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Boardriders: Minority Lenders Win Round One

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A common yet contentious liability management strategy is an "uptier" transaction, where lenders holding a majority of loans or notes under a financing agreement seek to elevate or "roll-up" the priority of their debt above the previously *pari passu* debt held by the non-participating minority lenders. In a recent decision in the *Boardriders* case, the minority lenders defeated a motion to dismiss various claims challenging an uptier transaction.

The Boardriders Case: Boardriders, a surfing and skateboarding apparel company, borrowed $450 million in first lien term loans under an April 2018 syndicated credit agreement (the "***Credit Agreement***"). Relevant facts, as pled by the plaintiffs[1], a group of non-participating minority lenders, include:

- The Boardriders' Credit Agreement provided that payments and prepayments of the loans must be made pro rata to lenders, subject to certain exceptions. The relevant exception permitted the repurchase of loans on a non-pro rata basis through "open market purchases". The Credit Agreement did not define "open market purchases", but notably it did spell out the terms of a Dutch Auction, which was required to be offered on a pro rata basis.
- Amendments to the Credit Agreement could be made by lenders holding a majority of the loans, *e.* required lenders, subject to "sacred rights" exceptions, which exceptions required the consent of lenders directly and adversely affected by the amendment. The pro rata sharing provisions were included in the list of sacred rights.
- A group of lenders (the "***Participating Lenders***") and the sponsor (who itself was a Participating Lender) negotiated a transaction where up to $110 million of new money secured by liens that ranked senior to the liens securing the existing term loans would prime the loans held by the excluded lenders (the "***Non-Participating Lenders***"), who were not offered the opportunity to participate in the uptier transaction.
- The borrower and the Participating Lenders agreed to various amendments to the Credit Agreement to effectuate the uptier transaction, including creating the basket

capacity for the borrower to incur new debt on a super-priority basis and authorizing the agent to enter into a new intercreditor agreement which granted the new loans super-priority status vis-à-vis the existing obligations under the Credit Agreement.

- The borrower and the Participating Lenders then entered into a new Super-Priority Term Loan Credit Agreement to evidence the new loans.
- The Super-Priority Term Loan Credit Agreement also left space for a second-out tranche ranking junior to the $110 million of new money term loans but senior to the debt under the existing Credit Agreement. In the uptier transaction, the Participating Lenders effectively exchanged their loans under the Existing Credit Agreement for an equal amount of loans in this second-out tranche. The exchange was done at par, though the loans were trading at a substantial discount to par (50-60% of par value).
- The mechanism used to effect the uptier exchange was the non-pro rata repurchase by the borrower of the Participating Lenders' loans under the Existing Credit Agreement pursuant to its "open market purchase" provisions.
- The Non-Participating Lenders sued the Participating Lenders, the borrower and the sponsor under a host of theories that distill to a claim that the transactions violate the express and implied provisions of the Credit Agreement.

The borrower and Participating Lenders filed a motion to dismiss the claims, arguing that the Credit Agreement permitted all of the amendments. Specifically, they asserted that (1) the Credit Agreement allowed required lenders to approve the incurrence of new super-priority debt and subordinate the existing liens to the liens securing such debt, and (2) that the repurchase of the Participating Lenders' existing loans comport with the "open market purchase" provisions in the Credit Agreement.

The Crux of the Case – Intent Matters: Here are the two core aspects of the decision by Justice Masley of the New York Supreme Court[2]:

First, despite the absence of an express “no subordination” sacred right, such a right could potentially be implicit in the pro rata sharing and related provisions of the Credit Agreement, read in concert with relevant context. The court found that while there was nothing in the sacred rights provision that *expressly* prohibited the subordination of the liens securing the existing obligations under the Credit Agreement, such a “narrow reading” of the sacred rights provision would “essentially vitiate the equal repayment provisions” of the Credit Agreement and be “contrary to the court’s obligation to consider the context of the entire contract and not in insolation [sic] of particular words – or in this case, the absence of particular words”. As a result, the court viewed the uptier transaction, in the context of the entirety of the Credit Agreement, as potentially violating the *intent* of the parties.

Second, the term “open market purchase”, undefined in the Credit Agreement, was susceptible to more than one meaning and therefore ambiguous.[3] Accordingly, the court would not accept at face value the borrower’s characterization of the transaction, and factual considerations, such as that the debt was exchanged (as opposed to retired), the purchases were allegedly not at market value, not all lenders were offered an opportunity to bid, and the exchange was done as part of various related transactions, were all relevant considerations.

Consequently the court denied the motion to dismiss the majority, and strongest, of the plaintiffs’ claims.[4]

Compare TPC: In the *TPC Group Inc.* case[5], District Judge Andrews approved a bankruptcy court’s decision that adopted a markedly different approach to a similar issue of the interpretation of a loan agreement. In *TPC*, participating majority noteholders under an indenture and TPC entered into a new super-priority indenture for new notes, and executed a new intercreditor agreement which afforded the liens securing the new notes priority over the existing notes. The transaction did not include an uptier. The non-participating noteholders challenged the transaction on the ground that under the existing indenture any amendment to the existing indenture and existing intercreditor agreement “dealing with the application of proceeds of Collateral” required the consent of all noteholders.

Bankruptcy Judge Craig Goldblatt found, and District Judge Andrews agreed, that the term on its face addressed only the ratable distribution of proceeds of collateral to noteholders of collateral and "should not be read as an anti-subordination provision in disguise". The bankruptcy court found that its reading was "readily apparent" as the indenture was not ambiguous. The court relied upon the express provisions of the indenture and did not need to consider the parties' intent. Therefore the court was able to resolve the issue based upon the four corners of the indenture.

The *Boardriders* court left open the possibility that the Credit Agreement was breached based on a reading of sacred rights in context with the agreement as a whole, whereas the *TPC* court constrained its analysis to the precise words of the indenture. How to square these decisions?

The *TPC* case involved a priming transaction and was not accompanied by an uptier transaction. In respect of a priming transaction, Judge Goldblatt found the words of the indenture provision at issue were clear on their face. Justice Masley was apparently influenced by the totality of the circumstances, and one must wonder whether the outcome would have been different if the case only involved a priming of the existing loans with the new loans not coupled with a roll-up of existing loans (as was the case in *TPC*). In any event, Justice Masley thought that the pleadings minimally warranted that the transaction be subject to further scrutiny.

Key Takeaways: (1) A court may consider whether a financing agreement was violated based on the "context of the entire contract" and intent of the parties rather than in strict adherence to individual provisions, each in isolation, and (2) in the absence of a clear definition, a court may scrutinize the facts and circumstances of a purported "open market purchase" using all relevant information.

Proskauer Private Credit Restructuring Group. We will continue to monitor these cases as we do not expect this to be the last word on these types of issues.

[1] A court must review a complaint in the light most favorable to the plaintiff when reviewing a motion to dismiss. So the facts presented are as pled by the plaintiffs and viewed in a light most favorable to them.

[2] Justice Masley is not unfamiliar with these transactions; she also presided over litigation concerning the *Serta* uptier transaction.

[3] Justice Masley looked to Black's Law Dictionary for the ordinary meaning of the term "open market", which describes it as "a market in which any buyer or seller may trade in [sic] and which prices and product availability are determined by free competition."

[4] A claim for tortious interference was dismissed. In a departure from the ruling on the motion to dismiss in the *TriMark* case, the court denied the motion to dismiss a claim for breach of the covenant of good faith implied in all contracts finding that sufficient grounds for bad faith were pled; namely, that the "allegations were sufficient to show that the defendants worked in concert and in secret to deprive the plaintiffs of the benefit of their bargain...."

[5] *Bayside Capital Inc. v. TPC Group Inc. (In re TPC Group Inc.)*, 2022 BL 233160, 2022 Bankr. Lexis 1853 (Bankr. D. Del. July 06, 2022).

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