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MINORITY LENDERS BEWARE: HOW MAJORITY HOLDERS IN DISTRESSED FINANCINGS ARE LEVERAGING THEIR RIGHTS AT THE EXPENSE OF MINORITY HOLDERS

With increasing regularity, majority debtholders in distressed financings are attempting to leverage their rights under their loan documents to secure certain benefits and opportunities for themselves at the expense of the minority holders; and while minority holders have attempted to challenge such acts, they've largely been unsuccessful. This issue has garnered significant attention due to the recent proliferation of "up-tier transactions," and in this article the authors describe other scenarios where majority lender groups have taken such actions at the expense of minority holders and how courts in various jurisdictions have resolved challenges to such transactions.

By Elie Worenklein and Mitchell Carlson *

More than a century ago, both the Supreme Court and the Second Circuit took aim at transactions in which the holder of a majority of debt securities took action at the expense of minority holders, declaring that "[w]hen two or more persons have a common interest in a security, equity will not allow one to appropriate it exclusively to himself, or to impair its worth to the others. Community of interest involves mutual obligation."[1] Yet, with increasing regularity, groups of majority debtholders (both lenders and noteholders) of distressed companies are leveraging their ability to deliver consents of a tranche of debt in order to procure, for themselves, opportunities that are not being offered to all other similarly situated debtholders, or are otherwise taking actions that may be adverse to the interests of minority debtholders. In addition to the recent expansion of "up-tier transactions,"[2] these opportunities also often take the form of DIP financing or backstop arrangements that are only offered to select debt investors, who can appropriate for themselves fees and other benefits that would otherwise be shared by the entire class of debt holders. In other instances, a group of majority debtholders may seek to exercise remedies, such as credit bidding, that can have a disproportionate impact on minority debtholders who may be unable to accept the proceeds of such credit bid or may find themselves

[1] *Hackettstown Nat. Bank v. D.G. Yuengling Brewing Co*., 74 F. 110, 113 (2d Cir. 1896) quoting *Jackson v. Ludeling*, 88 U.S. 616, 616 (1874).

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[2] One court recently described such transactions between a debtor and a majority (but not all) holders of a syndicated debt issuance as "tak[ing] advantage of technical constructions of loan documents in ways that some view as breaking with commercial norms." *In re TPC Group, Inc*., 2022 WL 2498751 at *1 (Bankr. D. Del. July 6, 2022).