Uptier Exchange Transactions: Lawful Innovation or Lender-on-Lender Violence?

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This Note examines the recent phenomenon of "uptier exchange transactions": transactions in which a borrower takes assignment of existing loans from participating lenders—those lenders holding a majority of the principal amount of the loan—and then issues new superpriority tranches of debt to the participating lenders, subordinating nonparticipating lenders in the process. Uptier exchange transactions were born in the throes of the COVID-19 pandemic and continue to evolve in the courts. This Note analyzes these transactions and all major litigation concerning them to date. It makes a normative argument in favor of curbing the reach of uptier exchange transactions through equitable judicial interpretation. Finally, this Note proposes an amendment to Article 9 of the Uniform Commercial Code that would protect nonparticipating lenders against these transactions, invoking the Trust Indenture Act of 1939 as a textual model.

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† Yale Law School, J.D. 2022. I am deeply grateful to Professor Eric Brunstad and Patrick Monaghan for their insightful comments and conversations. For their diligent work, I am indebted to the editors of the Yale Journal on Regulation, especially Caroline Lefever. All errors are my own. An earlier version of this Note received Yale Law School's Judge Ralph K. Winter Jr. Prize for Corporate Law.

Introduction

"This breach-of-contract case arises from a cannibalistic assault by one group of lenders in a syndicate against another."[1] So begins Audax Credit Opportunities Offshore's (Audax) complaint filed against TriMark, TriMark's private equity sponsors, and a syndicate of TriMark's lenders. In its complaint, Audax alleges that the defendants engaged in "lender-on-lender violence" by orchestrating a secret roll-up transaction and subordinating nonparticipating lenders' first-lien loans, rendering their first-lien loans "worthless in the event of a default."[2]

Audax's suit against TriMark and its "superpriority" lenders is just one of a rash of lender-on-lender cases playing out in New York state and federal courts. As of this writing, four separate groups of lenders—Audax,[3] North Star Debt Holdings,[4] LCM XXII,[5] and ICG Global Loan Fund[6]—are locked in ongoing litigation with their counterpart lenders and borrowers over "radical[]" amendments made to the original credit agreements.[7] Each case involves a financial maneuver known as an "uptier exchange transaction."

Uptier exchange transactions are a recent development, spurred on by the onset of COVID-19 in spring 2020. During the pandemic, many companies faced "unprecedented uncertainty and precipitous drops in revenue."[8] In response, several companies—including TriMark, Serta, and Boardriders, among others[9]—took an aggressive measure to raise new capital: they issued debt backed by new superpriority liens against all of their existing loan collateral. These transactions offered relief for the borrowers (to the tune of hundreds of millions

1. Complaint at 5, Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020 (N.Y. Sup. Ct. Nov. 7, 2020) [hereinafter Audax's Complaint].

2. Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *1 (N.Y. Sup. Ct. Aug. 16, 2021). The ongoing cases concerning uptier exchange transactions that this Note discusses all remain in the pleadings stage. Accordingly, the underlying facts discussed in this Note derive from the plaintiffs' complaints and constitute allegations that the courts presumed to be true on the defendants' motions to dismiss. *See* Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009); Nomura Home Equity Loan, Inc. v. Nomura Credit & Capital, Inc., 30 N.Y.3d 572, 582 (2017).

3. *See Audax*, 2021 WL 3671541, at *1.

4. N. Star Debt Holdings, L.P. v. Serta Simmons Bedding, LLC, No. 652243/2020 (N.Y. Sup. Ct. June 11, 2020).

5. LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 1:21-cv-03987, 2022 WL 953109 (S.D.N.Y. Mar. 29, 2022).

6. ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020 (N.Y. Sup. Ct. Oct. 17, 2022).

7. Audax's Complaint, *supra* note 1, at 5.

8. Bek R. Sunuu, *A Closer Look at How Uptier Priming Loan Exchanges Leave Excluded Lenders Behind*, S&P GLOB. RATINGS (June 15, 2021), https://www.spglobal.com/ratings/en/research/articles/210615-a-closer-look-at-how-uptier-priming-loan-exchanges-leave-excluded-lenders-behind-11991317 [https://perma.cc/337U-VNWB].

9. An S&P Global study also found evidence of the use of uptier exchange loans in the U.S. market by Murray Energy Corp., Renfro Corp., and GTT Communications Inc. *See id.*

in "critical new liquidity"),[10] triumph for the participating lenders, and woe for the excluded lenders. Because of the ramifications for nonparticipating lenders, the use of uptier exchange transactions is a controversial practice. And as some practitioners have noted, it is one that "could have a significant impact on future debt restructurings" because "the vast majority of existing New York law-governed credit agreements" likely contain language that would allow exchanges like those in *TriMark*, *Serta*, and *Boardriders*.[11]

Accordingly, a thorough legal analysis of uptier exchange transactions is overdue. The New York state and federal courts' treatment of uptier exchange transactions will almost certainly play an important role in determining the extent to which these transactions proliferate in the market. This Note provides a reading of the legal tea leaves drawn from the New York and federal courts' nascent reasoning in these matters, as well as a normative perspective on how courts *should* rule on these cases. New York trial courts have issued only two relevant decisions on the merits (in *Trimark*[12] and *Boardriders*[13]), and one decision denying plaintiffs' request for a preliminary injunction (in *Serta*[14]). In a separate suit filed against Serta in federal court, the U.S. District Court for the Southern District of New York has issued only one ruling on the merits: an order denying Serta's motion to dismiss.[15] Despite the limited number of judicial opinions addressing uptier exchange transactions, the courts to date have indicated at the pleadings stage that they are skeptical about the legality of uptier exchange transactions, although they may well find these transactions to be valid exercises of majority lenders' power under the text of their credit agreements.[16] With the courts' blessing, future borrowers and majority lenders would be emboldened to strongarm minority lenders and strip them of their first-lien rights "without even seeking—much less obtaining—their approval."[17] But this Note suggests that, before courts greenlight these cannibalistic exchanges, they ought to consider carefully the ambiguity of each

10. Boardriders, Inc.'s Memorandum of Law in Support of Its Motion to Dismiss the Complaint at 1, ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020 (N.Y. Sup. Ct. Dec. 7, 2020) [hereinafter Boardriders, Inc.'s MTD].

11. Natalia Sokolova, Anna-Marie Slot, Doug Murning & Ru-Woei Foong, *Nothing's Serta-in*, ASHURST (Dec. 18, 2020), https://www.ashurst.com/en/news-and-insights/legal-updates/nothing-s-serta-in [https://perma.cc/S8CC-3LLP].

12. *See* Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541 (N.Y. Sup. Ct. Aug. 16, 2021).

13. ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020, 2022 WL 10085886 (N.Y. Sup. Ct. Oct. 17, 2022).

14. *See* N. Star Debt Holdings, L.P. v. Serta Simmons Bedding, LLC, No. 652243/2020, 2020 WL 3411267 (N.Y. Sup. Ct. June 20, 2020).

15. *See* LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 1:21-cv-03987, 2022 WL 953109 (S.D.N.Y. Mar. 29, 2022).

16. *See, e.g.*, *id.* at *16 (denying Serta's motion to dismiss); *ICG*, 2022 WL 10085886, at *10 (denying in part Boardriders, Inc.'s motion to dismiss). *But see N. Star Debt Holdings*, 2020 WL 3411267, at *4 ("The Credit Agreement seems to permit[] the debt-to-debt exchange on a non-pro rata basis as part of an open market transaction.").

17. Complaint at 2, *N. Star Debt Holdings*, No. 652243/2020 (N.Y. Sup. Ct. June 11, 2020) [hereinafter North Star's Complaint].

credit agreement's text and the covenant of good faith and fair dealing implicit in each agreement. This Note concludes that a textualist reading of the credit agreements and applicable law informed by historical context may convince courts to reconsider sanctioning these exchanges. Ultimately, this Note contends that Article 9 of the Uniform Commercial Code (UCC), which governs the creation and enforcement of security interests, is powerless to prevent uptier exchanges in its current form—but historical interventions point to a path forward through amendment.

This Note proceeds in four parts. Part I introduces uptier exchange transactions, along with their potential advantageous and injurious features. Part II provides a taxonomy of pending litigation over uptier exchange transactions, analyzing legal issues ranging from nonparticipating lenders' standing to various breaches of contract. Part III situates uptier exchange transactions and the ongoing litigation in the broader context of applicable provisions of UCC Article 9. Part IV concludes by considering the normative implications of uptier exchange transactions for lenders' due-process rights and the role of courts and the New York State Legislature in addressing such innovations during market crises like the COVID-19 pandemic.

I. The Anatomy of Uptier Exchange Transactions: A Pandemic-Induced Revolution

This Part discusses the recent trend of uptier exchange transactions, in which distressed borrowers access new capital by amending their existing secured debt documents to permit new "superpriority" secured debt. Debt-restructuring amendments are nothing new in the borrower-lender world. Before the uptier exchange transaction, there was the drop-down priming transaction (known eponymously to lenders as being "J. Crewed"). In the drop-down priming transaction, the borrower uses a contractual "trap door" to transfer encumbered assets to unrestricted subsidiaries.[18] This mechanism grew out of J. Crew's exploitation of a loophole in an existing credit agreement. In December 2016, J. Crew, which possessed its domestic trademarks (IP) through a restricted subsidiary, used permitted investment covenants to transfer approximately $250 million in IP value to a foreign restricted subsidiary, which subsequently transferred the IP interests to an unrestricted subsidiary (an entity not subject to the covenants and restrictions for primary debt in the credit agreement).[19] By transferring the IP from a guarantor to an unrestricted subsidiary, J. Crew effectuated the IP's release from the collateral package. The unrestricted subsidiary then used those unencumbered assets to issue new debt,

18. *See, e.g.*, Kenneth Ayotte & Christina Scully, *J. Crew, Nine West, and the Complexities of Financial Distress*, 131 YALE L.J.F. 363, 368-69 (2021).

19. Jeff Norton et al., *COVID-19: Prime Time for Priming*, O'MELVENY (July 15, 2020), https://www.omm.com/resources/alerts-and-publications/alerts/covid-19-prime-time-for-priming [https://perma.cc/U2TV-RXLM].

refinancing existing payment-in-kind debt that was structurally subordinated to J. Crew's primary lenders. Following J. Crew's unforeseen move, the (formerly) primary lenders became structurally subordinated to the new debt issued by the unrestricted subsidiary.[20] Since J. Crew's "trap door" innovation first came into use in 2016, debtors and sophisticated lenders have continued to stretch the text of credit agreements, rendering these agreements essentially boundless in their flexibility for renegotiating debt.[21]

Enter the uptier exchange transaction. The instability induced by the pandemic brought necessity—a necessity for increased cashflow among cash-strapped corporations. And necessity breeds invention—an invention like the uptier exchange transaction. Uptier exchange transactions have evolved as an aggressive tactic for distressed borrowers to access new capital by amending their existing credit agreements to permit new "superpriority" secured debt.[22] Rather than removing collateral from the reach of existing creditors, the borrower in these transactions obtains consent from lenders holding a simple majority of outstanding loans and commitments (the "required lenders") to create new superpriority debt capacity under its existing credit agreement.

Standing in the way of this innovative would-be transaction are lenders' "sacred rights," which refer to the core economic terms that require the consent of all affected lenders to be amended.[23] In order to avoid running afoul of lenders' sacred rights,[24] the borrower crafts its amendment so as not to alter the credit agreement's *pro rata* sharing provisions. *Pro rata* sharing provisions,[25] which are a hallmark of lenders' sacred rights,[26] require that lenders must receive their *pro rata* share of any distribution of collateral proceeds, in accord with the face value of their loan ownership. Generally, to amend the *pro rata* sharing provisions (or any other sacred rights), the borrower must obtain the consent of all lenders or all affected lenders.[27] That is because sacred rights are

20. *Id.*

21. *See* Sunuu, *supra* note 8.

22. *See* Shana A. Elberg, Evan A. Hill & Catrina A. Shea, *Uptier Exchange Transactions Remain in Vogue, Notwithstanding Litigation Risk*, SKADDEN (Feb. 2, 2021), https://www.skadden.com/insights/publications/2021/02/uptier-exchange-transactions [https://perma.cc/TPA8-ERMF].

23. *See, e.g.*, LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 1:21-cv-03987, 2022 WL 953109, at *2 (S.D.N.Y. Mar. 29, 2022).

24. Sacred rights typically include "changes that extend the maturity, delay scheduled payments, reduce interest margins, change pro rata sharing of distributions and payments, release all or substantially all of the collateral or guarantors, or adversely affect the sacred rights." Jeff Norton et al., *Priming Transactions Update: Don't Sleep on Serta*, O'MELVENY (Dec. 10, 2020), https://www.omm.com/resources/alerts-and-publications/alerts/priming-transactions-update-dont-sleep-on-serta [https://perma.cc/3TAF-C8FK].

25. *Pro rata* literally means "in proportion" in Latin, and provides for the proportionate distribution of collateral proceeds among similarly situated lenders. *See, e.g.*, *LCM*, 2022 WL 953109, at *2.

26. Complaint at 4, 19, ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020 (N.Y. Sup. Ct. Oct. 9, 2020) [hereinafter ICG's Complaint].

27. *See* Elberg et al., *supra* note 22.

intended to protect minority lenders from the alteration of the core features of their investment by the majority. Apart from the sacred rights, every other provision of the credit agreement can usually be amended with only the consent of the required lenders. Increasingly, however, even the sacred rights are no longer truly sacred.[28] For example, Serta's credit agreement contains a carveout that "allows a First Lien Lender to assign its loans on a non-*pro rata* basis in certain limited circumstances through either a Dutch Auction or an open market purchase."[29]

Accordingly, in an attempt to circumvent the *pro rata* sharing provisions, a number of borrowers have used the undefined "open market purchase" language in their credit agreements to offer a subset of their first-lien lenders—but importantly, not all senior lenders—the opportunity to "roll up" participating lenders' existing loans into the superpriority tranche, exchanging their existing debt for superpriority debt.[30] The amended agreement then permits the borrower to set the relative priorities of the post-transaction tranches of debt. The end result is that nonparticipating lenders—who formerly held first-lien secured claims against the borrowers' assets—are subordinated not only to the new loans but also to a significant portion of previously *pari passu* debt.[31] And occasionally, as in the case of Serta, nonparticipating lenders are subordinated to junior debt.[32]

The uptier exchange transactions undertaken by TriMark and Boardriders added insult to injury for the subordinated lenders: in addition to exchanging their first-lien debt for super-senior debt, the superpriority lenders in both cases modified the original credit agreement to excise the vast majority of the affirmative and negative covenants, events of default, and other lender protections.[33] By stripping the original covenants and inserting new ones into the amended agreements, the borrowers have sought to ensure that they will not need the consent of nonparticipating lenders for any future covenant breaches under the existing loan documents.[34] Some amendments have also attempted to modify the open-market purchase provision so that it retroactively sanctions the

28. *See* Norton et al., *supra* note 24 (noting that "the trend in credit documentation has been to relax terms and make modifications more flexible," including minority lenders' sacred rights).

29. North Star's Complaint, *supra* note 17, at 13.

30. *See* Sokolova et al., *supra* note 11.

31. *Pari passu* literally means "on equal footing" in Latin and, as relevant here, refers to the equal rank and seniority of senior lenders' pre-transaction security interests.

32. *See* Elberg et al., *supra* note 22. For an illustration of the chain of reasoning involved in assessing uptier exchanges' permissibility under existing credit agreements, see *Serta's, Boardriders' Superpriority Uptier Exchanges Can Likely Be Replicated Under Most Existing Credit Facilities; Simple Drafting Changes Could Block Them in Future Facilities*, REORG (Sept. 22, 2020, 7:30 AM) [hereinafter *Uptier Exchanges Can Likely Be Replicated Under Most Existing Credit Facilities*], https://reorg.com/covenants-serta-simmons-covenant-analysis [https://perma.cc/CG2G-6MCH] (diagram using the suit against Serta as an example).

33. *See* Jeff Norton et al., *supra* note 24.

34. *See* Elberg et al., *supra* note 22.

contemplated roll-up transaction explicitly, by authorizing open-market purchases below or above par and for cashless considerations.[35]

The success of uptier exchange transactions has revealed that minority lenders may not be able to rely on *any* contractual protection not expressly covered by a sacred-rights provision, particularly in distressed situations.[36] In the absence of clear guidance from the courts, future majority lenders could well feel empowered to make aggressive amendments upending the rights and payment priorities of nonconsenting lenders.[37] To date, no court has blocked an uptier exchange transaction. And it is widely believed that the vast majority of credit agreements are flexible enough to enable uptier exchange transactions.[38] These agreements already contain many existing trap doors, loopholes, and exceptions that could permit a majority of lenders to subordinate the minority by amending an existing credit agreement to issue new superpriority debt and strip covenant protections from the minority lenders left in their wake.[39]

Because of the profound adverse consequences that uptier transactions threaten to wreak on subordinated lenders' debt, nonparticipating lenders have challenged these transactions on numerous grounds.[40] Nonparticipating lenders' claims include (1) that the superpriority lenders impaired the agreement's *pro rata* sharing rights through their amendments;[41] (2) that the superpriority lenders stripped them of collateral and covenant protections without their consent, in violation of the implied covenant of good faith and fair dealing;[42] and (3) that the borrower's principal equity owners tortiously interfered with the contract,[43] among others. In response, the borrowers and their superpriority lenders have primarily contended that (1) the amendments did not directly alter any of the lenders' "sacred rights"[44] and (2) the issuance of superpriority debt

35. *See id.*

36. *See* Norton et al., *supra* note 24.

37. *See* Jeff Norton et al., *Predatory Priming: How Can Investors Protect Their Priority?*, O'MELVENY (Sept. 9, 2020), https://www.omm.com/resources/alerts-and- publications/publications /predatory-priming-how-can-investors-protect-their-priority [https://perma.cc/3EXJ-FLXE].

38. *See* Sunuu, *supra* note 8.

39. *See id.*

40. Norton et al., *supra* note 37.

41. *See, e.g.*, North Star's Complaint, *supra* note 17, at 22; ICG's Complaint, *supra* note 26, at 45; Audax's Complaint, *supra* note 1, at 44; Complaint at 14, LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 1:21-cv-03987, 2022 WL 953109 (S.D.N.Y. Mar. 29, 2022) [hereinafter LCM's Complaint].

42. *See, e.g.*, North Star's Complaint, *supra* note 17, at 23; ICG's Complaint, *supra* note 26, at 48; Audax's Complaint, *supra* note 1, at 47; LCM's Complaint, *supra* note 41, at 15.

43. *See, e.g.*, North Star's Complaint, *supra* note 17, at 23; ICG's Complaint, *supra* note 26, at 50; Audax's Complaint, *supra* note 1, at 48.

44. *See, e.g.*, Boardriders, Inc.'s MTD, *supra* note 10, at 14; Trimark's Memorandum of Law in Support of Its Motion to Dismiss the Complaint at 15, Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541 (N.Y. Sup. Ct. Jan. 8, 2021) [hereinafter TriMark's MTD].

and the stripping of covenants were expressly permitted under the terms of the existing credit agreements.[45]

Uptier exchange transactions have the potential to serve as a lifeline to distressed businesses by allowing them to acquire much-needed new capital. In some cases, these transactions may enable a borrower to deleverage through discounted exchanges. Uptier exchange transactions also benefit participating lenders, who receive enhanced priority and premiums on exchanged loans, while strengthening their position in any future financing or restructuring decisions.[46] The New York trial court in *Serta* acknowledged these benefits when it refused to enjoin that transaction. It reasoned that "the harm to defendants in delaying this deal far exceeds that to plaintiffs" because "the transaction will provide Serta with more liquidity, less debt and flexibility for additional decreases in debt."[47] The court concluded that it could not "overlook the importance of such factors in light of the COVID shutdown and the eventual reopening of the world economy."[48]

Notwithstanding the advantages for borrowers and especially superpriority lenders, uptier exchange transactions can grievously injure nonparticipating lenders, who are excluded without notice or consent from the transaction. These lenders are left with "deeply subordinated loans trading at steep discounts to pre-transaction value."[49] Their loans are more likely to be undersecured in a future restructuring and are potentially subject to cramdown in a future chapter 11 plan.[50] Their loans are also exposed to potential credit-rating reductions.[51] These exchanges thus illustrate the lengths to which companies (and private equity sponsors) will go to stay afloat (and recoup their investment) when under duress.[52] The unfortunate reality is that uptier exchanges present a zero-sum game: an S&P Global study found that losses to nonparticipating lenders came directly from the increased recovery prospects that accrued to participating lenders.[53] In other words, the recovery/no-recovery line shifted from a first-lien/second-lien split to a participating lender/nonparticipating lender split.[54] For instance, Serta and its superpriority lenders recouped $262 million from the roll-up exchange, all of which came directly from the severely diminished recovery nonparticipating lenders will now (not) collect.[55] Although previously *pari passu* before the amendment,

45. *See, e.g.*, Boardriders, Inc.'s MTD, *supra* note 10, at 5; TriMark's MTD, *supra* note 44, at 11.

46. *See* Elberg et al., *supra* note 22; Norton et al., *supra* note 24.

47. N. Star Debt Holdings, L.P. v. Serta Simmons Bedding, LLC, No. 652243/2020, 2020 WL 3411267, at *6 (N.Y. Sup. Ct. June 20, 2020).

48. *Id.*

49. Elberg et al., *supra* note 22.

50. *See id.*

51. *Id.*

52. *See* Sununu, *supra* note 8.

53. *See id.*

54. *See id.*

55. *See id.*

nonparticipating lenders have been left holding the bag and stand to gain next to nothing from the borrower in bankruptcy.

II. Litigating Uptier Exchange Transactions: A Taxonomy

The four primary cases involving three debtors that have engaged in uptier exchange transactions—Serta, Boardriders, and TriMark—are all in different stages of litigation as of this writing. At the center of each case sits a debtor in the throes of financial distress, seeking additional liquidity during the pandemic. These cases share factual similarities but diverge in important ways. Most importantly, North Star and its accompanying nonparticipating lenders were offered the opportunity to participate in the uptier exchange transaction, but their proposal failed to satisfy Serta[56]—in other words, those subordinated lenders did not come to the litigation with clean hands. In the suits brought by Audax, ICG, and LCM, however, the subordinated lenders all allege that they were given no opportunity to participate; indeed, the debtors and participating lenders actively sought to keep the subordinated lenders in the dark so they could close what they knew would be a heavily contested transaction.

North Star's litigation in state court against Serta has halted, at least for now. After North Star's motion for a preliminary injunction enjoining Serta's uptier exchange transaction was denied in June 2020,[57] the plaintiffs filed a motion to discontinue their action without prejudice, pursuant to CPLR 3217(b).[58] Over the objections of Serta and the superpriority lenders, the court granted North Star's motion, permitting them to file a new action in the future if they so choose.[59] Meanwhile, LCM have enjoyed temporary, but meaningful, success in their diversity suit in federal court against Serta. In March 2022, Judge Failla denied Serta's motion to dismiss in its entirety, allowing the subordinated lenders to continue to pursue their claims against Serta for breach of contract and breach of the implied covenant of good faith and fair dealing.[60]

The *TriMark* court granted defendants' motion to dismiss on three counts (the claims for breach of the implied covenant of good faith and fair dealing, tortious interference with contract, and violation of the Uniform Voidable Transactions Act (UVTA)),[61] but allowed Audax's complaint to move forward

56. *See* N. Star Debt Holdings, L.P. v. Serta Simmons Bedding, LLC, No. 652243/2020, 2020 WL 3411267, at *2 (N.Y. Sup. Ct. June 20, 2020).

57. *See id.*

58. *See* Plaintiffs' Memorandum of Law in Support of Their Motion to Discontinue This Action Without Prejudice Pursuant to CPLR 3217(b), *N. Star Debt Holdings*, No. 652243/2020, 2020 WL 3411267 (N.Y. Sup. Ct. July 10, 2020).

59. *See N. Star Debt Holdings*, No. 652243/2020, at 33 (N.Y. Sup. Ct. Jan. 12, 2021) (granting plaintiffs' motion largely because "[t]he case was initiated to stop a transaction," "[s]o the timing was not actually within the plaintiffs' hands in this case").

60. *See* LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 1:21-cv-03987, 2022 WL 953109, at *16 (S.D.N.Y. Mar. 29, 2022).

61. This Note does not discuss the nonparticipating lenders' UVTA claims in depth because these claims have been dismissed outright by the courts on the grounds of their inapplicability. The New

on three other counts (two claims for declaratory relief and one for breach of contract).[62] Nonparticipating lenders later filed a supplemental complaint,[63] to which TriMark[64] and the participating lender defendants[65] responded. In March 2022, the case was resolved out of court through an undisclosed settlement, in which parties on both sides stipulated to discontinuance with prejudice.[66] Although the exact terms of the settlement remain confidential, Trimark has disclosed that the nonparticipating lenders have agreed to

> exchange . . . all outstanding First Lien Term Debt on a dollar-for-dollar basis for Tranche B Loans pursuant to the company's Super Senior Credit Agreement. Tranche A Loans outstanding under the Company's Super Senior Credit Agreement will retain their position in the Company's capital structure, senior to the Tranche B Loans.[67]

Finally, after seeking additional briefing in the wake of the *TriMark* decision,[68] the court in *Boardriders* issued a promising decision for nonparticipating lenders. It largely denied the defendants' motion to dismiss, granting it in part only as to the dismissal of the nonparticipating lenders' claim of tortious interference with contract.[69] In their briefing, the nonparticipating lenders pointed the court's attention to Judge Failla's decision in the federal

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York UVTA provides that a fraudulent transfer claim "is governed by the local law of the jurisdiction in which the debtor is located," and, where the debtor has more than one place of business, it "is located at its chief executive office." NY UVTA §§ 279(b), 279(a)(3). Because the "chief executive office" of Boardriders is in California and TriMark is headquartered in Massachusetts, the applicable local law in each case, respectively, is the law of California and Massachusetts, not New York's law. *See* Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *15 (N.Y. Sup. Ct. Aug. 16, 2021); Boardriders, Inc.'s MTD, *supra* note 10, at 21-22; Trimark's MTD, *supra* note 44, at 3.

62. *See* Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *2 (N.Y. Sup. Ct. Aug. 16, 2021).

63. Supplemental Complaint, *Audax*, No. 565123/2020 (N.Y. Sup. Ct. Aug. 27, 2021).

64. Answer and Affirmative Defenses of TMK Hawk Parent, Corp., *Audax*, No. 565123/2020 (N.Y. Sup. Ct. Sept. 17, 2021).

65. Answer, *Audax*, No. 565123/2020 (N.Y. Sup. Ct. Sept. 17, 2021).

66. *See* Joint Stipulation and Order of Stay, *Audax*, No. 565123/2020 (N.Y. Sup. Ct. Jan. 11, 2022).

67. *TriMark's Settlement with Lenders Could Pave the Way for Next Round of Attack on Lender Protections*, REORG (Jan. 12, 2022, 3:59 PM), https://reorg.com/trimark-settlement [https://perma.cc/A338-ZKWF].

68. *See, e.g.*, Plaintiffs' Supplemental Memorandum of Law in Support of Its Opposition to Defendants' Motions to Dismiss Addressing *TriMark*, ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020 (N.Y. Sup. Ct. Sept. 17, 2021) [hereinafter ICG's MOL Addressing *TriMark*]; Letter from Jonathan E. Pickhardt, Att'y for Defendants, Oaktree Capital Management, L.P., Oaktree Fund GP, LLC & Oaktree Fund GP I, L.P., to Hon. Andrea Masley, Com. Div., N.Y. Sup. Ct. (Sept. 17, 2021) (on file with author) [hereinafter Letter from Jonathan E. Pickhardt].

69. *See* ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020, 2022 WL 10085886, at *10 (N.Y. Sup. Ct. Oct. 17, 2022).

Serta case as supplemental authority bolstering their case against Boardriders and its participating lenders.[70]

This Part analyzes the claims that subordinated lenders have brought against the borrowers and superpriority lenders who initiated uptier exchange transactions. These claims include the invalidity of the amended agreements' "no-action" standing provisions,[71] the violation of the agreements' *pro rata* and open-market purchase provisions,[72] breach of the implied covenant of good faith and fair dealing,[73] and private-equity sponsors' tortious interference with the credit agreements.[74] In addition to examining the nonparticipating lenders' allegations as to each claim, this Part examines the debtors' and defendant lenders' responses and the courts' developing treatment of existing claims, and forecasts which claims may gain greater purchase in the courts moving forward.

A. Subordination Through Standing

Before a subordinated lender can have their claims heard on the merits, they must first establish standing.[75] Boardriders and TriMark (and Serta in its original agreement) each inserted no-action clauses into their amended credit agreements that threatened to further subordinate the nonparticipating lenders—by preventing them from accessing the courthouse altogether. Specifically, both credit agreements in *Boardriders* and *TriMark* were amended by the superpriority lenders to read: "No Second Amendment Non-Consenting Lender may take or institute any actions or proceedings, judicial or otherwise . . . other than through the Administrative Agent at the direction of the Required Lenders."[76]

The lack-of-standing defenses asserted by Boardriders and TriMark—predicated on the agreements' no-action clauses—are dual-pronged. First, the borrowers contend that by bringing this action directly, the nonparticipating lenders failed to comply with the no-action provision in the amended credit agreement, which requires that lenders must "act collectively and exclusively through the Agent in order to assert any claim against [the borrower] related to the Credit Agreement."[77] The amended agreement also imposed an additional,

70. Letter from Israel Dahan, Att'y for Plaintiffs, to Hon. Andrea Masley, Com. Div., N.Y. Sup. Ct. (Apr. 7, 2022) (on file with author).

71. *See infra* Section II.A.

72. *See infra* Section II.B.

73. *See infra* Section II.C.

74. *See infra* Section II.D.

75. Importantly, though, under New York law "[t]he burden is on the moving defendant to establish, prima facie, the plaintiff's lack of standing as a matter of law." Salem v. Fischman, 110 N.Y.S.3d 221, 221 (N.Y. Sup. Ct. 2018).

76. ICG's MOL Addressing *TriMark*, *supra* note 68, at 3.

77. Boardriders, Inc.'s MTD, *supra* note 10, at 7; *see also* TriMark's MTD, *supra* note 44, at 9 ("The No-Action Provision provides that Lenders *must* act collectively through the Agent when asserting claims or seeking remedies under the Amended Credit Agreement.").

harsher condition: lenders must "post a [substantial] cash indemnity before directing the Agent to commence any action with respect to the Liquidity Transaction."[78] And because neither the no-action provision nor the indemnity obligations fell under lenders' "sacred rights," the borrowers assert that "both are therefore subject to amendment with Required Lender consent."[79]

Second, even if the courts were to find the amended no-action provisions inapplicable, Boardriders and TriMark argue that the nonparticipating lenders were still required to comply with the original credit agreement's no-action provision, which, although narrower, "vested only the Agent with the power to bring an action."[80] Thus, because (1) the nonparticipating lenders' claims all pertain to the credit agreement or the liquidity transaction and (2) the plaintiffs did not direct their claims through the Agent as explicitly required or post the unwieldy cash indemnity, the borrowers assert that the plaintiffs' claims are therefore subject to the no-action provision and must be thrown out for lack of standing.[81] The borrowers' motions to dismiss conclude by underscoring the textual rule against superfluity[82] and "the well-recognized deference to collective action schemes in syndicated loan agreements under New York law."[83] The borrowers also decry the nonparticipating lenders' "feeble effort to excuse their failure to meet clear contractual obligations" through their reliance on allegations that the defendants acted in bad faith.[84]

What goes unmentioned in the borrowers' motions to dismiss, of course, is that in both instances, the Administrative Agent—the actor solely authorized to bring action under the amended agreement—"abruptly resigned" before the uptier exchange transaction took place amid litigation risk from the lenders that were not invited to join the non-*pro rata* recapitalization.[85] Immediately following the Agent's resignation, the borrowers and their private-equity sponsors handpicked the Agent's replacement, Alter Domus—in both cases, without the knowledge or consent of the nonparticipating lenders.[86]

The *TriMark*, *Serta*, and *Boardriders* courts sympathized with the plaintiffs' plights on this point, and all rejected the defendants' lack-of-standing

78. Boardriders, Inc.'s MTD, *supra* note 10, at 11; *see also* TriMark's MTD, *supra* note 44, at 6 ("Section 9.03(f), which requires Lenders to post a cash indemnity with the Agent before asserting a claim concerning the Liquidity Transaction, was also added.").

79. TriMark's MTD, *supra* note 44, at 10.

80. *Id.* at 10 n.4.

81. Boardriders, Inc.'s MTD, *supra* note 10, at 10; TriMark's MTD, *supra* note 44, at 9.

82. Boardriders, Inc.'s MTD, *supra* note 10, at 12 n.11 ("Permitting Plaintiffs to bring this action without complying with Sections 12.23 and 12.01(c) would render those provisions superfluous."); *see also* TriMark's MTD, *supra* note 44, at 11 n.5 ("Permitting Plaintiffs to bring this action without complying with Sections 9.03(f) and 9.18 would render those provisions superfluous.").

83. Boardriders, Inc.'s MTD, *supra* note 10, at 12 n.11; *see also* TriMark's MTD, *supra* note 44, at 11 n.5 (same).

84. Boardriders, Inc.'s MTD, *supra* note 10, at 11-12.

85. ICG's Complaint, *supra* note 26, at 6, 28.

86. *Id.*

defenses.[87] These courts' decisions on standing have revealed the grave due-process implications inherent in the amended no-action provision that the borrowers and superpriority lenders sought to implement. The *TriMark* court, for instance, recognized the aberrational nature of its ruling under New York state law; in its own words, it noted that "[t]his is not . . . a typical case."[88] The court brushed aside the defendants' appeal to the no-action provision, even though New York Court of Appeals precedent almost uniformly requires courts to respect and apply such provisions.[89] The court distinguished this case in emphatic terms: the no-action clause at issue here was allegedly "purpose-built to prevent *these Plaintiffs* from suing *these Defendants* in connection with *this transaction*—a preemptive self-pardon, of sorts."[90]

In refusing to dismiss the plaintiffs' claims on standing grounds, the *TriMark* court also cited concern for the due-process rights of the nonconsenting lenders. First, the amended no-action provision established a cash indemnity with *no* upper limit, set by "an entity hand-picked by the Lender Defendants" with "sole discretion" over its sum total.[91] But the plaintiffs, whose consent for this amended provision was not sought, maintained that they typically do not have the liquidity or even the legal authority to front an indemnity of such magnitude, which rendered that litigation route futile.[92] Second, the court examined the underlying intent animating TriMark's amended no-action provision. No-action provisions are generally enforceable "because they reflect an *ex ante agreement* to sacrifice certain individual rights for the 'salutary purpose' of benefiting the venture as a whole."[93] But the subordinated lenders never consented to the amended agreement. And the clause's prohibition on challenging that amendment

87. *See* Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *7-9 (N.Y. Sup. Ct. Aug. 16, 2021); ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020, 2022 WL 10085886, at *6 (N.Y. Sup. Ct. Oct. 17, 2022); LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 1:21-cv-03987, 2022 WL 953109, at *14 (S.D.N.Y. Mar. 29, 2022).

88. *Audax*, 2021 WL 3671541, at *7.

89. *Id.* (quoting Quadrant Structured Prods. Co., Ltd. v. Vertin, 23 N.Y.3d 549, 560 (2014)) (cautioning "that 'no-action clauses are to be *construed strictly* and thus *read narrowly*'"). Indeed, the court refused to apply the no-action provision against TriMark's subordinated lenders even though no-action clauses "typically are 'not unenforceable as violative of public policy, given [their] salutary purpose of preventing undue expense to certificate holders and inconvenience to the investment vehicle in general, and are 'not unconscionable.'" *Id.*

90. *Id.*; *see also ICG*, 2022 WL 10085886, at *6 (finding that *Trimark* presented "an analogous situation" and concluding that "plaintiffs have sufficiently alleged that [the no-action clause] was amended in bad faith to prevent plaintiffs from suing to enforce their rights under the Credit Agreement").

91. *Audax*, 2021 WL 3671541, at *7.

92. *Id.*

93. *Id.* at *8 (citing Sass v. New Yorker Towers, Ltd., 258 N.Y.S.2d 765, 767-68 (App. Div. 1965)).

certainly did not redound to their shared benefit; instead, it profited only the defendants.[94]

The court also rejected TriMark's contention that the "substantially narrower" *original* agreement's no-action clause similarly barred the nonparticipating lenders' complaint.[95] It noted that the original no-action provision only prevented lenders from individually "realiz[ing] upon any of the Collateral or to enforce any Guarantee of the Secured Obligations."[96] Because the nonparticipating lenders had not pursued such actions through the claims in their complaint, they did not run afoul of the original no-action provision. Moreover, it was evident from the amended agreement that the lender defendants *knew* how to draft a broad provision prohibiting the pursuit of any claims "when that was their intention"—but they had not done so in the original agreement.[97]

The Southern District of New York also found, on different grounds, that it was "clear that [Serta's] no-action clause does not strip Plaintiffs of standing to bring the[ir] claims."[98] "Even under a strict construction of [Serta's] no-action clause," the court held that the clause was inapplicable because the nonparticipating lenders were "not demanding payment on their loans or seeking to enforce any guaranty under the Agreement," as was prohibited by the clause.[99] Instead, the nonparticipating lenders were simply "seek[ing] damages and injunctive relief stemming from an allegedly improper transaction."[100] By closely parsing the text of the no-action clause, the court foreclosed Serta's dubious defense.

These courts' standing decisions are contestable, though certainly defensible, as a matter of law. Importantly, the courts arrived at the just and *equitable* conclusion, and were thereby able to reach the merits of the plaintiffs' complaints. No-action clauses are common in these types of agreements, but they are typically included to coordinate litigation brought by a multiplicity of investors against the debtor in the event of a default;[101] they are not designed to enable majority lenders to eviscerate the rights of minority lenders. Preventing the nonparticipating lenders from challenging a transaction to which they did not consent, on the basis of a litigation prohibition to which

94. *See id.* ("Regardless of the ultimate merit of Plaintiffs' claims, it cannot seriously be questioned—at least on this motion to dismiss—that Defendants' amendment of the no-action provisions was an act of *self*-interest, not a consensual decision to promote the interest of the 'investment vehicle in general.' And it certainly was not one to which the other First Lien Lenders willingly signed on.").

95. *Id.*

96. *Id.* at *8 n.4.

97. *Id.*

98. LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 1:21-cv-03987, 2022 WL 953109, at *14 (S.D.N.Y. Mar. 29, 2022).

99. *Id.*

100. *Id.*

101. *See, e.g.*, COMMERCIAL LITIGATION IN NEW YORK STATE COURTS § 113:39 (5th ed.) (noting that the no-action clause "aims to achieve 'collective action,' barring claims by individual holders that are not for the common benefit of all investors").

they *also* did not consent, would shut the courtroom door on the subordinated lenders' only avenue for redress. The courts recognized that this would produce an unjust outcome. Much like the Trust Indenture Act of 1939 (TIA)[102] sought to correct for the historical exploitation of bondholders by debtors and indenture trustees,[103] courts have also identified analogous concerns presented by debtors and majority lenders in uptier exchange transactions.

B. The Breach-of-Contract Claims: A Close Reading of the Text in Context

Significantly, each of the nonparticipating lenders' breach-of-contract claims—apart from North Star's—survived the respective defendants' motions to dismiss. That is because the plaintiffs were able to persuade the courts that sufficient ambiguity exists in the original and amended credit agreements to warrant careful consideration upon further discovery and briefing.[104]

In cases, as here, involving extensive textual analysis of parties' contractual agreements, New York law provides that a complaint should only be dismissed when the agreement "unambiguously contradicts the allegations supporting a [plaintiff's] cause of action."[105] An agreement is unambiguous if "the language it uses has 'a definite and precise meaning, unattended by danger of misconception in the purport of the [agreement] itself, and concerning which there is no reasonable basis for a difference of opinion.'"[106] Conversely, "[t]o be found ambiguous, a contract must be susceptible of more than one commercially reasonable interpretation," which can only be ascertained "by examining 'the entire contract and consider[ing] the relation of the parties and the circumstances under which it was executed,' with the wording to be considered 'in the light of the obligation as a whole and the intention of the parties as manifested thereby.'"[107]

1. Consensual *Pro Rata* Sharing as a Constitutive Sacred Right

Nonparticipating lenders in these cases have argued that various elements of uptier transactions violate the *pro rata* sharing provisions of existing credit agreements, including lender defendants' amendments to the agreement to (1)

102. Pub. L. No. 76-253, 53 Stat. 1149 (codified as amended at 15 U.S.C. §§ 77aaa-77bbbb).

103. *See* 15 U.S.C. § 77bbb.

104. *See* Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *11-13 (N.Y. Sup. Ct. Aug. 16, 2021); ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020, 2022 WL 10085886, at *7-9 (N.Y. Sup. Ct. Oct. 17, 2022); LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 1:21-cv-03987, 2022 WL 953109, at *6-9 (S.D.N.Y. Mar. 29, 2022).

105. 150 Broadway N.Y. Assocs., L.P. v. Bodner, 14 A.D.3d 1, 5 (N.Y. App. Div. 2004).

106. Greenfield v. Philles Records, Inc., 98 N.Y.2d 562, 569-70 (2002) (quoting Breed v. Ins. Co. of N. Am., 46 N.Y.2d 351, 355 (1978)).

107. Perella Weinberg Partners LLC v. Kramer, 153 A.D.3d 443, 446 (N.Y. App. Div. 2017) (quoting Riverside S. Plan. Corp. v. CRP/Extell Riverside, L.P., 60 A.D.3d 61, 66-67 (N.Y. App. Div. 2008), *aff'd* 13 N.Y.3d 393 (2009)).

permit new superpriority tranches of debt, (2) subordinate existing *pari passu* loans, (3) eviscerate the principal value of existing loans through the roll-up of existing loans into superpriority loans, and (4) authorize intercreditor agreements that radically alter post-transaction priorities.[108] Accordingly, nonparticipating lenders argue that these amendments strike at the heart of the agreement's sacred rights and thus require the consent of *every* affected lender, not merely the required lenders.[109]

Nonparticipating lenders have also argued that uptier exchange transactions effectively release all or substantially all of the collateral securing the existing loans and all or substantially all of the value of the guarantees backing the existing loans.[110] This challenge hinges on the factual assertion that the value of the collateral and guarantees becomes less than the value of the new superpriority loans upon distribution, placing the nonparticipating subordinated loans in essentially an unsecured position with meaningless guarantees.[111] Nonparticipating lenders have sought to inject ambiguity into the interpretation of the *pro rata* sacred rights, contending that uptier exchange transactions, with their attendant subordinating ramifications, must receive the consent of every lender, even if the transaction does not technically release collateral or guarantees.[112]

The New York courts in *Boardriders* and *TriMark*, but not the federal court in *Serta*, found that the plaintiffs had plausibly identified breaches of the agreements' sacred-rights provisions. In *TriMark*, the court held that the plaintiffs "stated a viable claim that the Amended Agreement was invalid because it impinged upon Plaintiffs' 'sacred rights' under section 9.02(b)(i) of the Original Agreement without their consent."[113] Audax alleged that Section 9.02(b)(i) of the original agreement provided that TriMark and the required lenders could only amend the agreement "through 'an agreement or agreements,' which could not, 'without the written consent of each Lender directly and adversely affected thereby,' reduce the principal amount of any loan, or waive, amend, or modify Section 4.02 of the Collateral Agreement," which governed the distribution of proceeds of the collateral.[114] Thus, treating the uptier exchange transaction *as a whole* to mean an "agreement or agreements," the transaction arguably violated provision 9.02(b)(i)(D) of the agreement, which provides that "no such agreement shall . . . without the written consent of each Lender directly and adversely affected thereby: . . . (D) waive, amend, or modify (i) Section 7.03 or (ii) Section 4.02 . . . in a manner

108. *See* Elberg et al., *supra* note 22.

109. *See id.*

110. *See, e.g.*, North Star's Complaint, *supra* note 17, at 17.

111. *See* Elberg et al., *supra* note 22.

112. *See, e.g.*, North Star's Complaint, *supra* note 17, at 17.

113. Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *11 (N.Y. Sup. Ct. Aug. 16, 2021).

114. Audax's Complaint, *supra* note 1, at 41.

that would by its terms alter the order of application of proceeds."[115] Because the nonparticipating lenders' liens were subordinated and thereby clearly altered in terms of the order of their proceeds, Audax raised a cognizable claim that the agreement did not "unambiguously contradict[]" the plaintiffs' allegations.[116]

Likewise, in *Boardriders*, the court found unavailing the defendants' claims that the amended agreement did not explicitly amend the *pro rata* distribution provisions of the original agreement. The court conceded that "there is nothing in the sacred rights provision that expressly prohibits the subordination of any lenders' liens," but refused to adopt the debtor's "narrow reading of the sacred rights provision" because it "would essentially vitiate the [agreement's] equal repayment provisions," in contravention of "the context of the entire contract."[117] The court also found that the plaintiffs had sufficiently posited an alternative, reasonable interpretation of Section 12.12(a)(i), which "does not specify whose term loans may not be reduced or forgiven."[118] The defendants argued that the transaction "[did] not implicate any sacred right" because the "plaintiff[s] retain[] the same principal amount of term loans at the same interest rate with the same maturity date they held prior" to the transaction.[119] But as the court correctly concluded, the plaintiffs' contention—that the transaction "extinguished the participating lenders and Oaktree lenders' initial $321 million worth of *pari passu* debt, reducing the principal amount of their debt to zero"—is an equally reasonable, if not more reasonable, interpretation, particularly in light of the economic reality of the transaction.[120]

The federal *Serta* court, by contrast, eschewed a holistic reading of the contract in favor of the narrower reading proposed by Serta. The court held that "[t]he plain terms of Section 2.18 of the Agreement make clear that the first-lien lenders' rights to *pro rata* payments apply only to debt within the same 'Class,'" meaning "first-lien lenders vis-à-vis other first-lien lenders."[121] Setting aside the plaintiffs' allegation that "[a] broader reading of Section 9.02(b)(A)(6) . . . would allow [Serta] to collude with a bare majority of lenders to alter nearly any provision of the Agreement, thus rendering the unanimous-consent requirement toothless," the court concluded that Section 9.02(b)(A)(6) does not protect against antisubordination as a sacred right and therefore does not require unanimous lender consent.[122] The diverging outcomes of the

115. *Audax*, 2021 WL 3671541, at *11.

116. 150 Broadway N.Y. Assocs., L.P. v. Bodner, 14 A.D.3d 1, 5 (N.Y. App. Div. 2004).

117. ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020, 2022 WL 10085886, at *7 (N.Y. Sup. Ct. Oct. 17, 2022).

118. *Id.* at *8.

119. *Id.*

120. *Id.*

121. LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 1:21-cv-03987, 2022 WL 953109, at *10 (S.D.N.Y. Mar. 29, 2022).

122. *Id.*

Boardriders and *Serta* decisions on the *pro rata* sharing provision underscore the critical difference that a *contextual* reading of the contracts can make.

2. The Exception: Open-Market Purchases

In their complaints, the nonparticipating lenders contend that the original agreements only permitted lenders to assign first-lien debt to the debtor under two exceptional circumstances—subject to a Dutch auction or an open-market purchase.[123] The subordinated lenders seek the invalidation of each uptier exchange transaction on the grounds that it did not constitute an open-market purchase because "it was not negotiated at arm's-length, was not at the prevailing market price (which should approximate fair market value), and was a debt exchange and not a purchase for cash."[124] The debtor's responses, though, are straightforward: because the open-market provision was not a sacred right, it was capable of amendment by only the required lenders, without the consent of all lenders.[125] Although the *TriMark* court did not find the nonparticipating lenders' open-market purchase argument availing, the *Boardriders* and federal *Serta* courts did, and the groundwork for future challenges to uptier exchange transactions has been laid.[126]

Nonparticipating lenders have challenged the non-*pro rata* open-market purchase transactions that have been used to roll up participating lenders' existing debt into superpriority loans on several grounds. They have maintained that uptier exchange transactions are improper because the open-market purchases (1) do not retire existing loans, but instead improperly swap existing loans for new loans—and by analogy, other credit agreement provisions require these kinds of cashless exchanges to be offered to all lenders on a *pari passu* basis;[127] (2) constitute "prepayments" that must be offered to all lenders;[128] (3) do not occasion the purchase of debt at market value, but rather the purchase (typically at par) of loans at far above their market value;[129] (4) do not actually

123. Audax's Complaint, *supra* note 1, at 46-47; ICG's Complaint, *supra* note 26, at 4, 5-6, 25-27; LCM's Complaint, *supra* note 41, at 2, 11. Dutch auctions and open-market purchases provide borrowers with a simple method for purchasing outstanding term loans at below-par prices, although the purchases need not be made below par. *See Uptier Exchanges Can Likely Be Replicated Under Most Existing Credit Facilities*, *supra* note 32. The key difference between Dutch auctions and open-market purchases is that Dutch auctions require borrowers to make offers to *all* lenders to purchase term loans on a *pro rata* basis, while open-market purchases can often be made on a non-*pro rata* basis without requiring the offer of term loans to all lenders. *Id*.

124. Audax's Complaint, *supra* note 1, at 47.

125. TriMark's MTD, *supra* note 44, at 16.

126. *See* ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020, 2022 WL 10085886, at *8-9 (N.Y. Sup. Ct. Oct. 17, 2022); *LCM*, 2022 WL 953109, at *7-9. *But see* Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *10-11 (N.Y. Sup. Ct. Aug. 16, 2021).

127. *See* Elberg et al., *supra* note 22.

128. *See* ICG's Complaint, *supra* note 26, at 19.

129. *See* Audax's Complaint, *supra* note 1, at 34.

take place in an open market, but are improperly negotiated privately;[130] and (5) are merely one component of broader integrated transactions, as opposed to true, standalone transactions.[131]

Significantly, virtually no existing credit agreements define "open-market purchases" or strictly provide for their regulation in any way.[132] One author defines an "open-market purchase" as "the typical unpublicized acquisition of shares at the current market price through a stock exchange or other public market."[133] But that definition is strained in its application to uptier exchange transactions. With no clear guidance from the contract on how to assess the validity of these purchases (e.g., are they meant to include cashless, debt-for-debt exchanges?), the *Boardriders* and federal *Serta* courts properly permitted the plaintiffs' claims to proceed.

To begin, the *Boardriders* and *Serta* courts acknowledged that the agreements do not define "open market purchase." Accordingly, both courts looked to *Black's Law Dictionary*, which defines an "open market" as "[a] market in which any buyer or seller may trade and in which prices and product availability are determined by free competition—Also termed free market."[134] And "[o]n a plain reading of the term," the courts determined that the transactions "did not take place in what is conventionally understood as an 'open market.'"[135] On the contrary, the transactions' alleged secrecy, lack of free competition, and sub-market-value exchanges contravene traditional understandings of what constitutes an open market.[136] The courts recognized that the distinction implicitly drawn by the agreements between the Dutch auction and the open-market purchase—i.e., the contracts specify that Dutch auctions, but not open-market purchases, are to be "open to all Lenders"—cuts in favor of the defendants.[137] But because the term "open market" "is undefined and the contractual language is reasonably susceptible of more than one interpretation," the courts rightly concluded that the agreements are ambiguous, and thus that the plaintiffs' claims could not be dismissed.[138]

Although the ambiguity inherent in the contractual language ultimately doomed the defendants' motions to dismiss the plaintiffs' breach-of-contract

130. *See id.* at 9-10.

131. ICG's Complaint, *supra* note 26, at 6.

132. *See Uptier Exchanges Can Likely Be Replicated Under Most Existing Credit Facilities*, *supra* note 32 ("[W]hereas credit agreements typically include a detailed schedule of how Dutch auctions should be conducted, they almost never include processes or requirements governing how open-market purchases should be.").

133. David A. Greenblatt, Note, *Post-Tender Offer Purchases: Rebalancing the Scales*, 65 TEX. L. REV. 185, 200 (1986).

134. *Open Market*, BLACK'S LAW DICTIONARY (11th ed. 2019).

135. LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 1:21-cv-03987, 2022 WL 953109, at *8 (S.D.N.Y. Mar. 29, 2022).

136. *See id.*; ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020, 2022 WL 10085886, at *8-9 (N.Y. Sup. Ct. Oct. 17, 2022).

137. *LCM*, 2022 WL 953109, at *8 & n.12; *see ICG*, 2022 WL 10085886, at *8-9.

138. *ICG*, 2022 WL 10085886, at *9.

claims, this ambiguity operates as a feature, not a bug, of the debtor's approach to drafting credit agreements. For it is in the interstices of the complex, malleable framework constructed by these agreements that the flexibility for spawning uptier exchange transactions can be found. Accordingly, as explored *infra* Section IV.C.1, if lenders were to pursue tighter drafting strategies, they would diminish the likelihood of facing subordination at the hands of uptier exchange transactions.

C. The Implied Covenant of Good Faith and Fair Dealing

Inherent in every contract is the requirement that parties engage in good faith and fair dealing with one another. In other words, the implied covenant "embraces a pledge that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract."[139] However, under New York law "[t]he duty of good faith and fair dealing does not imply obligations inconsistent with contractual provisions,"[140] nor can it "impose obligations . . . beyond the express terms of the parties' agreement."[141] And "[w]here a good faith claim arises from the same facts and seeks the same damages as a breach of contract claim, it should be dismissed" as duplicative.[142] More broadly, "an implied covenant claim 'may not be used as a substitute for a nonviable claim of breach of contract.'"[143] Rather, an implied-covenant claim "may be brought . . . only where one party's conduct, though not breaching the terms of the contract in a technical sense, nonetheless deprived the other party of the benefit of its bargain."[144]

Despite New York courts' narrowing of the implied covenant's applicability, the implied covenant of good faith and fair dealing remains a malleable litigation strategy. It calls upon the court's sense of justice and equity to remedy bad-faith actions taken by parties to a contract. Nonparticipating lenders in all three cases alleged that the uptier exchange transaction at issue breached the implied covenant of good faith and fair dealing because the

139. Moran v. Erk, 11 N.Y.3d 452, 456 (2008) (internal quotation marks and citation omitted); *see* Dalton v. Educ. Testing Serv., 87 N.Y.2d 384, 389-90 (1995).

140. Gottwald v. Sebert, 148 N.Y.S.3d 37, 47 (App. Div. 2021).

141. Darabont v. AMC Network Ent. LLC, 141 N.Y.S.3d 856, 857 (App. Div. 2021).

142. Mill Fin., LLC v. Gillett, 992 N.Y.S.2d 20, 24 (App. Div. 2014) (citation omitted); *see also id.* at 25 (dismissing a good-faith claim does not require that "[t]he conduct alleged in the two causes of action" be "identical in every respect," but merely that the claims "arise from the same operative facts"); MBIA Ins. Corp. v. Merrill Lynch, 916 N.Y.S.2d 54, 55 (App. Div. 2011) (holding that a good-faith-and-fair-dealing claim will not succeed where it is "intrinsically tied to the damages allegedly resulting from a breach of the contract").

143. Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *13 (N.Y. Sup. Ct. Aug. 16, 2021) (quoting StarVest Partners II, L.P. v. Emportal, Inc., 957 N.Y.S.2d 93, 96 (App. Div. 2012)).

144. CSI Inv. Partners II, L.P. v. Cendant Corp., 507 F. Supp. 2d 384, 425 (S.D.N.Y. 2007) (internal quotation marks and citation omitted).

borrower (1) orchestrated the transaction clandestinely with the participating lenders;[145] (2) did not seek the consent of all the lenders, nor offer them an opportunity to participate in the transactions;[146] and (3) destroyed the subordinated lenders' "rights to receive the fruits of their bargain" by rendering their first-lien loans effectively worthless.[147]

As further alleged evidence of bad faith on the part of the borrower and superpriority lenders, nonparticipating lenders have also pointed to the elimination of "*all* of the very important affirmative and negative covenant protections" the first-lien lenders initially agreed upon together.[148] In the words of ICG's complaint, the superpriority lenders "added insult to injury" by radically stripping all bargained-for covenants from the original agreement, while retaining them in the new agreement.[149] The nonparticipating lenders have also highlighted the onerous terms of new intercreditor agreements, including, for example, that they waive nonparticipating lenders' rights to "(i) contest debtor-in-possession financing provided by the participating lenders, (ii) seek adequate protection, (iii) propose plans of reorganization[,] or (iv) contest asset sales in a potential future chapter 11 filing by the borrower."[150]

Moreover, as discussed in Section II.A, the amendments made by Boardriders and TriMark included requirements that any nonparticipating lender seeking to bring action against the participating lenders must (1) direct the Administrative Agent, who was a willing participant in the disputed uptier exchange transaction, to take action on their behalf, and (2) post a cash indemnity not less than the fees and costs of litigation, including counterclaims.[151] ICG and other plaintiffs have characterized the additional indemnity requirement as "the epitome of bad faith," because it serves merely as a financial barrier constructed by the borrower and superpriority lenders to "cover their tracks" after their "obvious misconduct."[152]

145. *See* North Star's Complaint, *supra* note 17, at 23; ICG's Complaint, *supra* note 26, at 50; Audax's Complaint, *supra* note 1, at 5, 48; LCM's Complaint, *supra* note 41, at 15.

146. *See* ICG's Complaint, *supra* note 26, at 50; Audax's Complaint, *supra* note 1, at 41-42 (alleging that the decision by Trimark and the superpriority lenders "to reach a secret agreement designed to benefit a select subset of First Lien Lenders to the detriment of the other First Lien Lenders they left in the dark and then left behind is a textbook breach of the implied covenant of good faith and fair dealing"); LCM's Complaint, *supra* note 41, at 15 (alleging that Serta's actions "were not taken in good faith because they proceeded in secret, did not seek the consent of all debtholders, and did not offer Plaintiffs the opportunity to participate in the Subordination Transaction (and the exchange of debt)").

147. ICG's Complaint, *supra* note 26, at 48; Audax's Complaint, *supra* note 1, at 47-48; LCM's Complaint, *supra* note 41, at 15.

148. ICG's Complaint, *supra* note 26, at 7.

149. *Id.*; *see id.* at 49.

150. Elberg et al., *supra* note 22.

151. ICG's Complaint, *supra* note 26, at 32; *see id.* at 49.

152. *Id.* at 32; *see also* ICG's MOL Addressing *TriMark*, *supra* note 68, at 5 (alleging that "Boardriders and the Roll-Up Lenders made several amendments to the Credit Agreement that were done for no rational purpose other than to make it 'exorbitantly expensive, if not impossible' for Plaintiffs to file suit challenging the legitimacy and enforceability of the secret Roll-Up Transaction, and to leave Plaintiffs and the other Non-Participating Lenders with nothing more than a promissory note for the $120 million they loaned to Boardriders").

In their motions to dismiss, the borrowers and lender defendants contended—and the *TriMark* court found convincing[153]—that the nonparticipating lenders' implied-covenant claims, as well as their request for damages or the voiding of the transaction, all derived from their breach-of-contract claims, and were therefore duplicative.[154] Moreover, the borrowers denounced what they saw as an attempt by nonparticipating lenders, who are "sophisticated financial investors,"[155] to renegotiate the debt documents and "manufacture contractual obligations" retrospectively.[156] For instance, the borrowers underscored that the original credit agreement did not obligate them or the superpriority lenders to provide other first-lien lenders with transparency into their intercreditor agreements.[157] Nor, in keeping with the defendant lenders' analogous contractual arguments, did the original agreement require consultation or consent for the uptier exchange transaction from any first-lien lenders, beyond the required lenders.[158] Nor did the amended agreement actually destroy the nonparticipating lenders' "fruits of their bargain"; it merely revealed that the plaintiffs "d[id] not like th[e] bargain" they made under the permissive original agreement.[159] In other words, the defendant lenders have said "tough luck" to the nonparticipating lenders. They contend that the plaintiffs "cannot now, after the fact, seek to 'nullify other express terms of [the Original or Amended Credit Agreement], or to create independent contractual rights' under the guise of the covenant of good faith and fair dealing."[160]

The *TriMark* court declined to take the nonparticipating lenders up on their invitation to invalidate the uptier exchange transactions under the good-faith doctrine. The court relied on the above-mentioned precedential carveouts embedded in the implied-covenant principle to dismiss the good-faith-and-fair-dealing claims brought by Audax against TriMark.[161] Specifically, the *TriMark* court held that the plaintiffs' implied-covenant claim was "duplicative of [their]

153. Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *13 (N.Y. Sup. Ct. Aug. 16, 2021).

154. *See* Boardriders, Inc.'s MTD, *supra* note 10, at 18-19; TriMark's MTD, *supra* note 44, at 20.

155. TriMark's MTD, *supra* note 44, at 3.

156. *Id.* at 20.

157. *Id.* at 22.

158. *Id.* ("Plaintiffs could have demanded such terms and failed to do so, and no implied covenant claim can retroactively provide protections they now wish they had.").

159. *Id.* at 23.

160. *Id.* at 3 (quoting Fesseha v. TD Waterhouse Inv. Servs., 305 A.D.2d 268, 268 (N.Y. App. Div. 2003)).

161. *See* Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *13; *see also* N. Star Debt Holdings, L.P. v. Serta Simmons Bedding, LLC, No. 652243/2020, 2020 WL 3411267, at *5 (N.Y. Sup. Ct. June 19, 2020) ("[P]laintiffs' second cause of action appears to be identical to its breach of contract claim, and thus, it is unlikely to survive a motion to dismiss. Accordingly, plaintiffs cannot establish likelihood of success based on an alleged breach of the covenant of good faith and fair dealing.").

breach of contract claims, in that they arise from the same operative facts and seek essentially the same relief."[162]

But the *Boardriders* and federal *Serta* courts allowed the nonparticipating lenders' implied-covenant claims to move forward, because both found that the minority lenders had pleaded sufficient facts to demonstrate bad faith on the part of the debtors and, in *Boardriders*, the majority lenders. Pointing to the alleged secrecy and manipulation involved in the transactions, the Southern District of New York reasoned in *Serta* that one could well conclude "that [the defendants] systematically combed through the Agreement tweaking every provision that seemingly prevented [them] from issuing a senior tranche of debt, thereby transforming a previously impermissible transaction into a permissible one."[163] The *Serta* court further noted that, even if it were to eventually determine that the text of the agreement permitted Serta's amendments, an implied-covenant claim could still rest on Serta's alleged offer of superpriority debt "to only a subset of first-lien lenders, rather than to all of them on a *pro rata* basis."[164] Thus, because even "an 'explicitly discretionary contract right' cannot be 'exercised in bad faith' so as to deprive the other party of the benefit of the bargain,"[165] the *Boardriders* and *Serta* courts rightly found that the subordinated lenders had plausibly pleaded breaches of the implied covenant of good faith and fair dealing.

Moving forward, two potential avenues for success on the implied-covenant claim remain open for subordinated lenders under New York law. The first, which ICG has employed in its briefing,[166] contends that "the reasonable commercial expectations of the lenders participating in this arrangement" were undermined by the bad-faith actions undertaken by the majority lenders, at the expense of the minority lenders and for the self-interested advantage of the breaching lenders.[167] A second route argues that, even if the nonparticipating lenders' rights to receive the fruits of the contract were not destroyed, they

162. *Audax*, 2021 WL 3671541, at *13.

163. LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 1:21-cv-03987, 2022 WL 953109, at *15 (S.D.N.Y. Mar. 29, 2022). The *Boardriders* court came to the same conclusion on similar facts. *See* ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020, 2022 WL 10085886, at *9 (N.Y. Sup. Ct. Oct. 17, 2022) (internal citation omitted) ("Plaintiffs further allege that defendants, who constitute 'majority lenders' under the Credit Agreement, abused their ability to amend the Credit Agreement to effectuate the Transaction, going so far as to amend the no-action provisions to hinder plaintiffs' ability to sue and eliminating every affirmative and negative covenants [sic] set out in sections 8 and 9.").

164. *LCM*, 2022 WL 953109, at *15.

165. Shatz v. Chertok, 117 N.Y.S.3d 239, 239 (App. Div. 2020) (quoting Richbell Info. Servs., Inc. v. Jupiter Partners, L.P., 765 N.Y.S.2d 575, 587 (App. Div. 2003)); *see also Richbell*, 765 N.Y.S.2d at 587 (finding an implied-covenant claim to be viable where the defendant invoked its contractually established veto power for an allegedly illegitimate purpose and in bad faith).

166. ICG's Complaint, *supra* note 26, at 48-50.

167. Transcript of Proceedings at 21:11-22, Octagon Credit Invs., LLC v. NYDJ Apparel LLC, Index No. 656677/2017 (N.Y. Sup. Ct. Feb. 6, 2018).

were in fact injured,[168] because the uptier exchange transaction stripped them of their bargained-for priority. Because New York law forecloses duplicative implied-covenant claims, nonparticipating lenders face an uphill battle. But as this Note argues *infra* Section IV.B, the New York courts' reading of the implied covenant of good faith and fair dealing is unduly narrow and divorced from the claim's historical roots, and is thus due for revitalization.

D. The Last-Ditch Effort: Tortious Interference with Contract

The residual claim brought by nonparticipating lenders is one alleging tortious interference with contract on the part of the borrowers' private-equity sponsors. This claim smells of desperation and is unlikely to survive in court, as evidenced by the *TriMark* and *Boardriders* courts' decisions to dismiss it.[169] In order to plead a claim for tortious interference with contract, the subordinated lenders must demonstrate, through non-conclusory allegations, "the existence of a valid contract between the plaintiff and a third party, defendant's knowledge of that contract, defendant's intentional procurement of the third-party's breach of the contract without justification, actual breach of the contract, and damages resulting therefrom."[170] Under New York law, "a defendant may raise the economic interest defense" against a tortious-interference claim, which amounts to a contention by the interfering party that it "acted to protect its own legal or financial stake in the breaching party's business."[171] The defense's origins are intertwined with a theory of efficient breach: in other words, the private-equity sponsors' "[p]rocuring the breach of a contract in the exercise of equal or superior right is acting with just cause or excuse and is justification for what would otherwise be an actionable wrong."[172] In order to overcome the economic-interest defense, plaintiffs must make "a showing of either malice on the one hand, or fraudulent or illegal means on the other."[173]

The subordinated lenders have generally argued that the borrowers' private-equity sponsors used their "insider status" to induce the borrowers to amend the credit agreement's waterfall provisions and *pro rata* sharing requirements without the subordinated lenders' consent, thereby causing the

168. *See* Moran v. Erk, 11 N.Y.3d 452, 456 (2008) (quoting 511 W. 232nd Owners Corp. v Jennifer Realty Co., 98 N.Y.2d 144, 153) ("The implied covenant of good faith and fair dealing between parties to a contract embraces a pledge that 'neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract.'").

169. *See* Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *14-15 (N.Y. Sup. Ct. Aug. 16, 2021); ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020, 2022 WL 10085886, at *9-10 (N.Y. Sup. Ct. Oct. 17, 2022).

170. Lama Holding Co. v. Smith Barney Inc., 88 N.Y.2d 413, 424 (1996).

171. White Plains Coat & Apron Co., Inc. v. Cintas Corp., 8 N.Y.3d 422, 426 (2007).

172. Felsen v. Sol I Mfg. Corp., 24 N.Y.2d 682, 687 (1969).

173. Foster v. Churchill, 87 N.Y.2d 744, 750 (1996).

borrowers' breach of the agreement.[174] They have also argued that, even if the economic-interest defense were otherwise to apply, it should be foreclosed on the grounds of plaintiffs' allegations of malice. In order to demonstrate malice, ICG, for example, has contended that Boardriders' private-equity sponsor (1) secretly orchestrated the roll-up transaction, in knowing violation of their rights; (2) gave preferential treatment to its affiliates and handpicked lenders, at the plaintiffs' expense; (3) went ahead with the transaction over the original Administrative Agent's objection; and (4) unnecessarily stripped every affirmative and negative covenant protection from the original credit agreement.[175]

But the *TriMark* and *Boardriders* courts dismissed nonparticipating lenders' claims under the economic-interest defense because the sponsors' sizable equity stakes in TriMark and Boardriders sufficed to demonstrate that they both "st[oo]d to gain or to lose money on their investments depending on [the debtor's] financial performance."[176] Consequently, the pandemic's "grim" impact on the financial performance of TriMark and Boardriders likewise threatened the sponsors' economic interests.[177] The courts also brushed aside nonparticipating lenders' conclusory malice claims, finding that "even bad faith, without more, does not satisfy the malice requirement," and that the plaintiffs had not alleged any "fraudulent or illegal" action on the part of the sponsors.[178] Finally, the *TriMark* court reasoned that, at best, Audax could only contend that TriMark's $120 million in gained liquidity represented a suboptimal deal that could have been improved with the inclusion of the nonparticipating lenders. But "[a]sking whether a company received 'the best deal it could secure at the time,'" the *TriMark* court reasoned, "licenses judicial second-guessing of rational actors' economic decisions and demands the kind of fact-intensive inquiry that would render tortious interference claims virtually impervious to dismissal at the pleading stage."[179]

Audax, in its original complaint, and ICG, in its supplemental memorandum of law, took an additional, more nuanced tack. They contended that, while the sponsors' infusion of capital into the borrowers may have improved their economic interest in the borrowers (through the borrowers' renewed financial stability), the sponsors' decision to "[s]ecretly and

174. *See, e.g.*, North Star's Complaint, *supra* note 17, at 24; ICG's Complaint, *supra* note 26, at 50-51; Audax's Complaint, *supra* note 1, at 49-50.

175. ICG's MOL Addressing *TriMark*, *supra* note 68, at 20.

176. Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *14 (N.Y. Sup. Ct. Aug. 16, 2021); *see* ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020, 2022 WL 10085886, at *10 (N.Y. Sup. Ct. Oct. 17, 2022).

177. *Audax*, 2021 WL 3671541, at *14; *see ICG*, 2022 WL 10085886, at *10.

178. *Audax*, 2021 WL 3671541, at *14; *see ICG*, 2022 WL 10085886, at *10 (citation omitted) ("Although [the superpriority lenders] may not have acted in good faith in their actions, specifically with regard to shutting down avenues of communication, plaintiff fails to allege that the actions were fraudulent or illegal.").

179. *Audax*, 2021 WL 3671541, at *15.

deceptively strip[] Plaintiffs of their first lien priority and *pro rata* sharing rights did not provide any economic benefit to [the borrower]."[180] In other words, the "wrongful exclusion" of the nonparticipating lenders from the transaction itself "conferred no benefit on [the borrower]," but directly "line[d] the pockets" of the sponsors.[181] In fact, ICG contends, Boardriders could have obtained the necessary pandemic funding without excluding the nonparticipating lenders on a non-*pro rata* basis.[182]

But these arguments, while creative, stand little chance of persuading the New York courts in litigation over any future uptier exchange transactions. In *Boardriders*, as in *TriMark*, the borrower was "financially distressed"; the sponsor was Boardriders' controlling equity holder; and the transaction, even if not the "best deal," still made $110 million in liquidity available to Boardriders.[183] Moreover, the uptier exchange transaction was not undertaken solely for the sponsor's benefit; instead, the transaction preserved its economic interests in Boardriders. If anything, by subordinating the nonparticipating lenders' debt, the sponsor ensured that its economic interests would be even *more* firmly entrenched in the borrower. After all, the sponsor and other participating lenders now possess a greater share of Boardriders' debt and are thereby more heavily invested in the company's economic success. Inherent in majority lenders' participation in the uptier exchange transaction, then, is their "act[ion] to protect [their] own legal or financial stake in the breaching party's business"[184] —at the expense of nonparticipating lenders.

III. Uptier Exchange Transactions and Article 9

This Part explores whether, and to what extent, uptier exchange transactions comport with the text and purpose of Article 9 of the UCC. Article 9 "applies to transactions involving items of tangible personal property, such as equipment, inventory, and consumer goods, and a variety of less physically tangible assets, including accounts, instruments, and certain causes of action."[185] Put simply, an Article 9 security interest is a lien on "personal property designed to secure the performance of an obligation, typically the payment of a debt."[186] If a debtor fails to pay its secured debt, creditors (here, the superpriority lenders) can repossess the debtor's collateral and use it to satisfy the outstanding obligation.[187] Between creditors, the relative priority of their security interests determines the order in which they will be able to collect

180. Audax's Complaint, *supra* note 1, at 50.

181. ICG's MOL Addressing *TriMark*, *supra* note 68, at 2.

182. *Id.* at 18.

183. Letter from Jonathan E. Pickhardt, *supra* note 68, at 2.

184. White Plains Coat & Apron Co., Inc. v. Cintas Corp., 8 N.Y.3d 422, 426 (2007).

185. JAMES J. WHITE, G. ERIC BRUNSTAD JR. & HEATHER HUGHES, SECURED TRANSACTIONS: TEACHING MATERIALS 1-2 (5th ed. 2021).

186. *Id.* at 2.

187. *Id.*

on the debt.[188] This ordering matters because a defaulting debtor's collateral is typically insufficient to satisfy all creditors' liens. Thus, it pays to hold the highest priority liens, as lower-priority creditors may receive only pennies on the dollar when it finally comes time to collect.

Savvy creditors have tailored the design of uptier exchange transactions to take advantage of a variety of narrow loopholes embedded in Article 9. The key elements of creditors' approach rest on ambiguities within Article 9's provisions on priority,[189] default,[190] and covenants.[191] From an interpretive standpoint, creditors' use of these provisions takes advantage of a tension embedded within Article 9: the UCC is intended *both* to allow borrowers and creditors flexibility in using and designing security interests, *and* to prevent manipulative, bad-faith conduct. Creditors' behavior in executing uptier exchange transactions can be viewed through either lens: as a tortured legal manipulation designed to expropriate nonparticipating lenders *and* as a tool that vindicates Article 9's flexible structure by allowing distressed borrowers to survive otherwise certain destruction. Pinned between these conflicting aims, Article 9 is incapable of protecting nonparticipating lenders, at least as currently drafted.[192] By examining relevant provisions of Article 9, this Part demonstrates how uptier exchanges—while arguably complying with Article 9's text—simultaneously subvert its overriding norm of consent.

A. Priority

Section 9-322 establishes Article 9's baseline for determining priority among conflicting security interests in the same collateral. It provides that "[c]onflicting perfected security interests. . . rank according to priority in time of filing or perfection"[193] and "[a] perfected security interest . . . has priority over a conflicting unperfected security interest."[194] Of course, neither of those provisions is of much significance in an uptier exchange transaction, which generally entails more complex debt structures that differentiate superpriority "first out" debt from superpriority "second out" debt, first liens from second liens, and so on. Of greater relevance is Section 9-339, which establishes that creditors "entitled to priority" may enter into intercreditor agreements to subordinate each other's security interests between themselves.[195] This section permits some limited contracting around Article 9's priority baseline, but the

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188. *See* U.C.C. § 9-322 (AM. L. INST. & UNIF. L. COMM'N 2022).

189. *See id.* § 9-322, 9-339.

190. *See id.* § 9-627.

191. *See id.* § 9-401.

192. *See infra* Section IV.C.2 for this Note's proposed amendment to Article 9 of the UCC that would shield nonparticipating lenders.

193. U.C.C. § 9-322(a)(1).

194. *Id.* § 9-322(a)(2); *see also id.* § 9-317(a)(1) ("A security interest . . . is subordinate to the rights of . . . a person entitled to priority under Section 9-322 . . . .").

195. *Id.* § 9-339.

parties can only readjust their *own* priorities as between themselves. This proviso recognizes the fundamental value of any "agreement" contracting around Article 9's property-rights regime: readjustment of priority as between parties requires *consent*.[196]

Herein lies an initial tension between uptier exchanges and Article 9's consent-based vision of subordination. Superpriority lenders have flouted the consent-based norm undergirding the process for subordinating liens envisioned by Section 9-339, because that section only permits parties to contract away their *own* priority rights.[197] The superpriority lenders' process for amending the original credit agreements arguably comports with Section 9-339's text, however, because the subordinated lenders—although not parties to the *amended* agreement—were parties to the *original* credit agreement. Thus, the question of the amendment's legality hinges on whether the original credit agreements permitted subordination without the consent of all first-lien lenders. As discussed *supra* Section II.B, the nonparticipating lenders argue that the exchanges violate the general requirement that the borrower must distribute payments on the loans in a *pro rata* manner among first-lien lenders; the lender defendants maintain that the exchanges fit neatly within the open-market exception to the *pro rata* requirement. But even if one reads the original credit agreements to sanction uptier exchange transactions, the transactions themselves—conducted behind closed doors, without the consent of or notice to the other first-lien lenders—trample on the equitable[198] and consent-based norms underlying Section 9-339.[199]

B. Default

Nowhere in Article 9 is the term "default" defined. Instead, Article 9 leaves it to the parties to negotiate its meaning. Each of the credit agreements examined in this Note defined default similarly, including failure to comply with the agreement's array of affirmative and negative covenant protections.[200]

196. *See id.* § 9-339 cmt. 2 ("[A] person's rights cannot be adversely affected by an agreement to which the person is not a party.").

197. *See, e.g.*, ICG's Complaint, *supra* note 26, at 9 (contending that "at no point prior to execution of the Private Roll-Up Transaction did [the debtor, Boardriders] or any of the other Defendant [Lenders] seek the consent of Plaintiffs to these troubling amendments and new loan agreements, including the Unauthorized Intercreditor Agreement").

198. As between perfected secured parties on the same footing. Article 9 establishes a hierarchy for other interested parties (i.e., lien creditors, buyers, unperfected secured parties, unsecured creditors, and the debtor) that produces decidedly unequal outcomes.

199. Relatedly, these transactions also conflict with the *pro rata* standard that permeates these credit agreements. *See, e.g.*, ICG's Complaint, *supra* note 26, at 4 ("The governing Credit Agreement requires, in almost all instances, that the lenders under that agreement be treated equally with respect to the borrower's payment of interest and principal of the loans. . . . This equal treatment of lenders through the *pro rata* distribution of prepayments and payments is a hallmark of the Credit Agreement, which explicitly prohibits any amendments or modifications of the *pro rata* provisions absent the consent of *all* affected lenders.").

200. *See supra* Part I for a discussion of these covenants.

Under each agreement, once the borrower defaulted, the first-lien lenders were entitled to a *pro rata* share of available proceeds of the debtor's collateral, in accordance with the face amount of loans each lender owned.[201] But under the new amended agreements, the first-lien lenders lost virtually all of their rights upon default. In the case of *Boardriders*, for example, the amended agreement "includes a provision under which the Non-Participating Lenders indefinitely waive their ability to enforce an event of default under the Credit Agreement until all super-priority debt is paid off in full."[202] And because the subordinated lenders are "bur[ied] . . . under approximately $431 million of new super-priority debt,"[203] their anticipated recovery is now estimated at a negligible 5%—reflecting a reduction in recovery post-default of 50% and nearly $450 million.[204] Moreover, the amended agreement stripped *all* of the subordinated lenders' affirmative and negative covenant protections and "eliminated nearly all events of default other than payment- and bankruptcy-related defaults."[205]

Assuming the amendments were valid, the superpriority lenders' evisceration of the subordinated lenders' default protections likely comports with Part 6 of Article 9, which governs all defaults. Section 9-601(a) mandates that a borrower must *first* default before creditors can begin exercising any of their remedies.[206] If the subordinated lenders are bound by the new amendments, then they properly cannot ratably recover any of their debt until the superpriority debt is first distributed. If, instead, the nonparticipating lenders are correct that the lender defendants' amendment to the *pro rata* sharing provisions breached the agreement, then the borrowers have indeed defaulted and the first-lien lenders are entitled to collect a *pro rata* share of proceeds of collateral in the event the proceeds are distributed.[207] Section 9-615, which governs the distribution of proceeds following default, could be argued along similar fault lines. For instance, the applicability of Section 9-615(a)(3) would depend entirely upon the validity of the amendment's subordination of the nonparticipating lenders' first-lien loans.[208]

The nonparticipating lenders might also draw upon Section 9-602 to argue that the rights of the debtor and duties of the secured parties after default may not be varied except by agreement—and the subordinated lenders emphatically did not agree with the amendment's proposed variances. The lender defendants would respond by noting that the required lenders *did*, however, agree to the amendment's variances—and that is all the agreement requires. Yet another

201. *See* North Star's Complaint, *supra* note 17, at 2.

202. ICG's Complaint, *supra* note 26, at 8.

203. *Id.* at 28.

204. *See* Sunuu, *supra* note 8.

205. ICG's Complaint, *supra* note 26, at 28.

206. U.C.C. § 9-601(a) (AM. L. INST. & UNIF. L. COMM'N 2022).

207. *See* North Star's Complaint, *supra* note 17, at 24.

208. *See* U.C.C. § 9-615(a)(3) (providing that "[a] secured party shall apply or pay over for application the cash proceeds of disposition . . . to obligations secured by any subordinate security interest in or other subordinate lien on the collateral" where authorized).

counter by the plaintiffs would entail weaponizing Section 9-602 to contend that "good faith" may not be waived,[209] and the defendants' clandestine amendment was not transacted in good faith.[210]

Lastly, Sections 9-610 and 9-627 could provide ammunition for nonparticipating lenders in their attempt to discredit defendants' purported "open market" repurchase of loans on a non-*pro rata* basis. Sections 9-610 and 9-627 govern the disposition of collateral after default and provide guidance for determining whether a disposition was commercially reasonable. Section 9-610(b) requires that "[e]very aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable."[211] Section 9-627 provides the three individually sufficient requirements for a "commercially reasonable" disposition: the disposition must be made "(1) in the usual manner on any recognized market; (2) at the price current in any recognized market at the time of the disposition; or (3) otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition."[212]

In the courts' decisions on the defendants' motions to dismiss, they have acknowledged that "the term 'open market purchase' is undefined and the parties, predictably, reach conflicting interpretations about its meaning."[213] The interpretation of this term will likely prove central to lenders' litigation strategies on uptier exchange transactions in the future. Lender defendants claim that, because the waterfall provision exempts open market transactions from the *pro rata* requirement and does not impinge upon plaintiffs' "sacred rights," the agreement permits the debt-to-debt exchange on a non-*pro rata* basis.[214] Nonparticipating lenders counter by contending that "open market purchase" is "a term of art in the industry,"[215] one which requires that the transaction be "negotiated at arm's-length," "at the prevailing market price (which should approximate fair market value)," and through "a debt exchange

209. *Id.* § 9-602 cmt. 2.

210. For a discussion of plaintiffs' good-faith claims, see *supra* Section II.C.

211. U.C.C. § 9-610(b). The commentary on Section 9-610 also helpfully distinguishes between public and private dispositions, including by noting that the secured party may buy at public dispositions, but normally not at private dispositions. *See id.* § 9-610 cmt. 7.

212. *Id.* § 9-627(b); *see also id.* § 9-627 cmt. 4 (defining "recognized market" as a "quite limited" concept that "applies only to markets in which there are standardized price quotations for property that is essentially fungible, such as stock exchanges").

213. Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *12 n.9 (N.Y. Sup. Ct. Aug. 16, 2021); *see* ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020, 2022 WL 10085886, at *9 (N.Y. Sup. Ct. Oct. 17, 2022) ("[A]s the term [open market] is undefined and the contractual language is reasonably susceptible of more than one interpretation, an ambiguity exists."); LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 1:21-cv-03987, 2022 WL 953109, at *7 (S.D.N.Y. Mar. 29, 2022) ("To begin, 'open market purchase' is not a defined term in the Agreement.").

214. *See, e.g.*, N. Star Debt Holdings, L.P. v. Serta Simmons Bedding, LLC, No. 652243/2020, 2020 WL 3411267, at *4 (N.Y. Sup. Ct. June 19, 2020).

215. Audax's Complaint, *supra* note 1, at 34.

and not a purchase for cash."[216] Although Part 6 of Article 9 itself cannot provide a dispositive answer on this contested term, it does offer a pragmatic framework that, by analogy, might guide judicial decision-making on the legality of defendants' open-market transactions. Because of the ambiguity of the term, courts might benefit from additional briefing and even the testimony of expert witnesses to determine whether defendants' conduct comprises an "open market purchase" under industry standards.

C. Covenants

Another provision of Article 9 at play in uptier exchanges is Section 9-401, which governs affirmative and negative pledge covenants. As a general rule, affirmative covenants baked into credit agreements *require* borrowers to take certain actions and typically mandate the manner in which those actions must be taken, while negative covenants *prohibit* borrowers from taking specific actions, subject to various exceptions.[217] Regardless of the existence of "[a]n agreement between the debtor and secured party which prohibits a transfer of the debtor's rights in collateral or makes the transfer a default,"[218] though, Section 9-401 does not prevent the transfer from taking effect, even when it might "achieve priority over the earlier security interest."[219] Importantly, however, Section 9-401(b) does not render affirmative or negative pledge covenants "ineffective," and, as a result, "the debtor's breach may create a default."[220]

In the uptier-exchange context, the borrowers and superpriority lenders have sought to ensure that, in stripping the original credit agreements of their covenants, they would not trigger a default. In *Boardriders*, for example, the original credit agreement's negative covenants "prohibited [Boardriders] from granting liens upon its property or assets, paying dividends and making other restricted payments, and incurring new debt, among other things."[221] And Boardriders' failure to comply with the negative covenants, under the credit agreement, would result in an event of default.[222] Accordingly, the subordinated lenders argue that the lender defendants' last-minute votes to strip away *all* of the agreement's covenant protections represent a textbook example

216. *Id.* at 47.

217. *See Uptier Exchanges Can Likely Be Replicated Under Most Existing Credit Facilities*, *supra* note 32; *see also* Norton et al., *supra* note 37 ("The market presently demands many baskets and carve-outs to negative covenants, and a borrower will likely be able to cobble together multiple baskets and exceptions as a workaround.").

218. U.C.C. § 9-401(b) (AM. L. INST. & UNIF. L. COMM'N 2022).

219. *Id.* § 9-401 cmt. 5; *see id.* § 9-401 cmt. 7.

220. *Id.* § 9-401 cmt. 5.

221. ICG's Complaint, *supra* note 26, at 21-22.

222. *See id.* at 22.

of bad faith.[223] By stripping the subordinated lenders of all bargained-for covenants—while reinserting those same covenants into their new superpriority loan documents for the protection of the lender defendants' own priority status—the superpriority lenders allegedly rendered the original covenants essentially ineffective. In plaintiff ICG's words, the subordinated lenders have been left with "nothing more than a glorified promissory note against [Boardriders]."[224] Such a result appears to clash with the clear meaning of Section 9-401(b), which permits treating covenant violations as defaults. But while covenants in theory offer protection under Article 9, in practice, uptier exchange transactions reveal the UCC's limitations—the UCC is incapable of preventing a majority of lenders from stripping covenants out of these agreements.

Boardriders and the superpriority lenders have sought to brush aside nonparticipating lenders' covenant-stripping claims by pointing to the explicit terms of the credit agreement. If the agreement necessitates the consent of only the required lenders to amend the agreement, the lender defendants' reasoning goes, then Boardriders, along with the required lenders, have the authority to strip all the affirmative and negative covenants from the agreement. And if the covenants no longer apply to the agreement, then Boardriders has not defaulted on any covenants.[225] This reasoning makes out a neat syllogism and is defensible from an Article 9 perspective—after all, if the agreement does not contain any covenants, Section 9-401(b) cannot be triggered. But the plaintiffs' reasoning—that, "[a]s Defendants are well-aware, [they] would not have entered into the Credit Agreement without the . . . significant covenant protections"—once again invokes Article 9's overriding purpose.[226] Although Section 9-401(b) does not demarcate negative covenants as inviolable—and indeed, it explicitly allows for transfer over and above such covenants—it does implicate the importance of consent inherent in any "agreement."[227] And the uptier exchanges undertaken by lender defendants utterly lack the consent of the other first-lien lenders with whom they entered into the credit agreement.[228]

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In sum, Article 9 contains a variety of tools that lenders facing subordination might wield. But it also provides debtors such as Boardriders,

223. *See id.* at 7; *see also id.* at 30 ("Defendants struck the entirety of Section 8 in the Second Amended Credit Agreement, renaming it from 'Affirmative Covenants' to '*No* Negative Covenants.'").

224. *Id.* at 7.

225. *See, e.g.*, Boardriders, Inc.'s MTD, *supra* note 10, at 13-15.

226. ICG's Complaint, *supra* note 26, at 31.

227. U.C.C. § 9-401(b) (AM. L. INST. & UNIF. L. COMM'N 2022).

228. *See* ICG's Complaint, *supra* note 26, at 31 (alleging that defendants stripped away all covenant protections "without any prior notice or warning to Plaintiffs so that the Non-Consenting Lenders would have minimal protections as creditors to the Company going forward and the Roll-Up Lenders would have carte blanche to direct any future restructuring efforts relating to the Company").

Serta, and TriMark with flexibility to restructure their debt when confronted with the threat of bankruptcy. And although Article 9's text establishes a baseline norm of consent, this Part has sought to demonstrate that, without modification, the UCC is presently not equipped to protect minority lenders from uptier exchange transactions.

IV. Normative Implications of Uptier Exchange Transactions

This Part considers the implications of uptier exchange transactions for subordinated lenders' due-process rights, as well as for market instability generally;[229] urges a return to the historical, equitable core of judicial review of good-faith-and-fair-dealing claims;[230] and proposes several extrajudicial interventions, including a variety of measures to counter uptier exchange transactions through contractual sophistication,[231] as well as an amendment to UCC Article 9.[232]

A. Implications for Lenders' Due Process and the Stability of the Market

In its complaint filed against TriMark and the superpriority lenders, Audax gestures toward the dual normative harms of uptier exchange transactions. For individual lenders, they strip away subordinated lenders' covenant protections and priority liens without notice or consent. And for the larger leveraged market, which is dependent on multi-creditor syndication, they threaten to "trigger the devolution of the leveraged loan market into violence among lenders, with drastic negative consequences for the broader financial markets."[233]

LCM's complaint paints a vivid picture of the ramifications for individual lenders. In the wake of an uptier exchange transaction, lenders can be "bur[ied] . . . under $1 billion of new debt,"[234] and can be buried well below six feet under when the amended agreement permits the debtor to "incur still more super-priority debt through further exchanges."[235] As LCM's complaint notes, investors "typically pay a premium to secure top structural seniority" because of the protection it affords in the event of a default.[236] But "[i]f an issuer can change the structural seniority and subrogate the rights of minority debtholders" without their consent, "it would substantially and adversely affect not just [lenders'] holdings in Serta debt, but [lenders'] business more

229. *See infra* Section IV.A.
230. *See infra* Section IV.B.
231. *See infra* Section IV.C.1.
232. *See infra* Section IV.C.2.
233. Audax's Complaint, *supra* note 1, at 6.
234. LCM's Complaint, *supra* note 41, at 2.
235. *Id.* at 9.
236. *Id.* at 5.

generally."[237] Thus, were the courts to sign off on the legality of uptier exchange transactions, they would almost certainly inject uncertainty into the market and radically alter how lenders approach distressed lending.

The injury to subordinated lenders is further compounded by the amended agreements' incorporation of no-action provisions that were allegedly "purpose-built to prevent [nonparticipating lenders] from suing [lender defendants] in connection with [the uptier exchange] transaction."[238] Not only were the lenders' liens subordinated against their will, they (purportedly) could not even challenge the loan- and covenant-stripping in court without first posting a prohibitive cash indemnity bond.[239] Nor is the potential for a proliferation of these transactions imaginary; the vast majority of existing New York law-governed credit agreements contain the same open-market purchase provisions that purport to carve out lenders' *pro rata* sacred rights.[240]

Of equal significance are uptier exchanges' ramifications for the loan market as a whole. Sources on collateralized loan obligations (CLOs) have maintained that uptier exchange transactions "are a negative development for the loan market that needs to be addressed," because "non-pro-rata transactions have the potential to reduce recovery rates for leveraged loans, trigger widespread repricing and downgrades by rating agencies, and increase the perception of risk in the asset class."[241] As a result, CLOs are increasingly likely to lose flexibility as their lower-rating buckets balloon, causing them to struggle to obtain financing. In turn, lenders are incentivized to defend their credit protections more aggressively, even in strong markets.[242]

The difference in recovery expectations between winners and losers of uptier exchange transactions is stark. An S&P Global study found that the rolled-up portion (i.e., the exchange) has accounted for more harm to subordinated lenders than the superpriority portion of the debt, largely because the superpriority lenders' existing debt was exchanged at par, despite the significant discounts at which the loans were trading at the time.[243] And nonparticipating lenders' estimated recovery after default on their existing

237. *Id.*

238. Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *7 (N.Y. Sup. Ct. Aug. 16, 2021) (emphasis omitted).

239. *Cf.* Audax's Complaint, *supra* note 1, at 37 (alleging that the amended agreement eviscerated nonparticipating lenders' indemnity, while simultaneously "providing that the Administrative Agent, the Collateral Agent, and their Related Parties may be indemnified for acts taken in bad faith").

240. *See* Sokolova et al., *supra* note 11; Noah Schottenstein, *The New Trend of "Superpriority" Rescue Financings: Implications for Existing Priority Creditors*, DLA PIPER (June 14, 2020), https://www.dlapiper.com/en/us/insights/publications/2020/07/the-new-trend-of-superpriority-rescue-financings [https://perma.cc/5NLS-EMQ6].

241. *Uptier Exchanges Can Likely Be Replicated Under Most Existing Credit Facilities*, *supra* note 32.

242. *See id.*

243. *See* Sunuu, *supra* note 8.

loans dropped precipitously in each of the three cases, from 55% to 5% in the cases of Serta and Boardriders, and from 55% to 0% in the case of TriMark.[244]

In the case of Serta, if the company eventually defaults, the study estimated that the nonparticipating lenders' decrease in expected recovery would cost them nearly *$450 million*.[245] By contrast, Serta's participating lenders were expected to fully recover their $200 million in new superpriority capital, while also boosting their chance of recovery on their existing, rolled-up loans from 55% to 95%—representing a net gain of approximately $262 million.[246]

Similarly, the participating lenders in the Boardriders transaction were allegedly able to exchange $321 million of term loans trading at 50 to 60 cents on the dollar for nearly double their value at par, pocketing the roll-up lenders a substantial profit between $128.4 million and $160.5 million.[247] So, too, for the superpriority lenders who benefitted from TriMark's uptier exchange transaction, who allegedly exchanged roughly $307.5 million in first-lien loans for $120 million in first-out super senior loans and $307.5 million in second-out super senior loans—both ahead of the remaining $261.5 million of the now-subordinated first-lien loans.[248] As alleged in the Boardriders transaction, TriMark's participating lenders received an above-market, dollar-for-dollar exchange on their first-lien debt, which was trading at about 78 cents on the dollar at the time.[249] As a result, the uptier exchange allegedly netted the superpriority lenders approximately $67.65 million in immediate profit.[250]

As predicted by the S&P Global study, the debt of lenders like ICG is now allegedly trading "well below the value of the new rolled-up debt and super-priority debt."[251] Thus, uptier exchange transactions undercut the prized status that secured parties are meant to hold under Article 9, eviscerating nonconsenting lenders' possibility for recovery and destabilizing trust in the distressed loan market in the process.

B. The Judicial Intervention: Heightened Review of the Reasonable Commercial Standards for Parties' Fair Dealing

In reviewing challenges to uptier exchange transactions, courts might take one of two principal options: (1) apply closer judicial scrutiny to uptier

244. *Id.*

245. *Id.*

246. *Id.* Serta's capital structure before and after its uptier exchange transaction provides an illustration of the alleged devastation wrought by uptier exchange transactions on non-participating first-lien lenders. *See* North Star's Complaint, *supra* note 17, at 16.

247. ICG's MOL Addressing *TriMark*, *supra* note 68, at 18.

248. For a helpful diagram of TriMark's capital structure before and after its uptier exchange transaction, see Audax's Complaint, *supra* note 1, at 28.

249. *Id.* at 27.

250. *Id.*

251. ICG's Complaint, *supra* note 26, at 9.

exchange transactions, or (2) deferentially review amended agreements with an eye to the sophistication of the parties on each side bargaining for the best available deal. This Section contends that—in order to safeguard bargained-for priority positions under existing credit agreements and Article 9—courts should take the first path. But the superior path is neither obvious nor undisputed. The subordinated lenders are not case studies in sympathy. They, too, consist of banks and private-equity firms. They are experienced creditors; this is not their first rodeo. Accordingly, one could well argue that they knew what they were getting into and that they ought to have anticipated majority-led amendments of any provision outside of the sacred rights. That they did not, on this theory, is not the court's responsibility—the onus rested with the nonparticipating lenders at the outset, during negotiations over the original credit agreement.

Moreover, some commentators have argued that uptier exchanges might be the lesser evil among alternative credit-infusion models. Although the subordinated lenders in *Boardriders* and *TriMark* were not given any notice of the amendment, North Star and other lenders had the opportunity to propose a different, even more aggressive financing transaction to Serta.[252] In their complaint, North Star and the other lender plaintiffs characterized themselves as being "left out in the cold" after their first-lien loans were transformed by the transaction into virtually unsecured loans.[253] But the fact that they were given the chance to compete for Serta's approval, yet were rejected because their proposal for an unrestricted subsidiary transfer may have threatened the value of the collateral and been less effective at reducing total outstanding debt,[254] calls into question the extent to which their due-process rights were impinged.

However, the circumstances allegedly faced by subordinated lenders such as Audax, ICG, and LCM differed meaningfully from those experienced by North Star, and thus warrant closer judicial review to safeguard their rights. The *TriMark* court was unpersuaded by Audax's good-faith-and-fair-dealing claim because it determined that it arose from the same facts underlying the breach-of-contract claim and ought to be dismissed as duplicative.[255] But this interpretation of the implied covenant of good faith and fair dealing essentially guts the doctrine's equitable power. Implicit in the claim is an acknowledgment that it will always be accompanied by an alleged breach of contract, but the implied-covenant claim captures a broader range of bad-faith conduct that extends beyond pure breach. The *Boardriders* and federal *Serta* courts, by contrast, properly recognized the independent equitable authority inherent in this claim. These courts provided two separate paths forward: (1) as a claim

252. *See Uptier Exchanges Can Likely Be Replicated Under Most Existing Credit Facilities*, *supra* note 32.

253. North Star's Complaint, *supra* note 17, at 15.

254. *See Uptier Exchanges Can Likely Be Replicated Under Most Existing Credit Facilities*, *supra* note 32.

255. Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *13 (N.Y. Sup. Ct. Aug. 16, 2021).

that can be pleaded in the alternative, in addition to minority lenders' breach-of-contract claims;[256] and (2) as an independently substantive claim.[257]

The *Boardriders* decision did not explain its ruling on this issue in great depth, but a contextual understanding of the claim bolsters the court's conclusion. As explained *supra* Section II.C, under New York law even "an 'explicitly discretionary contract right' cannot be 'exercised in bad faith' so as to deprive the other party of the benefit of the bargain."[258] The implied covenant of good faith and fair dealing encompasses two distinct lines of inquiry, both of which courts ought to consider closely. Not only does the implied covenant implicate "honesty in fact," but it also requires the "observance of reasonable commercial standards of fair dealing."[259] In other words, the doctrine is concerned with the *fairness* of the parties' conduct, not merely with conduct capable of being proscribed ex ante by contract. It is therefore incumbent upon courts to consider the uptier exchange transactions undertaken by debtors and majority lenders in light of reasonable commercial standards of fair dealing, against the backdrop of potent norms such as consent.

Part II examined both existing and potential judicial responses to subordinated lenders' claims. The quickest fix for protecting lenders' rights and disincentivizing uptier exchange transactions in the short term may be through judicial intervention, to the extent that courts are better equipped to respond more quickly to fast-moving litigation developments. By providing borrowers and lenders with clear guidance on the legal limits of uptier exchanges, courts could once again usher in certainty to a presently uncertain market. They could also revitalize the quasi-moribund doctrine of good faith and fair dealing. In the long term, though, a legislative solution would almost certainly be more effective.[260]

To reduce the incidence of uptier exchange transactions—by voiding those that have been challenged in court and deterring future transactions out of fear of litigation risk—courts need not abandon the judicial function and legislate from the bench. Rather, by equitably invalidating amended no-action provisions, justifiably reading ambiguity into credit agreements' "open market purchase" language, construing *pro rata* distribution requirements as constitutive of credit agreements and thus inviolable, and by considering

256. LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 1:21-cv-03987, 2022 WL 953109, at *15 (S.D.N.Y. Mar. 29, 2022) (citing Hard Rock Café Int'l, (USA), Inc. v. Hard Rock Hotel Holdings, LLC, 808 F. Supp. 2d 552, 567 (S.D.N.Y. 2011)).

257. *See id.* at *15-16; ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020, 2022 WL 10085886, at *9 (N.Y. Sup. Ct. Oct. 17, 2022).

258. Shatz v. Chertok, 117 N.Y.S.3d 239, 239 (App. Div. 2020) (quoting Richbell Info. Servs., Inc. v. Jupiter Partners, L.P., 765 N.Y.S.2d 575, 587 (App. Div. 2003)).

259. U.C.C. § 1-201(20) (AM. L. INST. & UNIF. L. COMM'N 2022); *see also id.* § 1-201 cmt. 20 (noting that UCC amendments "brought the Article 2 merchant concept of good faith (subjective honesty and objective commercial reasonableness) into other Articles," replacing earlier definitions of good faith "simply as honesty in fact").

260. *See infra* Section IV.C.2 for a proposed legislative solution.

breach-of-good-faith arguments independent of breach-of-contract claims, courts can severely curb the destructive potential of uptier exchange transactions. In doing so, they could help prevent the displacement of hundreds of millions of dollars in existing secured debt, staving off the existential concerns wrought by these transactions on Article 9's framework.

C. Extrajudicial Interventions

However, courts might determine that "the well-recognized deference to collective action schemes in syndicated loan agreements under New York law" should prevail,[261] and accordingly employ a hands-off philosophy of judicial review. Were the courts to take such an approach, creditors would be left to their own devices. In the vacuum created by a lack of legal intervention, sophisticated market participants would need to equip themselves with the specific lender protections necessary to survive any future uptier exchange attempts. Alternatively, the American Law Institute and Uniform Law Commission could amend Article 9 to incorporate protections pulled from the TIA. This Section seeks to outline a path forward for lenders and legislatures.

1. Countering Uptier Exchange Transactions Through Contractual Sophistication

(i) Preventing Uptier Exchange Transactions

In order to prevent uptier exchange transactions altogether, creditors might pursue one of several options. First, lenders might demand that any amendments which subordinate the debt or lenders' lien priority be included among the sacred rights, thereby requiring the consent of all lenders.[262] As suggested by one commentator, such an alteration to the credit agreement's sacred-rights provision could be accomplished by the addition of a simple clause, such as the following: "[S]ubordination of any of the Secured Obligations of the Loan Parties under the Loan Document to any other Indebtedness, without the written consent of each Lender."[263] While straightforward, this additional sacred right would likely require substantial bargaining. In a study conducted between 2017 and 2019 by Reorg Covenants Prime of more than 200 private sponsored credit agreements, for instance, only five agreements (approximately 2.5%) were found to mandate consent from all lenders to amend lien priorities.[264] Of course, this study took place prior to the

261. Boardriders, Inc.'s MTD, *supra* note 10, at 12 n.11.

262. *See Uptier Exchanges Can Likely Be Replicated Under Most Existing Credit Facilities*, *supra* note 32; Norton et al., *supra* note 24; Norton et al., *supra* note 37.

263. *Uptier Exchanges Can Likely Be Replicated Under Most Existing Credit Facilities*, *supra* note 32.

264. *Id.*

COVID-19 pandemic and the onset of uptier exchange transactions. It is possible that, in the wake of these transactions, lenders will begin to demand a stronger consent-based sacred right.

Second, lenders could extend the *pro rata* sharing provisions to explicitly govern open-market purchases and any transactions that would produce inequitable lien-priority distributions.[265] Alternatively, lenders could "add[] more specific rules and regulations regarding what does and what does not constitute an open-market purchase" in the agreement, so as to prevent exchanges that result in the incursion of superpriority debt.[266] These modifications might run into serious opposition, because companies typically value their freedom to purchase their debt on the open market without being hindered by minority lenders seeking to stall beneficial transactions.[267] But if enough lenders collectively demand these terms, their sway could overcome the typically more diffuse bargaining power of debtors.

(ii) Minimizing the Harm of Uptier Exchange Transactions

An even greater number of options exists for creditors seeking to minimize the likelihood that they will be harmed by an uptier exchange transaction, without eliminating the risk altogether. Importantly, though, these changes will almost certainly face resistance, because they seek to buck the trend in credit agreements toward more borrower-friendly provisions that favor "majority control and easier amendments."[268] Fighting against this trend may prove difficult in the face of lenders' competition for deals, particularly given the critical value of malleable credit-agreement language "to debtors trying to keep their businesses afloat."[269] Confirming this intuition, an S&P Global study found that efforts by investors to limit the flexibility of priming loan transactions has had "limited success" because "it is widely believed the majority of credit agreements continue to be set up in a way that allows a majority of lenders to amend the contract to permit new money priming debt and the rolling up of existing debt into a priority position."[270] Nonetheless, some of the means discussed below will enable investors to protect their liens from uptier exchange transactions without handing inordinate control to the minority over the majority.

265. *See* Norton et al., *supra* note 24.

266. *Uptier Exchanges Can Likely Be Replicated Under Most Existing Credit Facilities*, *supra* note 32.

267. Norton et al., *supra* note 24.

268. *Id.*

269. *Id.*; *see also id.* ("This is good news for borrowers and sponsors looking to preserve wiggle room in distressed situations and priming lenders looking to preserve value and return on their investment. For minority lenders on the outside, however, . . . they will have to pick their battles as to where they can change the terms of credits they are investing in, particularly if the credit is already or likely to become distressed.").

270. Sununu, *supra* note 8.

First, borrowers might seek out more favorable methods for obtaining new money without sacrificing lenders' relative priority in a "cannibalistic assault."[271] For instance, a borrower might "increase the size of its *pari passu* debt basket to raise sufficient new capital," or offer "attractive interest rates, fees, call protection and most favored nation rights" to incentivize new lender investments.[272]

Second, borrowers might offer an uptier exchange transaction to all lenders in the style of Renfro, which received near-unanimous consent from its lenders to borrow additional priming funds.[273] Although recovery prospects for all lenders might decline some due to near-universal participation, borrowers might incentivize universal participation by setting aside a disproportionate amount of the new money opportunity as a reward for the negotiating lender group.[274]

Third, lenders might demand that the credit agreement reflect an increase in the "required lender" voting threshold from a bare majority to two-thirds, which would make it more difficult for superpriority lenders to exclude a broad host of first-lien lenders.[275] Such a super-majority change might gain more traction over the stricter proposed alteration that would require unanimous consent via a sacred-rights provision.[276] This change would require a broader remit for uptier exchange transactions, while preventing a small sliver of investors from holding up a transaction that would be broadly beneficial.

Fourth, lenders might seek to expand *pro rata* requirements such that, "in any transaction where existing collateral is used for any lender to take a position that is senior to other existing lenders," *pro rata* sharing would be required amongst the lenders.[277] This *pro rata* provision would not restrict an uptier exchange transaction presented with notice to all lenders, but would instead seek to disincentivize inequitable distribution of superpriority debt to a class of favored lenders, at the expense of disfavored lenders.[278]

Finally, lenders could insert a provision in the credit agreement making it impossible for a debtor and superpriority lenders to strip minority lenders of *all* of their secured share, for example, by mandating a floor below which their secured share could not be subordinated. By ensuring that a certain percentage of each minority lender's senior loans would be shielded from subordination in the event of an uptier exchange transaction, lenders could attempt to make uptier exchange transactions more costly on the margins, thereby disincentivizing them. Such a provision would in turn make offering *pari passu* debt to all lenders a more attractive proposition to a debtor. Admittedly,

271. Audax's Complaint, *supra* note 1, at 5.
272. Elberg et al., *supra* note 22.
273. *See* Sunuu, *supra* note 8.
274. *See* Elberg et al., *supra* note 22.
275. Norton et al., *supra* note 24; *see* Norton et al., *supra* note 37.
276. *See supra* Section IV.C.1.i.
277. Norton et al., *supra* note 37.
278. *See id.*

determining the proper non-subordination floor—one that would dissuade all but the most desperate debtors from pursuing an uptier exchange transaction—would be difficult to do ex ante. But for sophisticated parties, it would not be an impossible task.

Each of the changes discussed above cannot prevent uptier exchanges on their own; instead, a combination of changes might be necessary to protect secured parties' priority. But, as discussed, borrowers and their sponsors will almost certainly oppose these measures strenuously. Due to market competition for increased transactional participation, it is unlikely that lenders will be able to procure—or retain—many of these protections. Instead, the *quickest* bet for clarity in the market, this Note contends, is through the binding legal interpretation of the New York courts, which have the necessary tools—including textual analysis and expert testimony—to determine which actions are or are not permissible under existing credit provisions. The policy solution detailed in the next Section may furnish the most *comprehensive* avenue for achieving clarity in the market.

2. The Policy Solution: Importing the Trust Indenture Act's Consent Requirement into Article 9

The New York courts' decisions thus far in the uptier exchange transaction cases discussed in this Note have illustrated the precarity of lenders' fundamental consent protections. The New York courts' precedents have whittled away the implied covenant of good faith and fair dealing such that very little remains.[279] Consequently, lenders find themselves in a perilous position—and Article 9 has little to say on the matter.[280] Against this backdrop, the most robust solution moving forward—one that would restore lenders' confidence in intercreditor agreements—is to amend Article 9 to include protections modeled from language in the TIA.

Like the pandemic-induced fiscal crisis that precipitated the uptier exchange transaction, the TIA grew out of an economic calamity: the stock market crash of 1929 and the ensuing Great Depression.[281] After the crash, lenders lacked confidence in the public securities markets and protection from opportunistic debtors and indenture trustees. The text of the TIA itself acknowledges the "[n]ecessity for regulation" that arose out of exploitative practices by debtors and trustees, who were inserting "misleading or deceptive" provisions into indentures and possessed "material conflict[s]" of interest.[282] In the absence of regulation, Congress recognized that these practices were

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279. *See supra* Section II.C.

280. *Cf.* U.C.C. § 9-339 cmt. 2 (AM. L. INST. & UNIF. L. COMM'N 2022) (providing generally that "a person's rights cannot be adversely affected by an agreement to which the person is not a party").

281. *See* Elizabeth D. Lauzon, Annotation, *Construction and Application of Trust Indenture Act of 1939 (TIA), 15 U.S.C.A. §§ 77aaa et seq.*, 80 A.L.R. FED. 2d 329, 2.

282. 15 U.S.C. § 77bbb(a).

"injurious to the capital markets, to investors, and to the general public."[283] So, Congress responded by passing the TIA to ensure that the sale of corporate debt securities "conforms to federal statutory standards," enforced by the Securities and Exchange Commission.[284] Crucially, Section 316(b) of the TIA protects bondholders against modification by aggressive security holders of "any core term of the indenture, such as the holder's right to receive payment of principal or interest."[285] Federal and New York state courts have held that "the purpose of Section 316(b) is to require the consent of bondholders of an indenture security for any changes in payment terms."[286] Specifically, Section 316(b) provides:

> (b) *Prohibition of impairment of holder's right to payment.* Notwithstanding any other provision of the indenture to be qualified, the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder . . . .[287]

To head off any future harms flowing from the similarly opportunistic actions of majority lenders in uptier exchange transactions, an analogous provision could be adopted in Part 6 of Article 9, providing something to the following effect: "The right of any secured party or participant in a security agreement to retain their bargained-for priority in the secured agreement shall not be impaired or affected without the consent of such secured lender."

As some courts have noted, the use of such a hardball solution tends in practice "to force recapitalizations into bankruptcy court because of the difficulty of completing a consensual workout."[288] Critics might contend that the importation of TIA-like language into Article 9 would detrimentally hamper debtors in their use of flexible intercreditor agreements to avoid bankruptcy. This provision would almost certainly reduce the ease with which debtors might employ creative methods to secure additional financing. Undoubtedly, this solution is more paternalistic than it is laissez-faire. But this intervention

283. *Id.* § 77bbb(b).

284. Lauzon, *supra* note 281, at 2.

285. *Id.* at 13.

286. Bank of N.Y. v. First Millennium, Inc., 598 F. Supp. 2d 550, 566 (S.D.N.Y. 2009) (internal quotation marks omitted); *see* Brady v. UBS Fin. Servs., Inc., 538 F.3d 1319, 1325 (10th Cir. 2008) (quoting George W. Shuster, Jr., *The Trust Indenture Act and International Debt Restructurings*, 14 AM. BANKR. INST. L. REV. 431, 433-37 (2006)) ("Section 316(b) was adopted with a specific purpose in mind—to prevent out-of-court debt restructurings from being forced upon minority bondholders."); Springwell Navigation Corp. v. Sanluis Corporacion, S.A., 849 N.Y.S.2d 34 (App. Div. 2007); Petrohawk Energy Corp. v. Law Debenture Trust Co. of N.Y., 2007 WL 211096 (S.D.N.Y. 2007); *In re* Bd. of Dirs. of Multicanal S.A., 307 B.R. 384 (Bankr. S.D.N.Y. 2004).

287. 15 U.S.C. § 77ppp(b).

288. *Brady*, 538 F.3d at 1325.

would uphold the crucial principles of priority and consent that undergird all credit agreements, much like the "absolute priority" rule does in bankruptcy.[289]

Considered "bankruptcy's most important and famous rule,"[290] absolute priority "requires that superior classes (creditors) either be paid in full or consent to less than full payment before inferior classes (equity owners) receive any distribution on account of their ownership."[291] Absolute priority protects against "risks of collusion," such as "senior secured creditors and general unsecured creditors teaming up to squeeze out priority unsecured creditors."[292] In much the same way that senior creditors historically sought to "squeeze out" priority unsecured creditors in bankruptcy proceedings, majority secured lenders have created the uptier exchange transaction to subordinate minority secured lenders. Time and time again, the Supreme Court has intervened to protect the interests of nonconsenting creditors against inequitable Chapter 11 plans.[293] This Note's proposed amendment to UCC Article 9 seeks to fulfill a similar role for lenders who would be subordinated by uptier exchange transactions.

This amendment would discourage gamesmanship among creditors and encourage collective lender action by eliminating the zero-sum game intrinsic to uptier exchange transactions. It has deep roots in the prevailing norms of Article 9.[294] This amendment would also justify the tradeoff in debtor flexibility by bringing enhanced stability and due-process benefits to the secured lending market, and thereby reducing litigation costs. And it would have the benefit of channeling restructuring maneuvers such as those at play in uptier exchange transactions into bankruptcy proceedings that prioritize fairness and transparency.[295]

Conclusion

The courts stand poised to decide the fate of uptier exchange transactions. Although uptier exchanges are creative devices that provide meaningful benefits to borrowers facing distressed situations, these transactions cause very

289. *See* 11 U.S.C. § 1129(b)(2).

290. Mark J. Roe & Frederick Tung, *Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain*, 99 VA. L. REV. 1235, 1236 (2013).

291. Elizabeth Warren, *A Theory of Absolute Priority*, 1991 ANN. SURV. AM. L. 9, 9 (1992); *see* Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 983 (2017) (holding that "a priority-violating plan still cannot be confirmed over the objection of an impaired class of creditors").

292. *Czyzewski*, 137 S. Ct. at 987; *see* Bank of Am. Nat. Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 458 (1999) (holding that "plans providing junior interest holders with exclusive opportunities free from competition and without benefit of market valuation fall within the prohibition of § 1129(b)(2)(B)(ii)").

293. *See, e.g.*, Case v. L.A. Lumber Prods. Co., 308 U.S. 106 (1939); *203 N. LaSalle*, 526 U.S. 434; *Czyzewski*, 137 S. Ct. 973.

294. *See* U.C.C. § 9-602 (AM. L. INST. & UNIF. L. COMM'N 2022).

295. *See Case*, 308 U.S. at 114 (stating that a court can only approve a bankruptcy plan that is "fair and equitable as a matter of law").

real harm to subordinated secured parties. Not only do they dislodge creditors' bargained-for priority, they also subvert the consent-based norms of Article 9 and threaten to destabilize the distressed-lending market. What might become of Article 9's edifice when secured parties are no longer secure? The courts are well positioned to re-establish stability for lenders, but they may yet decline to act. And court-led reform may in any case prove incomplete. A lasting solution to the problems posed by uptier exchange transactions will likely require legislative action, through an amendment to Article 9 of the UCC modeled after the TIA's mandatory consent language.