King & Spalding

WHAT IS IT?

Frequently Discussed Liability Management Transactions

King & Spalding Private Credit & Special Situations Investing

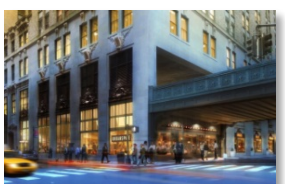
Provisions/Tactics Used by Sponsors

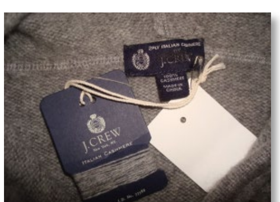
Provisions/Tactics Used By Sponsors

Since J.Crew's siphoned valuable IP away from creditors, creating leverage to effectuate a distressed exchange, secured lenders have been far more sensitive to weak covenant constructs that could allow future J.Crew-type transactions.

- As noted in How Did They Do It? J. Crew & The Original Trap Door, the J.Crew "trap door" refers to a specific pass-through investment basket pursuant to which a non-loan party restricted subsidiary may make investments in unrestricted subsidiaries to the extent such investments are financed with the proceeds received by such restricted subsidiary from a permitted investment.
- J. Crew used this provision to move valuable IP to one of its non-loan party restricted subsidiaries and then transfer such IP (i.e., proceeds of investment) to an unrestricted subsidiary to effectuate a distressed exchange.

IDENTIFY ASSETS THAT COULD BE TRANSFERRED





ASSESS WHERE VALUE COULD LEAK TO

- Unrestricted Subsidiaries
- Non-Loan Parties
- Junior/Subordinated Creditors
- Sponsor/Affiliates

DETERMINE HOW MUCH VALUE CAN BE TRANSFERRED

- Restricted Payments
- Permitted Investments
- Permitted Dispositions
- Affiliate Transactions

Provisions/Tactics Used By Sponsors (cont'd)

Sponsors have taken advantage of weak protections against the incurrence of debt.

- Incremental debt baskets have been getting larger.
  - **Fixed Dollar Amount ("Free and Clear") Baskets**: Up from 0.5x to 1.0x of EBITDA; sometimes now set at 110% of LTM PF EBITDA with a grower component.
  - **Leverage Ratio Based Incurrence ("Ratio Debt") Baskets**: Unlimited incurrence of incremental debt so long as an agreed leverage ratio is satisfied on a pro forma adjusted basis (typically set at the leverage on the closing date, but could be inside closing leverage or above closing leverage (i.e. allowing immediate additional debt incurrence) depending on the transaction).
- Sponsors also often have the ability to Stack, Reload, and Reclassify debt baskets.
  - **Stack**: Free and Clear basket can always be deemed to have been incurred after Ratio Debt basket is exhausted.
  - **Reload**: Free and Clear basket can often be "reloaded" by the amount of voluntary prepayments, debt purchase transactions, and undrawn commitments which have been cancelled.
    - Prepayments shouldn't include mandatory prepayments or prepayments of different ranking debt.
  - **Reclassify**: Ability to 'reclassify' debt between Free and Clear basket and Ratio basket or between those baskets and any other form of Permitted Financial Indebtedness.

Provisions/Tactics Used By Sponsors (cont'd)

NYDJ-Type Transaction

- The 2017 NYDJ amendment transaction has focused the attention of lenders on layering risks in their debt documents.
  - It is important to note that there is no case law addressing the enforceability of the NYDJ amendment or similar transactions. Although in fall 2017, minority lenders filed a lawsuit challenging the NYDJ amendment, the case was settled prior to the court rendering any decision.
- Layering risks may arise when lender voting rights with respect to amendments of pro rata sharing, pro rata payment, and waterfall provisions are not treated as a "sacred right" (i.e. amendments requiring consent of each affected lender or 100% of all lenders).
  - In NYDJ, the company and the majority lenders argued that the pro rata sharing and pro rata payment provisions could be amended by majority of each adversely affected class.
  - There are a number of formulations involving amendment of pro rata sharing and pro rata payment provisions in the market which, depending on the aggressiveness and creativity of the requisite lender groups, could possibly allow for similar amendments to the one consummated in NYDJ.
  - Set forth below is a chart indicating K&S' view of the spectrum of such amendment provisions in the market today.
  - For more on this transaction, see How Did They Do It? NYDJ, or Can You Really Prime 47% of Lenders Without Their Consent? and for related protections, see What can I do? Drafting Tips to Address Liability Management Transactions.

Amendments to pro rata/waterfall provisions not addressed (i.e. simple majority would arguably be controlling) Definition of "Pro Rata" requires 100% vote but other pro rata and waterfall provisions may arguably be amended by simple majority	Amendment of only post default pro rata sharing provision requires 100% vote Amendment of specified pro rata sharing provision requires 100% but the provision provides "unless otherwise provided in the credit agreement and/or does not provide "notwithstanding anything to the contrary herein"	Any modification or amendment affecting pro rata sharing and waterfall (including turnover requirement) requires 100% vote

Provisions/Tactics Used By Sponsors (cont'd)

Certain often overlooked provisions in credit agreements may be exploited by Sponsors/Borrowers to extract incremental value, maximize optionality, and/or preserve runway.

RELEASE OF GUARANTEE THROUGH STOCK TRANSFER	• Credit Agreements often carve-out non-wholly owned subsidiaries from guarantee and lien obligations: (i) non-wholly owned subsidiaries may not be required to provide guarantees or pledge assets and (ii) the guarantees and liens of a guarantor subsidiary may have to be released once that subsidiary ceases to be wholly-owned. – "Wholly owned" may be defined as 100% owned by parent or its wholly-owned subsidiary. • Parent could transfer a *de minimis* percentage (e.g., 1%) of its equity interests in a subsidiary to a third party, including to its PE sponsor or a new non-wholly owned unrestricted subsidiary, and the guarantee and any pledged collateral supporting the guarantee would be required to be released by the Administrative Agent and cease to be part of the lender's collateral package. For more see How did they do it? PetSmart & The Original Trap Door.
EBITDA ADD-BACKS AND AVAILABLE AMOUNT	• EBITDA definitions have grown increasingly borrower friendly, allowing uncapped add-backs for many types of estimated cost savings and synergies which, in many cases, may never be realized. • Be aware of seemingly customary add-backs that actually effectively override negotiated caps (e.g., "anything contained in a Quality of Earnings Report"). • Understand the interplay between definitions of Excess Cash Flow (which is subject to mandatory prepayment covenant) and Available Amount (which may create availability for Restricted Payments and Investments). – If not drafted carefully, Borrowers can choose to make Investments and Restricted Payments with Excess Cash Flow rather than to prepay indebtedness. For more see How did they do it? PetSmart & The Original Trap Door.
GOING CONCERN CARVE-OUTS AND RELATED AMENDMENTS	• In a covenant light credit agreement or indenture, the covenant requiring the issuer or borrower to deliver audited financials without a "going concern" qualification is often looked to as a possible restructuring trigger. • However, often times such covenant carves out "going concern" qualifications that are based on impending maturities and the actual or prospective failure to satisfy a financial covenant. • Further, companies can get around this potential default by changing the fiscal year. – Credit Agreements may permit change of fiscal year simply by notifying Agent. – For example, *Gymboree* amended its fiscal year in order to avoid a covenant breach in its term loan credit agreement arising from a going concern qualification.

Case Studies

J. Crew

Neiman Marcus

NYDJ

PetSmart

Revlon

Golden Nugget

AMC

Serta Simmons

J. Crew

SITUATION OVERVIEW	• In 2016, *J.Crew Group Inc.* ("J.Crew") began exploring out-of-court restructuring options to address the maturity of ~$543 million of unsecured PIK notes due 2019 and provide J.Crew time to make operational turnaround and grow into its capital structure. — If the PIK notes were held to maturity, the note balance would grow by $125 million due to PIK interest — J.Crew also faced a potential going concern qualifications in 2018 if auditors determined that J.Crew could not satisfy the PIK Notes obligations upon their maturity.
EXCHANGE	• In order to create currency to be used as consideration in a discounted debt exchange with the PIK noteholders, J.Crew invested ~72% of its domestic trademarks ("IP"), which J.Crew valued at $250 million, into a newly formed foreign subsidiary. • J.Crew contributed the IP into a foreign subsidiary (a non-loan party restricted subsidiary) first to take advantage of the "trap-door" provision under its "Permitted Investments" basket which allowed a non-loan party restricted subsidiary to make unlimited investments in unrestricted subsidiaries. • The foreign subsidiary, in turn, contributed the IP to a newly formed unrestricted subsidiary ("IPCo"). • The investment of the IP into IPCo sparked litigation from the J.Crew's term loan lenders, although the case was largely resolved in connection with the closing of a below-described exchange transaction. • J.Crew engaged an ad hoc group of PIK noteholders to structure the following series of interrelated exchange transactions: — The PIK notes were exchanged for a combination of (x) new notes issued by IPCo and secured by the IP, as well as (y) preferred and common equity. — In exchange for dismissing the litigation over the investment of IP, the term lenders received a $150 million par paydown (funded, in part, from combination of newly issued term loan and new notes issued by IPCo), increased interest rate and amortization, and tightening of restrictive covenants. • 99.9% of the PIK notes and ~88% of the term loans participated in the exchange • Despite consummating the exchange, J. Crew filed for bankruptcy in May 2020 which it exited in September 2020, pursuant to an order giving controlling ownership to its lenders.
KEY TAKEAWAYS	• J.Crew identified and utilized creative strategies using an investment basket now known in the market as the "trap-door" basket to maximize the size of the investment assets and set the stage for the exchange transactions with its PIK noteholders. • Expecting an adverse reaction from the term lenders, J.Crew filed a preemptive lawsuit against the term loan agent seeking declaratory judgment that its actions were permissible under the term loan agreement and applicable law (a creative tactic that resulted in any dispute being litigated in preferred forum and bringing interested parties into the open). • Cross-holder dynamics helped shaped the transaction as significant cross-holdings between PIK notes and the term loans helped push for a global deal that resulted in term loan repayment and amendment. • For more on this transaction see How Did They Do It? J. Crew & The Original Trap Door and for further detail on proposed protections, see What can I do? Drafting Tips to Address Liability Management Transactions.

Neiman Marcus

SITUATION OVERVIEW	• In March 2014, Neiman Marcus acquired the MyTheresa business which is an e-commerce business based in Germany. • In March 2017 Neiman Marcus designated the certain subsidiaries that owned the MyTheresa business as Unrestricted Subsidiaries and then used available dividend capacity to move that business up the organizational chart above the Borrower as a subsidiary of Neiman Marcus Group, Inc. • In May 2020, Neiman Marcus filed for Chapter 11 amidst the economic pressures of the COVID-19 pandemic, emerging in September 2020, pursuant to a Chapter 11 plan that hands ownership to pre-petition lenders and reduces Neiman Marcus' debt by ~$4 billion.
MOVING VALUE UP AND OUTSIDE OF THE LENDERS' REACH	• On or about March 10, 2017, Neiman Marcus designated certain of its subsidiaries as Unrestricted Subsidiaries as permitted by its debt documents including the subsidiaries that owned the MyTheresa business of Neiman Marcus and related real property. • The MyTheresa entities had been owned by NMG International LLC ("NMG Sub"), itself a Guarantor of Neiman Marcus' existing credit facilities, but the MyTheresa entities were not guarantors at any time under the debt documents. • The assets of NMG Sub (including the equity in the entities that owned the MyTheresa business) were distributed up the organizational chart (including through the Borrower) and ultimately became subsidiaries of Neiman Marcus Group, Inc. (i.e. out of the credit package available to the existing secured lenders). • The restricted payments covenant in the debt documents provided for a carve-out that permitted the distribution, as a dividend or otherwise, of the capital stock of any Unrestricted Subsidiaries (other than Unrestricted Subsidiaries the primary assets of which are cash). Accordingly, the actions of Neiman March were permitted by the terms of the debt documents.
KEY TAKEAWAYS	• The company's unfettered ability to dividend or spin out an Unrestricted Subsidiary was a crucial feature of the existing loan documents that permitted this transaction. • To limit similar leakage risk, lenders should consider including provisions limiting or restricting the free distribution of the stock of an Unrestricted Subsidiary or cap the value of such distribution. • Another requirement to consider is to stipulate that all Restricted Payments be in cash other than dividends in stock of the party making the Restricted Payment. • Finally, lenders should consider limiting the designation of Unrestricted Subsidiaries to subsidiaries being newly formed or acquired, after closing and consider other limitations on Unrestricted Subsidiaries (caps on assets, etc.). • For more on this transaction see How did they do it? Neiman Marcus and the myTheresaSpin-off and for further detail on proposed protections, see What can I do? Drafting Tips to Address Liability Management Transactions.

NYDJ

SITUATION OVERVIEW	• In May 2017, NYDJ Apparel, LLC entered into amendments to its credit agreement with the majority consent of its lenders (the “Majority Lenders”) which purported to prime the outstanding loans of the non-consenting minority lenders (the “Minority Lenders”) with a new $20 million term loan tranche. The Minority Lenders were not approached for their consent to the ultimate amendment. • In November 2017 certain Minority Lenders filed suit against NYDJ and the Majority Lenders with respect to the purported priming of their loans. • The claims included breach of contract, breach of the implied covenant of good faith and fair dealing, unjust enrichment and breach of the NY Debtor and Creditor Laws. • The litigation ultimately settled and the court did not ultimately rule on the merits of the Minority Lenders’ claims. As part of the settlement, the Minority Lenders were offered the same deal that the Majority Lenders received.
FALLING DOWN THE WATERFALL	• The Majority Lenders and Borrower argued that they could amend the credit facility to permit the incurrence of a $20 million super-priority incremental term loan at the top of the post-default payment waterfall. • The Majority Lenders and Borrower further argued that, by majority vote, the original loans of the Majority Lenders could be moved up ahead of the original loans of the Minority Lenders in the waterfall, resulting in the Minority Lenders holding a last out term loan. • The positions taken by the Majority Lender and the Borrower were based on the fact that the amendment/voting provisions of the credit agreement did not expressly include the pro rata payment and pro rata sharing provisions as "sacred rights" of the lenders, which allowed them to argue that these provisions could be revised with only the consent of the Majority Lenders.
KEY TAKEAWAYS	• Minority lenders should ensure that the sacred rights in the amendment/voting section include amendments to the pro rata payment, pro rata sharing AND the waterfall of payments such that the amendment of such sections will require the vote of all lenders or at least all lenders adversely affected thereby. • Minority lenders should ensure that the pro rata sharing and waterfall provisions apply notwithstanding any other provision of the Credit Agreement; be thoughtful about any language that would permit these provisions be subject to exceptions (e.g., “Except as otherwise set forth herein…”), which could provide a simple majority of lenders with the ability to amend the credit agreement by adding a provision elsewhere that could arguably supersede or otherwise negatively impact the pro rata sacred right. • To the extent possible, the broadest protections may be obtained by adding catch-all protection to the list of specific sections that cannot be amended in the pro rata sacred right provision such as “or any other provision of this Agreement, or add any provision to this Agreement in a manner that would alter the pro rata sharing of payments required hereunder as of the date hereof without the prior written consent of each Lender”. • For more on this transaction see How Did They Do It? NYDJ, or Can You Really Prime 47% of Lenders Without Their Consent? and for further detail on proposed protections, see What can I do? Drafting Tips to Address Liability Management Transactions.

PetSmart

SITUATION OVERVIEW	• In 2017, PetSmart, Inc. ("PetSmart") purchased the online-pet retailer Chewy.com for $3 billion, $1 billion of which was funded by PetSmart's PE sponsor, BC Partners. • In light of substantial flexibility under its debt documents, including significant capacity under applicable restrictive covenants, the market had long-speculated whether PetSmart would effectuate a spinoff of Chewy to benefit BC Partners and/or to effectuate a J.Crew like transaction. • Given that some investors believed that Chewy's value was increasing exponentially, many assumed that PetSmart would effectuate the transaction in the short term to maximize the amount of value that could be spun out under the restrictive covenants.
INVESTMENT & DIVIDEND	• In June 2018, PetSmart announced that it had spun-off 20% of Chewy's equity through a dividend to BC Partners and transferred 16.5% of Chewy's equity to a newly-formed unrestricted subsidiary. — Given that Chewy was no longer a wholly-owned subsidiary, PetSmart requested that the term loan agent release Chewy's liens and guarantee, though Chewy would still a "Restricted Subsidiary" under the loan documents and, therefore, would continue to be subject to the restrictive covenants. — The new unrestricted subsidiary that held 16.5% of Chewy's equity was not subject to any restrictive covenants and thus could effectuate a variety of transactions that would not have to comply with such restrictions. • Under PetSmart's debt documents, spinning off Chewy's equity through a dividend required capacity under the restricted payments basket equal to at least the fair market value ("FMV") of equity being spun off, and transferring Chewy's equity to an unrestricted subsidiary required capacity under the restricted payments and/or investment baskets equal to at least the FMV of equity being transferred. — PetSmart reportedly disclosed to the term loan agent that Chewy was valued at $4.45 billion for purpose of this transaction. — If that valuation was correct, the transaction was within the Restricted Payment and Investment baskets under both the term loan and the note indentures. • Under fairly standard boilerplate provisions inthe term loan documents concerning administrative agent action, to the extent that a restricted subsidiary ceased to be a wholly-owned subsidiary of PetSmart pursuant to transactions authorized under the term loan agreement, *the agent was required to release* such Restricted Subsidiary's liens and guaranties under the term loan documents. — Under PetSmart's note indentures, Chewy's liens and guarantee *are released automatically* upon any release of its liens and guarantee under the term loan. • PetSmart sued the term loan agent requesting release of Chewy. The agent countersued, but using coercive amendment techniques PetSmart obtained consent from the requisite term lenders and settled the litigation. The settlement confirmed the release of Chewy, approved Chewy's IPO and required proceeds from the IPO to pay down the term loans. During the IPO Chewy was valued at approximately $8.8 million.
KEY TAKEAWAYS	• BC Partners utilized generous basket capacity and loose (but not uncommon) covenants to divert value away from lenders and preserve optionality to maximize its return on the Chewy investment. For more on this transaction see How Did They Do It? PetSmart & The Phantom Guarantee and for further detail on proposed protections, see What can I do? Drafting Tips to Address Liability Management Transactions.

Revlon

SITUATION OVERVIEW	• In 2019, Revlon disclosed that it had transferred a significant amount of IP to newly-created unrestricted subsidiaries ("BrandCo") and entered into a new credit agreement for a secured $200 million term loan (the "2019 Loans") senior to its existing debt (the "Existing Debt") on the transferred assets and pari on all other assets. The transferred IP was then licensed back to the operating business. • In 2020, Revlon transferred the majority of its remaining IP to BrandCo and used the transferred IP to secure on a first priority basis a new term loan facility (the "2020 Loans") that, among other things, refinanced in full the 2019 Loans.
TRANSFER OF ASSETS	• Before the incurrence of the 2019 Loans and 2020 Loans, Revlon capitalized on its ability to make unlimited investments in non-guarantor subsidiaries that are restricted subsidiaries because only investments that are in cash are capped. • Revlon's non-guarantor subsidiaries had the ability to make uncapped investments in other non-guarantor subsidiaries (including unrestricted subsidiaries), which allowed for the ultimate transfer of IP to BrandCo. • The 2019 Loan generally shared the same guarantors and collateral pool as the Existing Debt but was also secured by a first priority lien on certain IP which no longer secured the Existing Debt because it was released upon transfer to a foreign subsidiary (i.e., an excluded subsidiary under the Existing Debt). • Following the incurrence of the 2019 Loans, BrandCo leased back the right to use the transferred IP to Revlon's operating business. • A similar approach was used for the 2020 Loans, but on a greater scale (including the transfer to BrandCo of the valuable Elizabeth Arden brand). The 2020 Loans are secured by a first lien on substantially all of Revlon's IP assets. • The 2020 Loans required consent of 50% of Existing Debt lenders. As a slim majority of Revlon's existing lenders was organizing to defeat the transaction, Revlon used existing incremental capacity to add a $65 million revolving commitment under the Existing Debt facility, and the holders of these new commitments voted to approve the proposed transaction (following which their commitments were ultimately rolled into the 2020 Loans). • Existing Debt lenders filed claims against Revlon alleging breach of contract and implied covenant of good faith. Claims were also filed against Citi as agent alleging breach of requirement to act in lenders' interest because of a conflict of interest. Furthermore, Citi subsequently wired a payment to Existing Debt lenders sufficient to repay Existing Debt in full, although Citi has filed suit claiming the payment was merely a clerical error. The litigation is ongoing.
KEY TAKEAWAYS	• Consider the issue of accordion debt and reducing layering risk, including appreciating aggregate pari passu debt capacity, seeking ROFOs with respect to pari passu debt, requiring pari debt to have terms consistent with existing debt (including scope of collateral package) and/or seeking approval rights for intercreditor agreements. • Consider limiting the transfer of crown-jewel assets, imposing caps on non-loan party investments, requiring leverage tests and EBITDA/Asset tests for designation of unrestricted subsidiaries, remove automatic lien release mechanism where collateral has been transferred to affiliates and/or tighten sale leaseback provisions. • For more on this transaction see How did they do it? Revlon's BrandCo Spin-Off, or J. Crew Revisited and for further detail on proposed protections, see What can I do? Drafting Tips to Address Liability Management Transactions.

Golden Nugget

SITUATION OVERVIEW	• In early April 2020, Golden Nugget, LLC announced its intention to raise $250 million of debt capital (ultimately upsized to $300 million) (the "iGaming Term Loan") to provide incremental liquidity to navigate the impact of COVID-19. • The proposed transaction involved a capital structure reorganization, whereby the Company's online gaming business would be carved out of the asset pool securing the obligations under the existing secured Credit Agreement.
INVESTMENT & DIVIDEND	• Golden Nugget, LLC and Loan Parties contribute the online gaming assets to a pre-existing, wholly-owned Unrestricted Subsidiary ("iGaming") of Golden Nugget Atlantic City, LLC ("GNAC"). Because iGaming was a pre-existing Unrestricted Subsidiary, the Company did not need to meet any tests associated with the creation or designation of a new Unrestricted Subsidiary (e.g., pro forma financial covenant compliance). Using the fairly customary provisions that permitted a similar release in PetSmart, the liens on the iGaming assets were released upon the transfer. • Using a customary restricted payment basket, GNAC distributed iGaming to Landry's Fertitta, LLC ("TopCo") via a dividend of the equity of iGaming (TopCo is not a Loan Party). This dividend effectively moved the iGaming (and the online gaming assets) outside of the restricted credit group. • In connection with the spinoff, iGaming entered into a new operations and licensing agreement with GNAC and entered into the iGaming Term Loan, secured by the iGaming assets, as well as a TopCo guarantee of the New Term Loan. • iGaming distributed the proceeds of the New Term Loan to TopCo via an intercompany loan. • TopCo then used the $300 million and existent incremental equivalent debt capacity to extend new loans to Golden Nugget. The note is pari passu with the Credit Agreement and underlying Collateral (pursuant to a customary intercreditor agreement). • Finally, TopCo pledged the note to the lenders under the iGaming Term Loan to secure the TopCo guaranty. The pledge indirectly granted the New Term Loan lenders a pari passu lien on all Collateral securing the Credit Agreement (in addition to the first lien on the online gaming assets).
KEY TAKEAWAYS	• Consider including strong limits on the ability to invest in, or transfer assets to, Unrestricted Subsidiaries. • Prohibit Unrestricted Subsidiaries at closing so that any future investment in such an entity would require tests for designation (e.g., leverage-based incurrence tests) to be satisfied. • Understand that, unless the parties affirmatively provide otherwise, a wide variety of existing baskets (e.g., Available Amount, unlimited Investments up to a ratio limit and general baskets) can be used for investments in Unrestricted Subsidiaries. • Neiman risk can be mitigated by defining specific limits on the ability to dividend the equity of a subsidiary or other part of the business up the corporate chain and above the borrower • Careful consideration should be given to whether an issuer may use incremental capacity to incur debt (particularly pari passu debt) provided by sponsor-affiliates.

AMC

SITUATION OVERVIEW	• On June 3, 2020, AMC announced a proposed bond exchange whereby outstanding (i) unsecured subordinated notes would be exchanged at a discount for new second lien secured debt ("Subordinated Notes Exchange") and (ii) convertible notes held by Silver Lake Group LLC ("Silver Lake") would be exchanged for new first lien debt, ultimately reducing AMC's debt by over $1.0 billion. Although the terms of the Subordinated Notes Exchange were subsequently modified, AMC stated its belief at the time that the original terms of the contemplated exchange transactions were fully permitted by existing debt documents. • Prior to the Subordinated Notes Exchange, the debt capital structure was as follows: (i) First Lien Credit Facilities comprised of (x) $1,895 billion term loan facility and (y) $225 million revolving loan facility, (ii) $500 million of 10.5% Senior Secured Notes due 2025, (iii) $600 million of 2.95% Senior Unsecured Convertible Notes and (iv) Senior Subordinated Notes.
UNSECURED BONDS EXCHANGED FOR SECURED BONDS	• Under the terms of the original proposal, existing Subordinated Notes were to be exchanged for new second lien secured notes due 2026 (the "New 2L Notes") at a discount of approximately 50 to 53 cents on the dollar. To the extent the company were to receive the consent of a majority of each tranche of such notes, AMC would be able to strip the Subordinated Notes of various protective covenants and exceed an otherwise-applicable $640 million cap for the exchange. • Due to the more restrictive provisions around refinancing debt in Silver Lake's indenture, the Subordinated Notes Exchange would also require the consent of Silverlake, a board member. See What can I do? "Insider" treatment in bankruptcy? What does that mean?. To secure such consent, the company offered Silver Lake an opportunity to receive (either by an amendment or an exchange) a first priority security interest in the collateral securing AMC's Credit Agreement and 1L Notes. • All new classes of exchanged notes could be secured because the indentures governing the existing Subordinated Notes contain a flawed concept of "refinancing debt" that does not require a refinancing of any unsecured subordinated notes to retain the same relative payment and lien ranking within AMC's capital structure. For more on refinancing provisions see What is it? Refinancing Provisions in Credit Documents. • While any exchange of the Subordinated Notes would constitute a payment on account of "Junior Financing" under the company's existing first lien facilities (and therefore be subject to negative covenants restricting prepayments of junior debt), the existing first lien facilities provide extremely generous capacity to prepay such junior debt (well in excess of $900 million before even giving effect to potentially available builder baskets and ratio based basket capacity). • The new $600mm Silver Lake debt can be a pari passu first lien debt instrument because the 1L Notes have a "credit facilities" basket that, based on 2019 adjusted EBITDA, would allow AMC most of the necessary capacity (~$578 million), with the potential to use a 3x leverage ratio prong and multiple other debt and lien baskets to secure the remainder. The indenture for the existing 1L Notes includes a "credit facilities" basket that includes a prong based on 75% of adjusted EBITDA as well as a prong based on 3x leverage (each of which is calculated using 2019 adjusted EBITDA since the Company's Q1 2020 reporting is not due until the end of June 2020).
KEY TAKEAWAYS	• A key component to this deal is the fact that the concept of refinancing debt did not require that the refinancing debt maintain the same payment and lien ranking (i.e. whether first lien, second lien, unsecured, subordinated) as the debt that it is refinancing. Also, since Silver Lake's document has more restrictive terms with respect to refinancing debt, it was able to use its consent to the transaction to extract value that the first lien lenders would never have anticipated. Finally, the company benefited from generous basket capacity. • For more on this transaction see How did they do it? AMC Entertainment 2020 Bond Exchange and What can I do? Drafting Tips to Address Liability Management Transactions.

Serta Simmons

SITUATION OVERVIEW	• Serta Simmons Bedding LLC, a portfolio company of Advent International, entered into three credit facilities on November 8, 2016 comprised of: (i) a $1.95 billion first lien term loan agreement (the "Existing First Lien Term Loans"), (ii) a $450 million second lien term loan agreement (the "Existing Second Lien Term Loans") and (iii) a $225 million asset based revolving credit facility. • On June 8, 2020, Serta announced that it had entered into a transaction support agreement with a group of lenders (the "Priming Lenders") that provided for a debt recapitalization (the "Proposed Transaction") that included: (i) $200 million of newly funded super-priority "first out" debt ranking ahead of the Existing First Lien Term Loans, (ii) $875 million of super-priority "second out" debt ranking ahead of the Existing First Lien Term Loans in exchange for the exchange of certain Existing First Lien Term Loans and Existing Second Lien Term Loans held by the Priming Lenders, and (iii) additional basket for super-priority "third out" debt that would rank ahead of the Existing First Lien Term Loans that can be used for future similar exchanges.
PRIMING DEBT EXCHANGE	• On June 11, 2020, several lenders who held approximately $600 million of the Existing First Lien Term Loans, but who were not included in the Priming Lender group (the "Minority Lenders"), filed a lawsuit challenging the Proposed Transaction for breach of contract and breach of the implied covenant of good faith and fair dealing. • As noted in the Minority Lenders' complaint, the Proposed Transaction, which had majority lender support of the Existing First Lien Term Loan and the Existing Second Lien Term Loan would allow a minimum of $1.075 billion of Super Priority Loans with liens superior to those securing the Existing First Lien Term Loan. The Complaint alleged that such transaction would impermissibly prime the $814 million of the remaining Existing First Lien Term Loans and the Minority Lenders sought a preliminary injunction to prevent the parties from closing the Proposed Transaction. • In its response to the Minority Lenders' complaint, Serta responded that the Proposed Transaction would fully comply with the Credit Agreement and noted in support of its view the following: — The incurrence of $200 million of incremental equivalent debt which is permitted under Section 6.01(z); and — The non-pro rata debt exchange was permitted under applicable open market purchases under Section 9.05(g)); • On June 20, 2020, the court denied the Minority Lenders' motion for a preliminary injunction noting that "the harm to defendants in delaying this deal far exceeds that to plaintiffs, particularly given that money damages are available to plaintiffs" on the basis that, according to the court, the credit agreement appears to permit the Proposed Transaction. • The Proposed Transaction closed on June 22, 2020. • The litigation over the Minority Lenders' claims remains ongoing.
KEY TAKEAWAYS	• Transactions such as these are likely permitted under many loan documents unless the subject documents contain express limitations restricting lien and payment subordination. The situation is worsened where there is a lack of drafting clarity as to what, exactly constitutes an "open market" transaction. For more see How did they do it? Serta Simmons Transaction, What can I do? Drafting Tips to Address Liability Management Transactions.