consenting lenders
- Others?


Creditor
Rights
Coalition
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INTRA-CREDITOR
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HOSTED BY: LOWENSTEIN SANDLER
JUNE 21 ▮ 1:00 PM-4:30 PM