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Lender Smackdown



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New York, New York



Agenda

- Lender Infighting
- Gifts Under a Plan or 363 Sale
- Credit Bidding Issues
- Disclosure Required of Creditor Groups

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Lender Infighting



Lender Infighting

- Not limited to “lender group dissension”
- Source of friction: one creditor may hold multiple positions in the capital structure
- First lien lenders v. second lien lenders



ION Media Networks, Inc.

- Plan gave value of debtor's FCC licenses to first lien lenders
- Purchaser of second lien debt sought to oppose plan confirmation
- Principal arguments:
 - The law does not permit liens on FCC licenses
 - The value of those licenses should be shared among the unsecured creditors



Bankruptcy Court Holdings

- The second lien lenders could not challenge whether the FCC licenses were included in the first lien lenders' collateral package
- The second lien lenders lacked standing to object to the debtor's plan, even in their capacity as unsecured creditors



Why the Second Lienholders Couldn't Challenge the Lien

Court relies on language of intercreditor agreement

- The intercreditor agreement provided that each secured party acknowledged and agreed:
 - To the relative priorities as to the collateral defined in the security agreement
 - That such priorities shall not be affected or impaired in any manner whatsoever, including any non-perfection of any lien purportedly securing any of the first lien lenders' loans



Why Did the Court Find No Standing as an Unsecured Creditor?

- Upon commencement of a case under the Bankruptcy Code by or against any grantor, secured parties agree not to take action inconsistent with the intercreditor agreement so as to contest:
 - Validity or enforcement of the Security Documents
 - Validity, priority or enforceability of the Liens, mortgages, assignments and security interests granted pursuant to the Security Documents
 - Relative rights and duties of the holders of the First Priority Secured Obligations
 - Any plan or disclosure statement the terms of which are consistent with the rights of the first lien lender



ION Media Networks, Inc.

- Except as otherwise specifically set forth in the Agreement, the Second Priority Secured Parties may exercise rights and remedies as unsecured creditors against any Grantor in accordance with the terms of the Second Priority Documents and applicable law



Why Ruling is Surprising

- Blurs the distinction between lien subordination and claim subordination
- Strong basis to argue that FCC licenses cannot be pledged
- Appears to eviscerate the second lien lenders' rights as unsecured creditors
- Highly critical of second lien lenders



Factors Behind the Ruling

- Second lien lenders had engaged in aggressive litigation tactics
- All other constituencies supported plan confirmation
 - Would result be the same if second lien lenders seek to protect interests of all unsecured creditors?
 - Would it matter if dispute involved preliminary matters such as cash collateral use as opposed to plan confirmation?

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Gifts Under a Plan or 363 Sale



Problem

- Secured lenders want to settle with unsecured creditor constituency or equity holder but others object
 - Absolute Priority Rule
 - Unfair discrimination
- Parties who may object
 - Subordinate lender
 - Priority creditors
 - Unsecured creditors



The Law is Not Settled

- Some courts have refused to permit such gifts
 - *On-Site Sourcing* (Virginia 2009)
 - *Snyders Drug Stores* (Ohio 2004)
 - *Sentry Operating Co.* (Texas 2001)



The Law is Not Settled (cont.)

- Bankruptcy judges in New York and Delaware have permitted gifts under either plans or sales of assets outside of a plan
 - Gift is a carve-out from the secured creditor's lien, not a distribution of estate property
 - Gift facilitates a settlement; bankruptcy favors settlements



Final Thoughts on Gifts

- Structure them as distributions from property that clearly belongs to the secured lender
- Be prepared to present strong business justification, such as need to preserve relationships with trade creditors
- If attacking the gift, focus on whether lien is disputed, argue the gift is not from sale proceeds and invoke the absolute priority rule

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Credit Bidding



Uncertainties Regarding Credit Bidding

- Offsetting a secured creditor's claim against the purchase price for its collateral
- Bankruptcy tool typically used to transform secured debt into ownership of a borrower's assets
- “Loan to own” strategies:
 - Purchase of pre-petition debt
 - DIP financing



Secured Creditor's Right to Credit Bid: New Doubts

- **Yellowstone Mountain Club**
 - Debtors propose sale of package of assets, not all of which is secured by lenders' liens
 - Bidding would require cash deposit by bank group
- **Pacific Lumber**
 - Plan provides for cash-out of secured lender at price equal to judicially determined value of its collateral; no auction held
- **Philadelphia Newspapers**
 - Secured creditors do not have the right to credit bid where plan proposes an asset sale; appeal pending

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Disclosure Required of Creditors Functioning as a Group



Federal Rule of Bankruptcy Procedure 2019

- Requires every entity or committee representing more than one creditor or shareholder to disclose in writing:
 - Members of committee
 - Nature and amount of their claims or interests
 - Dates of acquisition and amounts paid(!)
 - Any sales or dispositions of claims or interests
 - Supplemental disclosures regarding any material changes



Washington Mutual Case

- 23 entities collectively holding over \$1.1 billion in notes participated in noteholder group
- Group wanted to avoid the result in *Northwest Airlines*, which required disclosure by ad hoc committee
- Motion is made to compel disclosures



Noteholder Group Opposes the Motion

- Contends the rule is inapplicable
- Claims to be merely a loose affiliation of creditors sharing the costs of advisory services
- Relies on holding in *Scotia Pacific* case, which did not require disclosure by ad hoc “group”



The Bankruptcy Court Grants the Motion

- Characteristics of the Noteholder Group and an ad hoc committee are not different
- Agrees with holding in *Northwest Airlines*
 - Rule 2019 applies to the formal organization of a group of creditors holding similar claims
 - Ad hoc committees implicitly ask courts to give their positions a degree of credibility appropriate to a unified group with large holdings



Surprising Statement from the *Washington Mutual Court*

- The Noteholder Group argued that the Rule applies only to a body that speaks on behalf of an entire class or broader group of stakeholders in a fiduciary capacity
- The Bankruptcy Court said collective action by creditors in a class implies some obligation to other members of that class
- The Court quoted an old U.S. Supreme court case indicating there is an obligation to act in good faith



Implications of *Washington Mutual*

- Breaks new ground: multiple creditors coordinating efforts may owe duties to similarly situated creditors
- Delaware Bankruptcy Court sides with New York Bankruptcy Court requiring distressed debt investors to reveal carefully guarded trading data
 - Will this chill hedge funds from functioning as a group?



Proposed Amendment to Rule 2019

- Securities Industry and Financial Markets Association and The Loan Syndication and Trading recommend *repealing* the rule
- The Advisory Committee has recommended *expanding* the rule to include disclosures of the parties' economic interests beyond their holdings as members of the group
 - Parties may hold positions in multiple levels of a debtor's capital structure such that their economic interest is adverse to the class as a whole
 - The private agendas of those speaking should be revealed since they are seeking to influence the court

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