King & Spalding

HOW DID THEY DO IT?

At Home Group and the "Double Dip" Claim Financing Structure

King & Spalding Private Credit & Special Situations

Situation Overview: Background[1]

- At Home Group Inc. (the "Company"), a Dallas-based retailer of home décor, was acquired by the private equity firm Hellman & Friedman LLC (the "Sponsor") in July 2021 in a leveraged buyout (LBO) valued at $3.1 billion.
- Post-LBO and prior to the "Double Dip" financing transaction discussed herein, the Company's capital structure consisted of (i) a $425 million ABL facility ("ABL"), (ii) $600 million first lien term loan ("1L Term Loan"), (iii) $300 million senior secured notes ("Senior Notes"), and (iv) $500 million unsecured notes ("Unsecured Notes").
- Around the time of the LBO and thereafter, the Company (like many of its peers) faced a sharp contraction in EBITDA and gross margin due to industry wide headwinds following higher supply chain costs and inventory glut, partially resulting from the COVID-19 lockdown.
- Rating agencies downgraded the Company's credit rating status to Caa1 in November 2022 and CCC+ in January 2023, and on or around April 21, 2023, the Company reported 4Q22 earnings (with same store sales down 12%). Soon thereafter, as a result of tightening liquidity and other operational issues, the Company explored new money financing and other transactions to extend maturities and deleverage.

[1] The following presentation is based solely on public information, including the Company's press release announcing the financing transaction and other reputable news sources.

Situation Overview: the "Double Dip" Financing Transaction

- As widely reported, in May 2023, the Company, through a new Cayman subsidiary, At Home Cayman ("Cayman Sub"), privately placed newly issued $200 million senior secured notes ("New Senior Notes"), and separately offered the holders of the Unsecured Notes the opportunity to exchange their notes at 90% par value into additional New Senior Notes.[2]
  - While the indenture and related offering information is not publicly available, it has been widely reported that the Cayman Sub is a non-guarantor/non-Loan Party restricted subsidiary of the Company.[3]
  - The Cayman Sub issued the New Senior Notes, which were also guaranteed on a senior secured basis by the Company and certain of its restricted domestic operating subsidiaries (the "Restricted Opcos"; and such guarantees, the "New Senior Notes Guarantee"). The Cayman Sub likely did not have any significant assets, but it lent the $200 million of proceeds from the New Senior Notes issuance to the Company in exchange for an intercompany note (the "Secured Intercompany Loan") in favor of the Cayman Sub that was guaranteed on a senior secured basis by the Company and the Restricted Opcos.
- As explained on the next slide, the holders of the New Senior Notes have two separate paths to recovery or a "double dip" because they have (i) a direct claim against the Cayman Sub and the Restricted Opcos via the New Senior Notes Guarantee and (ii) an indirect secured claim via the Cayman Sub's interest in, and pledge of, the Secured Intercompany Loan.

[2] A chart illustrating the Company's pre- and post-transaction capital structure is attached hereto as Appendix A.

[3] Typically, a loan or notes are guaranteed by the borrower's material, domestic and wholly-owned subsidiaries (referred to as "Loan Parties" or "Credit Parties"). A borrower's subsidiaries that are not required to be "Loan Parties" – typically all foreign subsidiaries – are referred to as non-Loan Party Restricted Subsidiaries. While they are not required to guarantee the underlying debt, they are subject to (or "restricted by") the terms of the loan documents. "Unrestricted Subsidiaries," in contrast, are neither guarantors nor subject to the covenants of loan documents.

Situation Overview: the "Double Dip" Financing Transaction (cont'd)

- By way of illustration, if the New Senior Notes had a $200 million claim in respect of the New Senior Notes Guarantee and a direct residual interest in the Cayman Sub's $200 million secured claim in respect of the Secured Intercompany Loan, and there was a $200 million claim held by another *pari passu* secured creditor, and there was $200 million of collateral value at the Restricted Opcos, the New Senior Notes would be entitled to 66.67% of the collateral value (v. 50% without the double dip structure).
  - The New Senior Notes would have a direct claim for 1/3 of the collateral value and an indirect claim via the Secured Intercompany Loan of an additional 1/3 of the collateral value.
  - The New Senior Notes could also benefit from the Cayman Sub's deficiency claim in respect of the Secured Intercompany Loan, further increasing recovery.
    - By way of example, in a typical single claim structure, the New Senior Notes would have a deficiency (i.e., unsecured claim) of $100 million, which would be entitled to share pro rata in any unencumbered assets of the Restricted Opcos' estates.
    - In a "double dip" structure, the New Senior Notes would have a direct deficiency claim of $133.33 million and an indirect deficiency claim via the Secured Intercompany Loan's deficiency claim of $133.33 million.
    - Thus, if unsecured creditors received a recovery of 5% based on the value of unencumbered assets, the New Senior Notes would be entitled to an additional $13.33 million distribution in respect of its deficiency claim (v. $5 million in a typical single claim structure).
  - Thus, in this illustrative example, the total recovery of the New Senior Notes is approximately $147 million (or 73.5%) as compared to $105 million (or 52.5%) in a typical single claim structure.
  - Total recovery on the New Senior Notes (in the case of a bankruptcy) would still be capped at 100% recovery (i.e., par plus accrued interest as of petition date).

“Double Dip” Financings – An Alternative Financing Structure?

- Companies looking to reduce capital costs by improving the terms of financing may find the “double dip” structure attractive as an alternative to priming or “drop down” financing (**See The Hub’s Frequently Discussed Liability Management Transactions piece**).
  - In contrast to a priming transaction, where the financing needs to come from existing “Required Lenders” who have to amend the existing loan documents to permit the priming financing, which may be at a higher cost of capital since it can only come up from one source – a group constituting Required Lenders, the “double dip” financing can be provided by both existing and third-party financing sources.
  - In contrast to a drop-down financing, which requires the transfer of assets to an Unrestricted Subsidiary and other corporate reorganization steps that may have significant legal and non-legal costs and may be disruptive to the company’s operating business, the “double dip” financing does not require such asset transfers and corporate reorganization.
- As set forth below, the following credit agreement and bond indenture provisions will need to be reviewed to determine whether a “double dip” financing structure could be utilized under the existing credit documents (or, alternatively, what amendments are needed):[4]
  - Non-Loan Party Restricted Subsidiary Debt and Lien Capacity: The applicable credit documents need to have debt and lien capacity for the Non-Loan Party Restricted Subsidiary to incur the financing.
    - Although the loan documents may have specific debt baskets for the incurrence of debt and liens by a Non-Loan Party Restricted Subsidiary, most credit documents allow Non-Loan Party Restricted Subsidiaries to incur debt using general debt and lien baskets.

[4] The double-dip financing could also be issued by an Unrestricted Subsidiary. However, typically loan agreements prohibit Loan Party guarantees of debt issued by Unrestricted Subsidiaries

"Double Dip" Financings – An Alternative Financing Structure? (cont'd)

- General Debt and Lien Capacity for Loan Party Guarantees: The applicable credit documents need to have ***additional*** general debt and lien capacity in respect of the guarantees provided by the Non-Loan Party Restricted Subsidiaries.
  - The guarantees may also constitute investments under loan documents, in which case the Company must have sufficient investment capacity as well. However, if the guarantee is provided in reliance on general debt and lien baskets, there is often a corresponding investment basket that allows the investment without requiring the utilization of separate investment capacity.
- Debt and Lien Capacity for the Intercompany Loan: The intercompany loan in respect of the proceeds funded by the Non-Loan Party Restricted Subsidiary borrower of the "double dip" loan will utilize ***additional*** general debt and lien capacity.
  - Note that some loan agreements may require that any debt owed to a Restricted Subsidiary be subordinated to the underlying loan obligations, which would undermine the recovery value of the intercompany receivable and, therefore, the recovery on the second claim in the "double dip" structure.
  - However, such subordination requirement may only apply if the intercompany loan is incurred pursuant to an intercompany loan basket; if the intercompany loan utilizes a general debt and lien basket, it may not need to be subordinated.

“Double Dip” Financings – An Alternative Financing Structure? (cont’d)

- Given that the “double dip” structure requires the incurrence of an intercompany loan to fund loan proceeds to operating subsidiaries from a sister shell subsidiary (rather than an equity capital contribution from the parent borrower), the potential tax consequences related to this structure should be considered by the Company and the prospective lender.
- In addition to ensuring that the “double dip” structure is permitted under the Company’s bond and/or loan documents and potential tax implications, the lender providing “double dip” financing should also consider the following terms and conditions:
  - Special Purpose Vehicle (“SPV”): The borrower should be a special purpose vehicle specifically set up such that the only liability it has is the underlying “double dip” debt and the only asset it has is the Intercompany Secured Debt Receivable.
  - Tight “SPV” Covenants: The loan documents should have tight covenants that restrict the ability of the borrower from incurring any debt, transferring any assets, or conducting any business other than related to servicing the Intercompany Secured Debt receivable and performing its obligations on the underlying “double dip” debt.
  - Governance: Given that the “double dip” structure is premised on the Non-Loan Party’s ability to fully enforce the intercompany loan on an arm’s length basis, the Non-Loan Party Restricted Subsidiary and/or Unrestricted Subsidiary should have a Board consisting solely of one or more independent directors acceptable to the lender and in place at closing.
  - “Bankruptcy Remote” Protections: The governing docs of the SPV should have special provisions limiting the SPV’s ability to commence a bankruptcy, as the filing of a bankruptcy by the SPV could affect the lender’s ability to foreclose on the Intercompany Secured Debt Receivable and enforce the SPV’s rights thereunder.

Potential Challenges to "Double Dip" Claims / Structure

- The "double dip" financing structure is designed to improve creditor recovery in a downside scenario. Yet, given the nature of the structure and the strategy of "doubling" the creditor's claim at the expense of other creditor recoveries, in a chapter 11 scenario,[5] a debtor-in-possession (or chapter 11 trustee) or other party-in-interest may seek to challenge the allowability of such claim or bring estate claims seeking to avoid certain of the guarantees, liens and/or obligations in respect of the "double dip."
  - As other commentators have noted, "double dip" claims in transaction structures similar to the At Home Group "double dip" financing have been either approved (see Latam Airlines (2020) chapter 11 case) or factored into a favorable creditor settlement (see Lehman Brothers (2008) and General Motors (2009) chapter 11 cases). Ultimately, allowance and recovery on such financings will likely be highly fact and circumstance dependent.
- Claim Disallowance: Any party-in-interest may seek to disallow the intercompany loan guarantee on the basis "such claim is unenforceable against the debtor and property of the debtor" under applicable law. (11 U.S.C. § 502(b)(1)). Here, the movant will have to show that the intercompany loan and related guarantee are not enforceable under applicable state law, which will likely be difficult assuming the court respects the separateness of the Company and the SPV.[6]
- Recharacterization: A party could also seek to eliminate the intercompany loan guarantee by moving for an order, based on the Bankruptcy Court's equitable powers, that the intercompany loan should be recharacterized as equity on the basis that its "true character" was equity and not debt. Courts typically apply a multifactor analysis set forth in *Basco Corp. v. Masco Tech, Inc. (In re: AutoStyle Plastics, Inc.)*, 269 F.3d 726 (6th Cir. 2001).[7]
  - Note: in the case of an upstream intercompany loan from a subsidiary to parent as is the case in At Home, the recharacterization issue relating to the intercompany loan would likely be whether the subsidiary made a dividend to the parent instead of a loan.

[5] Note that existing creditors could also file (i) a breach of contract lawsuit to the extent they think that the "double DIP" loan structure is not permitted under their applicable loan documents or (ii) a constructive fraudulent transfer lawsuit under state law outside of bankruptcy.

[6] *See, e.g., In re: LATAM Airlines Grp. S.A.,* 2022 Bankr. LEXIS 1178, *23 (S.D.N.Y. April 19, 2022) (describing applicable legal principles for analyzing disallowance of intercompany loan pursuant to Section 502(b)(1)).

[7] Those factors are: (1) the names given to the certificates evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) identity of interest between creditor and stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advance was used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments.

Potential Challenges to "Double Dip" Claims / Structure (cont'd)

- Constructive Fraudulent Transfer: A debtor (via itself as debtor-in-possession or its bankruptcy trustee) or a creditor (with derivative standing) could seek to void the intercompany guarantee and/or the direct guarantee as a constructive fraudulent transfer (**See The Hub's Fraudulent Transfer piece**) on the basis that the guarantors did not receive reasonably equivalent value in exchange for the guarantee:
  - Reasonably Equivalent Value: The key will be whether the obligors (i.e., the borrower(s) and guarantors) received reasonably equivalent value (i.e., benefited from the loan proceeds) in exchange for incurring the obligations and granting liens in respect thereof. Given that in the "double dip" structure the debtor has incurred two separate obligations (one direct obligation/guarantee and another obligation/guarantee on account of the intercompany loan) on account of a single stream of money (which is structured as two loans), it is possible that one of the secured obligations/guarantees could seek to be voided (although the lender could protect the other secured obligation/guarantee from being voided assuming it benefited from the loan proceeds) (i.e., resulting in a "single DIP" normal loan structure).
  - Collapsing Doctrine: Note that as part of the constructive fraudulent transfer analysis, courts may apply the "collapsing doctrine" whereby courts, including the Second and Third Circuits, have held that multi-staged lending transactions may be collapsed and treated as integrated phases of a single transaction for purposes of evaluating whether a transferor or obligor received reasonably equivalent value.[8]
  - Solvency: The party seeking to void the "double dip" claims (and the obligations, guarantees and liens in respect thereof) as constructive fraudulent transfers will have to prove that the obligors were either (i) insolvent at the time they incurred such obligations, guarantees and liens or were rendered insolvent as a result thereof; or (ii) operating with unreasonably small capital at the time of or after giving effect to such incurrence of the obligations, guarantees and liens.

[8] *See HBE Leasing v. Frank,* 48 F.3d 623, 635 (2d Cir. 1995); *see also* Arthur J. Steinberg & Michael R. Handler, *Mitigating Lender Risk In Constructive Fraudulent Transfer Litigation*, NYLJ Sept. 2019 for overview of collapsing doctrine (found here).

Potential Challenges to "Double Dip" Claims / Structure (cont'd)

- Equitable Subordination: A party could also seek to equitably subordinate the intercompany claim guarantee to other claims against the guarantor under Section 510(c) of the Bankruptcy Code on the basis that allowing two claims in respect of two guarantees for the practical equivalent of a single stream of loan proceeds was based on the inequitable conduct of the lender in insisting on such a structure.[9]
  - Note that a Bankruptcy Court may be unlikely to find that aggressive structuring of a loan constitutes "inequitable conduct," as this prong is usually based on the conduct of the lender and not on the structure of the loan itself.
- Substantive Consolidation: A debtor or interested party may seek to substantively consolidate the estates of one or more debtors, which would eliminate guarantees and intercompany claims. With a substantive consolidation, the assets of every debtor (and the claims against those debtors) are given commonality and treated as one. Thus, whereas guarantees are joint and several (meaning each guarantor is liable for the full portion of the claim), substantive consolidation would eliminate the benefit of this. Substantive consolidation is rare and highly unlikely to be successful, especially in the context of a sophisticated company that typically observes corporate formalities and legal separateness such as At Home Group.[10]
  - Note that substantive consolidation of a non-debtor is even rarer, but some courts have ruled it is a remedy available to a bankruptcy court. Thus, given that the intercompany loan may be owed to the non-loan party issuer, which may not be a debtor, the effect of substantive consolidation on unwinding a "double dip" claim may be even further limited.

[9] The widely accepted three-prong standard for equitable subordination, set forth in *Benjamin v. Diamon (In re: Mobile Steel CO.)*, 563 F.2d 692, 699-700 (5th Cir. 1977) requires satisfaction of three prongs to equitably subordinate: (i) claimant must have engaged in some sort of equitable conduct; (ii) misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant, and (iii) equitable subordination of the claim must not be inconsistent with the provisions of the Bankruptcy Code.

[10] Although the case law varies on the factors warranting substantive consolidation, courts generally look at whether corporate separateness was disregarded so significantly that creditors relied on the breakdown of such separateness.

Potential Challenges to "Double Dip" Claims / Structure (cont'd)

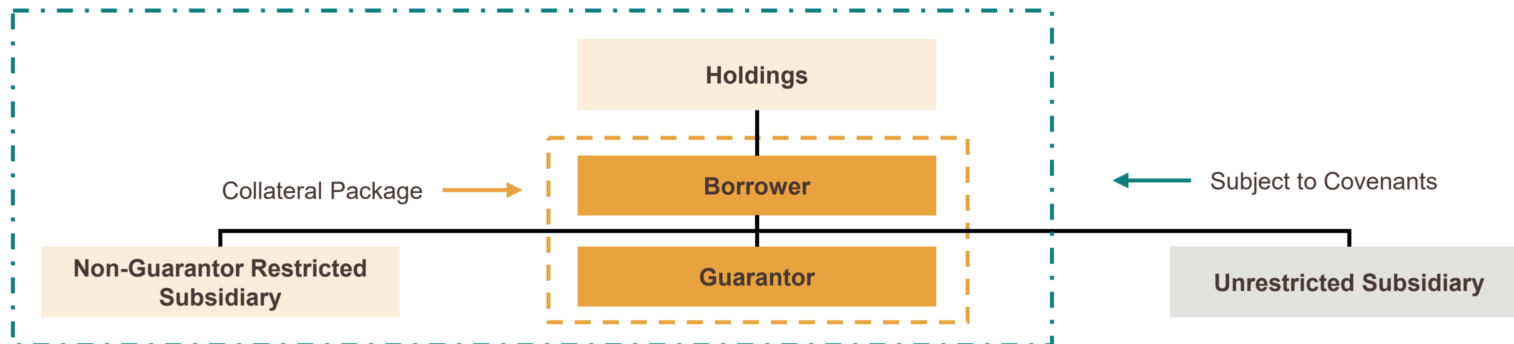
- Setoff/Subrogation: Under state law, the obligation of a parent or subsidiary (the "parent/subsidiary obligor") in respect of an intercompany loan owed to a parent or subsidiary borrower affiliate (the "borrower"), which funded the proceeds of such intercompany loan by issuing debt that was guaranteed by the parent/subsidiary obligor could be subject to set off on account of the parent/subsidiary obligor's subrogation claim against the borrower for amounts the parent/subsidiary obligor paid on account of its guarantee of the borrower's debt. However, the Bankruptcy Code has certain provisions that may neutralize such parent/subsidiary obligor's subrogation claim in bankruptcy.[11]
  - Section 502(e)(1)(b) provides that the guarantor is not entitled to an allowed claim for reimbursement against the principal obligor if such claim is "contingent" (i.e., if the guarantor has not paid on the guarantee). Even if the guarantor pays a portion of the amount due (rendering the claim no longer "contingent"), section 509(c) subordinates the claim of the guarantor until the primary creditor is paid in full (either from the debtor or from any other source).
  - Section 509(a) provides that a guarantor who pays a portion of the principal claim can subrogate to the claim of the original creditor, that subrogation right is also subordinated to payment in full of the underlying creditor. Because the claim is disallowed (if contingent) and subordinated (if not fully paid), it can never be set off against the intercompany claim until the loan obligations derivative of the subrogation claim are paid in full.

[11] This was flagged in the seminal article on "double dip" claims written by Mark Kronfeld in the March 2012 issue of the ABI Journal entitled "The Anatomy of a Double DIP." The bullets on Section 502(e)(1)(b), 509(a) and 509(c) are taken from the article with minor modifications.

Appendix A:
Pre- and Post-Transaction Capital Structure

Pre- and Post-Transaction Capital Structure

	Pre-Transaction Capital Structure		Post-Transaction Capital Structure				
ABL Priority Lien Collateral Creditors	**$425M** ABL		**$425M** ABL				
Term Priority Lien Collateral Creditors	**$600M** 1L Term Loan	**$300M** Senior Notes	**$600M** 1L Term Loan	**$300M** Senior Notes	**$412M** New Senior Notes	**$200M** New Senior Notes	**$200M** Intercompany Loan
					Existing First Lien Collateral claims diluted by $812M		
	$900M		$1,712M				
Unsecured Creditors	**$500M** Unsecured Notes		**$53M** Unsecured Notes				



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