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DROP-DOWN FINANCINGS IN TODAY'S MARKET

Over the past several years, drop-down financing transactions have become increasingly prevalent in the debt markets. Such transactions can offer distressed companies an alternative financing option and provide new money lenders with structurally senior claims on a borrower's assets. Drop-down financing structures are continually evolving, and new variations, such as the so called "pari-plus" and "double-dip" structures, have attracted attention recently. This article provides an overview of drop-down financing structures and discusses some of the common documentation terms that are often implicated by such financings.

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Out-of-court liability management transactions (or "LMTs") have recently emerged as a popular alternative to in-court restructuring processes for companies, both public and private, seeking to address liquidity shortfalls, extend maturities, and capture discount. In an effort to preserve equity value and avoid the potentially staggering cost of a proceeding under the US Bankruptcy Code or the premiums associated with a "regular-way" refinancing of their funded debt — even if the syndicated loan or capital markets are readily available for a borrower or issuer in the company's current financial position — companies have turned to adopting novel transaction structures that are disrupting credit market norms and forcing investors to reexamine how they traditionally thought about their investments.

One form of LMT is the so-called "drop-down" financing. Drop-down financings come in many varieties, but the basic principle across all types is a concept called "structural subordination." The concept is simple: Debt issued by an entity with assets (an "OpCo") is "senior" with respect to the value of such assets relative to debt issued by the parent company of that OpCo (a "HoldCo"). The reason for this is that HoldCo debt has recourse only to the residual equity value of OpCo, whereas the OpCo debt has recourse to the value of the assets of OpCo and generally recovers value on its claim before any equity value of OpCo flows to the HoldCo's creditors. Thus, the HoldCo debt, merely by virtue of the corporate structure, is "structurally subordinated" to the OpCo debt.

To structurally subordinate an existing debt financing to a new one through a drop-down financing, assets securing the existing debt are typically transferred from an existing collateral package to a new corporate entity, which is often a subsidiary outside of the reach of a company's existing creditors and covenants under its

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