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Legal Update
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Intercreditor Agreements After *Momentive*: When a Hindrance Is Not a "Hindrance"

Intercreditor agreements—contracts that lay out the respective rights, obligations and priorities of different classes of creditors—play an increasingly important role in corporate finance in light of the continued prevalence of complex capital structures involving various levels of debt. When a company encounters financial difficulties, intercreditor agreements become all the more important, as competing classes of creditors seek to maximize their share of the company's limited assets. Disputes often follow, as can be seen from the recent bankruptcy case of MPM Silicones, LLC and its affiliates (collectively, "Momentive").

On November 30, 2018, the US District Court for the Southern District of New York issued its decision in intercreditor litigation relating to Momentive's bankruptcy.[1] In affirming the bankruptcy court's 2014 and 2015 decisions, the district court held that Momentive's undersecured, junior lienholders had not breached their obligations to senior lienholders under the governing intercreditor agreement by voting in favor of Momentive's plan of reorganization or by receiving equity in the reorganized debtors and payment of certain professional fees without senior lienholders having been paid in full.

As discussed in greater detail below, *Momentive*, at its core, is a contract interpretation decision, and whether this decision will strengthen the hand junior lienholders have in corporate restructuring efforts—even if at the expense of senior lienholders—will depend upon the language of the operative provisions of the intercreditor agreements at issue in those future cases.

Background

MOMENTIVE'S CAPITAL STRUCTURE & INTERCREDITOR AGREEMENT

As of its petition date, Momentive had approximately $3 billion in debt across four separate secured and unsecured facilities: (1) a first-lien note facility for approximately $1.1 billion; (2) a 1.5 lien note facility, between the first-lien and second-lien notice facilities, for approximately $250 million (holders of notes in the first lien and 1.5 lien facilities, collectively, the "Seniors"); (3) a second-lien note facility for approximately $1.35 billion (holders of notes in the second lien facility, the "Seconds"); and (4) an unsecured subordinated note facility for approximately $382 million (holders of notes in the unsecured facility, the "Unsecureds"). Both the Seniors and Seconds were secured by the same shared collateral with their relative lien priorities governed by an intercreditor agreement entered into by the applicable note trustees in 2012. The intercreditor agreement governed only lien priority in the noteholders' shared collateral; it did not address payment priority. Instead, all three classes of secured noteholders were entitled to be paid at the same time, and none were required to defer receiving payment until any others had been paid in full.

With respect to lien priority, the intercreditor agreement established that the Seniors had complete priority over the Seconds' liens with respect to the common collateral. No Second was permitted to take "any action that would hinder any exercise of remedies undertaken by" the Seniors with respect to the common collateral, and each Second waived any and all of its rights "as a junior lien creditor or otherwise to object to the manner in which" the Seniors sought to enforce or to collect on their claims or the liens granted to them on the common collateral.[2] In addition, so long as the Seniors had not been paid in full, each Second agreed that it would not, "in the context of its role as secured creditor, take or receive any Common Collateral or any proceeds of Common Collateral" in connection with the exercise of any right or remedy with respect to such common collateral and also agreed that any "Common Collateral or proceeds thereof" that it received in contravention of these provisions would be "segregated and held in trust for the benefit of" the Seniors.[3]

That said, each of these provisions was qualified by a later section, which provided that "notwithstanding anything to the contrary" in the intercreditor agreement, the Seconds were permitted to "exercise rights and remedies as an unsecured creditor" against Momentive.[4] In addition, nothing in the intercreditor agreement was to prohibit the Seconds from receiving required payments of interest and principal so long as such receipt was not "the direct or indirect result of the exercise" by any Second "of rights or remedies as a secured creditor in respect of Common Collateral."[5]

Momentive's assumed enterprise value, at the time of its bankruptcy filing, was well below the amount of its secured debt, thus causing the Seconds to be massively undersecured and to be the fulcrum security holders. As the district court noted, this fact, and the "two hats" that Seconds wore as a result of being both secured and unsecured creditors, "was not a mundane fact" and instead "deeply mattered" to the court's ultimate decision.[6]

MOMENTIVE'S BANKRUPTCY FILING

In April 2014, Momentive and its affiliates filed Chapter 11 bankruptcy cases and included with their initial filings a proposed Chapter 11 plan. Pursuant to that plan, the Seniors could opt to either (i) accept the plan and receive a cash payment of the outstanding principal and interest due on their notes, without a make-whole premium contemplated by their note indentures which Momentive argued did not apply, or (ii) reject the plan and receive replacement notes while litigating their entitlement to a make-whole premium and the appropriate interest rate. As to the Seconds, the plan provided that the Seconds would receive the equity value of Momentive's assets in two tranches of reorganized Momentive stock.

Subsequently, a majority of the Seconds entered into a restructuring support agreement with Momentive, under which they agreed to support Momentive's Chapter 11 plan. The plan was to be funded through $600 million in new capital raised by Momentive. Those Seconds who had entered into the restructuring support agreement with Momentive also agreed to enter into a backstop commitment agreement under which they guaranteed the success of the capital raise by committing to purchase any unsubscribed stock in the reorganized Momentive in exchange for a payment in the form of additional equity.

In accordance with the restructuring support agreement, the Seconds voted to accept Momentive's Chapter 11 plan, while the Seniors voted to reject it. After a multi-day trial, the plan was confirmed over the Seniors' objections, which the bankruptcy court, district court and Second Circuit Court of Appeals subsequently affirmed on appeal, on most issues.[7]

BANKRUPTCY COURT INTERCREDITOR LITIGATION

In June 2014, while litigation concerning Momentive's plan, the make-whole premium and the appropriate cramdown interest rate was ongoing, the Seniors commenced litigation against the Seconds in New York State Court (which litigation was subsequently removed from state court to federal court and then referred to Momentive's bankruptcy court) alleging that the actions taken by the Seconds in support of Momentive's plan violated the intercreditor agreement. In particular, the Seniors alleged (i) "Interference Claims"—i.e., that by voting in favor of Momentive's plan, the Seconds breached their obligation under the intercreditor agreement not to "hinder any exercise of remedies undertaken" by the Seniors with respect to the common collateral; and (ii) "Turnover Claims"—i.e., that by receiving both a fee in connection with the restructuring support and backstop commitment agreements in the form of additional equity in the reorganized Momentive, and certain professional fees, the Seconds breached their obligation under the intercreditor agreement to turn over to the Seniors any common collateral proceeds that the Seconds received until the Seniors had been paid in full.[8]

The Seconds moved to dismiss the Seniors' claims and, when the Seniors attempted to amend their allegations, to deny the Seniors' motions for leave to file amended complaints. The bankruptcy court granted each of the Seconds' motions, finding that the Seniors had not pled sufficient facts to support their claims and that their requested amended complaints would be futile. The Seniors subsequently appealed these decisions to the district court.

District Court Opinion

On November 30, 2018, the district court issued its opinion affirming the bankruptcy court's decisions in all respects, dismissing both the Seniors' Interference Claims and their Turnover Claims and finding that any additional, amended complaints would be futile.

INTERFERENCE CLAIMS

With respect to the Interference Claims, the court focused on the inherent tension between (i) provisions of the intercreditor agreement, which provided that no Second could "hinder any exercise of remedies" by the Seniors and that each Second waived its rights "*as a junior lien creditor* or otherwise" to object to the manner in which the Seniors sought to enforce their liens, and (ii) other provisions of the intercreditor agreement, which provided that "*notwithstanding anything to the contrary*" in the intercreditor agreement, the Seconds were entitled to "exercise rights and remedies" against Momentive "*as an unsecured creditor*." Taking a "holistic view," the court underscored that, as fulcrum securityholders, the Seconds were acting as both secured and unsecured creditors in Momentive's bankruptcy case.[9] While as junior lien creditors, the Seconds were barred by the intercreditor agreement from hindering the Seniors' exercise of remedies in that case, the court held that the intercreditor agreement did not similarly bar the Seconds from doing so as unsecured creditors.

Instead, citing to a "growing consensus" that it had gleaned from its review of "decisions throughout the nation," the district court held that "where there is no express waiver or specific constricting language in the contract, courts are reluctant to read such constraints into broad provisions."[10] There were "no express constraints or waivers" in the intercreditor agreement that prevented the Seconds from voting in favor of Momentive's proposed plan even when the Seniors opposed it.[11] As a result, the Seniors' claims that the Seconds breached the intercreditor agreement by voting in favor of Momentive's plan had to be dismissed.

TURNOVER CLAIMS

As to the Turnover Claims, the key issue, according to the district court, was whether the

fees Momentive was paying to the Seconds as part of its confirmed plan (which fees included both additional equity in the reorganized entity and certain professional fees) constituted proceeds of the common collateral in which both the Seniors and Seconds had rights. If the fees constituted proceeds of the common collateral, the Seconds would be required to turn over such fees to the Seniors, under the terms of the intercreditor agreement, so long as the Seniors had not been paid in full (which they were not, under the terms of Momentive's plan). If the fees were not proceeds of the common collateral, on the other hand, then the intercreditor agreement would not be implicated and the Seconds would be free to retain the fees they had received.

The intercreditor agreement itself did not define the term "proceeds." As a result, the court looked to the Uniform Commercial Code's definition of the term, which included "whatever is collected on, or distributed on account of, collateral."[12] The Seniors argued that the Seconds obtained fees "on account of" the common collateral—i.e., that they negotiated for fees in exchange for the release and discharge of their claims and liens—and that the fees therefore constituted "proceeds" of the common collateral.

The district court disagreed. In particular, the court emphasized that for an item to be deemed "proceeds of collateral," an action must have been taken with respect to the collateral that "exhausted, decreased, diluted or otherwise used [it] up."[13] In the case of Momentive, no such action created the fees payable to the Seconds. Instead, the court agreed with the bankruptcy court that the common collateral "will not have been diminished one iota by the distribution of the new stock under the plan" to the Seconds.[14] To the contrary, no party with rights in the common collateral, including the Seniors, could "assert a lien on the [new] common stock."[15] That stock instead constituted "proceeds of the [Seconds]' liens and claims," not proceeds of Momentive's collateral.[16] Similarly, the district court also held that the Seniors could not "plausibly argue that their rights and remedies" were infringed with respect to proceeds of common collateral based on the payment of the Seconds' professional fees, since even after the payment of such fees, the common collateral "remained unscathed."[17] In that regard, the court emphasized that the fees that the Seconds were receiving "had nothing to do" with the common collateral, the Seconds' "previously affixed liens" or the "Seconds' role as secured creditors."[18] Instead, the fees related to the Seconds' negotiation of the restructuring support and backstop commitment agreements. In connection with the negotiations over the backstop commitment agreement, the court held that the Seconds clearly "wore only their unsecured hats" as that agreement governed how the Seconds would fund Momentive's *new* equity.[19] And while the restructuring support agreement was a closer call, the court held that it was "likely the Seconds' unsecured deficiency claims that brought them a seat at the table, not their secured claims." [20]

Finally, the court also stated that "as a matter of principle," the Seniors' Turnover Claims had to fail since, "at their core," the claims attempted "to circumvent one of the bedrock functions of bankruptcy law, which is to enable a distressed debtor to reorganize itself." [21] Entering the restructuring support and backstop commitment agreements were not obstructionist tactics, engaged in by the Seconds in an attempt to extract additional value for themselves. They were instead "part of legitimate efforts to reorganize" Momentive "under the Bankruptcy Court's direct supervision, in a manner acceptable in the industry and preferred by Congress."[22] Based on that, the court opined that it could not "look fondly upon" arguments that sought to transform an intercreditor agreement "into a sword to enable the Seniors to work around the Bankruptcy Code." Instead, the Seconds were entitled to their professional fees.[23]

Takeaways

There are several possible takeaways from the *Momentive* decision, which bears further watching as the Seniors are likely to further appeal their claims to the Second Circuit Court of Appeals.

With respect to junior lienholders, the district court's opinion, specifically, in repeatedly referencing the crucial role such lienholders are expected to play in restructurings as fulcrum security holders, might embolden junior lienholders in future cases, particularly if the intercreditor agreement at issue is drafted similarly to the one in *Momentive*. Depending on the exact phrasing of an intercreditor agreement's provisions, junior lienholders might attempt to cite *Momentive* and its progeny as a basis for taking action, or at least threatening to take action, that might otherwise be interpreted as harming or hindering senior lienholders.

However, *Momentive*, at its core, is a contract interpretation decision, and its interpretation of the junior lienholders' ability to take action as an unsecured creditor was against the background of the language of the particular intercreditor agreement at issue there. The extent to which *Momentive* proves to have precedential value is likely to depend on the intercreditor agreement provisions at issue in future cases, including the extent to which those provisions might further define or restrict what actions constitute permitted "unsecured creditor" actions or "proceeds" of a senior creditor's collateral in ways not articulated in the *Momentive* intercreditor agreement.

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Endnotes

[1] *BOKF, NA v. Wilmington Savings Fund Society, FSB (In re MPM Silicones, LLC*), No. 15-cv-2280-NSR (S.D.N.Y. Nov. 30, 2018) (slip op.) (Hereinafter "BOKF").

[2] *Id.* at 17.

[3] *Id.* at 24.

[4] *Id.* at 18.

[5] *Id.*

[6] *Id.* at 6, 43.

[7] *See In re MPM Silicones, LLC*, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff'd*, 531 B.R. 321 (S.D.N.Y 2015), *aff'd*, 874 F.3d 787 (2d Cir. 2017). Issues relating to the make-whole premium and cramdown interest rate were separately litigated and were largely resolved by a later Second Circuit opinion. See *Matter of MPM Silicones*, L.L.C., 874 F.3d 787 (2d Cir. 2017) (holding that senior lien noteholders were not entitled to make-whole premium on notes that had been automatically accelerated upon bankruptcy filing and that the cramdown interest rate should account for the market rate, if an efficient market for similar debt exists). Litigation relating to the specific interest rate that will apply is still ongoing.

[8] The Seniors also claimed that the Seconds had violated the implied covenant of good faith and fair dealing. The district court dismissed those claims, however, on the grounds that, under New York law, such claims cannot be based on the same conduct underlying a claim for breach of express contractual provisions.

[9] *BOKF, supra*, at 18.

[10] *Id.* at 19-22.

[11] *Id.* at 23.

[12] *Id.* at 26.

[13] *Id.*

[14] *Id.* at 27.

[15] *Id.* at 28.

[16] *Id.*

[17] *Id.* at 50.

[18] *Id.* at 44.

[19] *Id.*

[20] *Id.* at 45.

[21] *Id.*at 50.

[22] *Id.*

[23] *Id.*

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