Proprietary Insights Debtwire

Liability management deals heat up amid widespread borrower stress

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Distressed companies are expected to employ ever more sophisticated and, in some cases, aggressive liability management transactions (LMTs) as advisors continue to test the boundaries of credit documents.

The deals, which typically involve a combination of shuffling assets, exchanging existing debt and raising fresh funds, have become widely employed tools for companies to raise liquidity and extend debt maturities in order to buy precious time to complete a turnaround without a trip through bankruptcy court.

Several restructuring advisors told Debtwire they foresee more activity this year as companies struggle with the same issues that pushed many to restructure last year.

“I’m confident that, unless something changes materially, 2024 is going to be even busier than 2023,” said Scott Greenberg, global co-chair of Gibson Dunn’s restructuring practice, adding that “it will be a combination of straight-up restructurings for companies that finally tip over and a tenfold amount of liability management transactions.”

In the biggest LMT launched so far this year, **EchoStar** and **DISH Networks** announced in January that the recently merged telecom groups had moved assets into unrestricted subsidiaries and commenced distressed debt exchanges for some of DISH’s convertible and unsecured notes. DISH bondholders quickly organized to push back on the moves and this week Echostar cancelled the exchange offer for the unsecured notes.

Despite optimism around the resilience of the US economy, the major headwinds plaguing corporate issuers—primarily high interest rates and cost inflation—are expected to continue weighing on leveraged companies, placing further strain on cash flows and exacerbating refinancing challenges.

Initial market exuberance over imminent rate cuts has been tempered after the Federal Reserve this week signaled that while policymakers may be done hiking rates, they are not quite ready to cut. Either way, some investors don’t expect any rate cuts this year to have a real impact on borrowers’ financial statements in the near term.

“Companies may increasingly turn to liability management exercises in 2024 if the debt capital markets don’t open up,” said Jacob Adlerstein, a partner on Paul Weiss’s restructuring team, adding that “companies will continue to reach out to existing capital structure lenders and try to find ways to push out maturities and raise incremental capital from within their capital structure as opposed to outside."

Amid this difficult operating environment, distressed borrowers will continue to exhaust all options in hopes of staving off increasingly expensive and time-consuming bankruptcies. “These liability management transactions are almost always done in the shadow of bankruptcy. And that's a pretty powerful motivator for the company to say to its lenders, you know, if you don't agree to this out-of-court transaction, we have the option of bankruptcy in the back pocket,” said Lisa Holl Chang, a partner in Mayer Brown’s restructuring team.

Enabling conditions

In addition to the macro forces at play, companies and their financial sponsors have been able to take advantage of a boom in private credit and third-party capital providers coupled with loose credit documents, attorneys said.

“There are a lot of opportunistic players in the market that need to deploy capital. There's a lot of capital structures that still have documents that are kind of wide open for asset transfers and drop downs,” said Gibson Dunn’s Greenberg. Moreover, “there's a ton of reverse inquiries into all these situations, unsolicited bids from third parties to facilitate some kind of financing transaction so I think that'll continue in force.”

“The overall growing awareness and perception among private equity sponsors that these tools exist and have become widely accepted is also contributing to the rise in popularity of LMTs,” added Davis Polk Partner David Schiff.

In anticipation of these transactions, wary lenders are increasingly organizing ahead of time with advisors if they foresee potential liquidity and refinancing triggers.

Case in point, a group of lenders to porta potty provider **United Site Services** recently coalesced with Akin Gump as legal advisor. The mandate comes amid the company’s delining cash flow, which last fall prompted investors to worry about potential financial manoeuvres that sponsor Platinum Equity could take to address its portfolio company’s liquidity crunch.

Investors are watching to see how Clearlake Capital addresses specialty materials maker **Alkegen**’s USD 1.5bn term loan due December 2025 with some gaming out the possibility of Clearlake pursuing an LMT to tackle the term loan along with longer-dated senior secured and unsecured notes, said a sellsider and buysider. Lenders have already tapped Milbank to advise on potential talks with the company.

Alkegen’s term loan was last quoted at 94.9/96, while its USD 800m 5.25% senior secured notes due 2028 traded at 66.5 on Thursday, according to Markit and MarketAxess, respectively.

Another Clearlake-backed firm, plastic packaging provider **MRP**, previously known as Valcour Packaging or Mold-Rite, has been scouted as a potential LMT candidate, according to two other buysiders. The company's earnings have suffered over recent quarters from the impact of industry-wide destocking headwinds that hit many packaging firms.

MRP’s USD 420m first lien TL due 2028 was last quoted today at 79/81.58 compared to quotes at 82/85.5 at the beginning on 2023.

Last year, Clearlake executed LMTs on two portfolio companies, aftermarket auto parts supplier **Wheel Pros** and packaging company **Pretium**, that permitted existing lenders to participate.

Since Wheel Pros’ double-dip financing execution, prices on the borrower’s outstanding term loan that didn’t sign on to a transaction support agreement have been volatile with the loan quoted today 73.167/75, versus 76.5/78.5 at the start of the week, but in line with quotes seen at the start of the year, according to Markit. The issuer’s new USD 235m first lien FILO due 2028 continues to trade above par with quotes at 107.3/108.4 today, roughly in line with recent levels.

Meanwhile, after Pretium Packaging’s uptier transaction in October, the issuer’s new roughly USD 1bn super senior second-out term loan due 2028 has climbed to 81.75/83.42 versus 77.5/79.67 at the start of the year, according to Markit. The new USD 325m super first out term loan due 2028 was last quoted at 99.69/100.63.

The companies and sponsors did not respond to requests for comment.

Evolving dynamics

While uptier transactions and asset drop downs have become mainstream forms of liability management over the last few years, double dip transactions are the relatively newer form of liability management increasingly being employed in the market.

Briefly, a double dip typically involves a company creating a new subsidiary that issues new debt to lenders participating in the transaction, proceeds of which are used to fund an intercompany loan made to the new subsidiary’s parent on a secured basis. The borrower also provides a guarantee on this intercompany loan. Hence, the loan to the parent company, along with the loan guarantee, creates two claims on company assets.

“Many borrowers that have the covenant flexibility to undertake double-dip transactions under their existing credit documentation are opting for this structure over asset-drop downs,” said Damian Ridealgh, head of US private credit & capital solutions at Freshfields. In terms of the benefits, “from a borrower’s perspective, these transactions (as opposed to asset drop downs) are less disruptive to its day-to-day operations given that they do not require that assets be transferred to different entities and do not eat into investment capacity if subsidiaries holding such assets are designated as unrestricted subsidiaries. From a lender’s perspective, a double-dip transaction ostensibly provides new money creditors with multiple independent claims against the borrower’s capital structure.”

Additionally, a modified version of the double-dip, the so-called “pari plus” structure, became popular last year and will continue to be, Schiff said, further noting that these structures involve lenders putting in a new financing secured by pari passu liens on the collateral that secures a company's existing debt, along with separate standalone collateral that was previously unencumbered or that was dropped out of another creditor's collateral package.

The structures and documentation used to set up these transactions can be complicated and might include intercompany loans and bespoke intercreditor agreements. Often, they are set up to combine pockets of flexibility across multiple covenant baskets, said Schiff.

"In this new variation of a double-dip financing the additional credit support is provided by additional assets that are not part of the existing credit group and therefore the improvement in the position of the new money lenders is effected in a manner that is not directly at the expense of the group of the lenders who are left out of the enhanced protections", said Meir Dominitz, a partner in Mayer Brown's banking and finance team. Dominitz highlighted the case of Sabre Corp as the first transaction that introduced the so-called pari plus financing.

Dominitz believes that further modification of the true double-dip structure will continue to evolve further over the course of this year and the next.

Along with more complex structures, borrowers are pushing lenders to sign more expensive non-disclosure agreements going into liability management negotiations with companies, said Schiff.

"The provisions are becoming more aggressive in some cases and can include terms that have nothing to do with confidentiality at all. For example, lenders are in some cases pushed to sign these agreements before they have organized in a group or engaged counsel, and the draft agreements will include commitments to not join an ad hoc group, not sign a cooperation agreement and not challenge the legality of a transaction, sometimes for a period of a year or longer," Schiff said.

Pro-rata deals

To minimize or avoid litigation risk associated with LMTs, issuers are increasingly utilizing pro-rata deals that allow all lenders to participate, said Arnold Porter Partner Brian Lohan.

Consensual transactions also help a borrower move quickly to complete a deal, said Mayer Brown's Dominitz. "It's easier to advance faster when everyone is on the same page and cooperating, and everyone is signing the agreement," he said. "I think we will see more and more of those and less of the transactions where there are disputes and violence among lenders."

Creditors, too, must weigh the costs and benefits of working together or pursuing a deal at the expense of others.

"Lenders are looking to take full advantage of opportunities to better their positions. None of them want to be left out and we're seeing more cooperation agreements among lenders to avoid costly litigation. It is a cost-benefit analysis of value leakage by cooperating versus capturing maximum value and keeping everyone else out," said Jacob Czarnick, a managing director at Raymond James.

Aggressive transactions done at the expense of some creditors often end up in court with Debtwire actively tracking five disputed deals.

Case Name	Court	Commencement Date	Status
Audax Credit Opportunities Offshore Ltd v. TMK Hawk Parent, Corp (TriMark)	Supreme Court of the State of New York, County of New York	7-Nov-20	The parties resolved the litigation following mediation
Serta Simmons Bedding v. AG Centre Street Partnership	US Bankruptcy Court, Southern District of Texas	24-Jan-23	Bankruptcy Court order upholding the transaction is subject to an appeal before the US Court of Appeals for the Fifth Circuit
Ocean Trails CLO VII v. MLN TopCo Ltd (Mitel)	Supreme Court of the State of New York, County of New York	14-Mar-23	Pending, plaintiffs have appealed 7 December order partially granting motions to dismiss
Wesco Aircraft Holdings, Inc v. SSD Investments Ltd (Incora)	US Bankruptcy Court, Southern District of Texas	1-Jun-23	Pending, trial is ongoing
Vibrant Capital Partners, Inc v. Envision Healthcare Corporation	US Bankruptcy Court, Southern District of Texas	31-Jul-23	Case dismissed upon effective date of plan of reorganization
The Guardian Life Insurance Company of America v. Robertshaw US Holding Corp	Supreme Court of the State of New York, County of New York	29-Nov-23	Pending, response to complaint is due on 16 February

Source: Court Documents

In last year's most notorious case, KKR-backed **Envision Healthcare** filed for Chapter 11 after attempting to stay afloat with LMTs that benefited some lenders at the expense of others. Aggrieved "fourth out" lenders filed an adversary complaint in the case and the UCC investigated the deals. The UCC later settled with Envision to facilitate confirmation of the bankruptcy plan and the fourth out lenders withdrew their case.

Other LMT cases remain locked in litigation, as in the ongoing court cases contesting **Robertshaw** and **Wesco Aircraft Holdings**'s uptier transactions.

In January, Judge Marvin Isgur of the US Bankruptcy Court for the Southern District of Texas allowed many noteholder plaintiff's breach of contract claims to survive summary judgement, leaving the company open to significant potential liability, Debtwire legal analysts have noted. A trial over the uptier transaction is ongoing.

By Huiling Cai, Madalina Iacob and Mariana Santibanez

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Issuer Summary

Issuer
Alkegen

Likely To Distress
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Location
New York, United States

Issuer Summary

Issuer
Mold-Rite Plastics LLC

Likely To Distress
51

Location
Chicago, United States

Relationships

Issuer	Alkegen
Issuer	Mold-Rite Plastics LLC
Other	Alkegen
Other	DISH Network Corp
Other	EchoStar Corp
Other	Envision Healthcare Corp
Other	Incora
Other	Pretium Packaging LLC
Other	Robertshaw Controls Co
Other	Sabre Corp
Other	United Site Services Inc
Other	Wheel Pros LLC