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LME legal challenge evolution — the success of selective inclusion



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Lenders to [Magenta Buyer](#) (dba Trellix and Skyhigh) had a choice earlier this year: they could go along with the company's liability management exercise, or they could abstain in favor of pursuing a legal challenge.

If they [agreed to the deal](#), they could exchange their first lien holdings at 80 cents and second lien holdings at 65 cents. For comparison, the ad hoc group involved in the deal were able to exchange their first lien debt for 85 cents on the dollar, while **Elliott Management** — which led the transaction — was able to exchange its first lien holdings at 89 cents on the dollar, *9fin* reported at the time. Opting out of the transaction would have relegated a creditor to the bottom of the debt stack.

Ultimately, [99.9% of lenders signed on](#) to the transaction, and a lawsuit never materialized, despite certain creditors [hiring counsel](#).

Magenta fits into a broader pattern: LMEs have become a game of calculated and often times unequal inclusivity, making justifying the costs and risks of challenging

one in court more difficult.

That shift has led to less litigation around LMEs even as the number of transactions has increased, said Dan Fliman, a financial restructuring partner at law firm **Paul Hastings**.

“More and more people are being afforded an opportunity at lesser economics to buy in, and you have a very difficult choice to make as a minority holder,” Fliman said. “Do you take the lesser economics even though you’re unhappy with it, or do you then try to bring a lawsuit?”

As the calculus shifts, only the most egregious deals are being litigated. And the lawsuits that do materialize are gambits aimed at settlement on better terms, hoping to avoid protracted legal battles and/or bankruptcy.

LME litigation timeline

Magenta is one of 36 LMEs conducted in 2024 so far, according to data compiled by *9fin*. Of those, only a handful — **Dish/Echostar**, **Del Monte** and **AMC Entertainment** — have resulted in litigation. Separately, bankruptcy judges this year ruled on LMEs that involved **Incora** and **Robertshaw**, which both ended up filing for Chapter 11 and dragging outstanding lawsuits with them to Texas bankruptcy court in the process.

Following the percentages, just a fraction of the transactions in the last two years have ended up in court. But in the early days of LME litigation, when the most aggressive uptiering transactions first emerged — cases like **Serta Simmons**, **Boardriders**, and **Trimark** — a legal fight was all but guaranteed because excluded lenders had no means to participate in those deals or otherwise recoup the losses inflicted on them.

Those initial battles played out in state courts, and plaintiffs scored early wins, overcoming motions to dismiss and progressing far enough to raise questions about the viability of future LMEs in the process.

“One of the lessons from that wave of litigation is that certain LMEs may not survive judicial scrutiny if the company and majority lenders rely on a hyper-technical interpretation of the credit agreement,” said Shai Schmidt, a partner with **Glenn Agre** who focuses on restructuring and represented **Invesco** in the Robertshaw case.

But things took a turn when Serta Simmons filed for Chapter 11 bankruptcy and landed in US Bankruptcy Court for the Southern District of Texas last year. Judge David R. Jones — who resigned months later following a romance scandal — upheld the uptiering transaction, signaling to the market that similar transactions could remain intact if the company that engaged in the transaction wound up bankrupt.

Modern times

Since the Serta decision, two other LMEs have migrated from New York state court to SDTX: Incora and Robertshaw. But the results of those cases diverged heavily from each other.

In the case of Incora, the **Platinum Equity**-backed aerospace parts supplier that filed for bankruptcy in 2023, Judge Marvin Isgur ruled after a month's worth of court dates that stretched out from January until June that a credit breach had taken place. Judge Isgur decided to reverse the transaction in a major win for the ad hoc group challenging the uptiering.

Meanwhile, Judge Christopher Lopez decided after a week-long trial that the Robertshaw LME constituted a breach of the credit agreement — but that only left Invesco with an unsecured claim. The appeal process in that case is ongoing.

It's difficult to draw market-wide conclusions from those two decisions, particularly because of the unique circumstances surrounding the cases. Judge Isgur himself [cautioned](#) that his decision in Incora "does not challenge the legality of uptiering transactions."

But an obvious conclusion is that litigation can be time-consuming and expensive, even when it plays out in a venue such as bankruptcy court.

"If you keep your new money financing transaction simple, there's less to look at when you get to bankruptcy," said Michael Handler, a partner in law firm **King & Spalding's** finance and restructuring practice. "At a minimum, your recovery is going to be reduced just based on incremental professional fees, and that can be significant."

Alternatives

An out-of-court restructuring is almost guaranteed to be cheaper and faster than bankruptcy. After the Serta decision last year, certain sponsors started [gravitating](#) toward LMEs that allowed a wider swath of creditors to participate on more even terms — perhaps with the tacit realization that such deals would be easier for creditors to swallow.

“Sponsors and sponsors’ lawyers have been smart enough to realize that if you give everyone a little bit, you’re less likely to get sued,” said a buysider focused on restructuring situations. “I think some of it is minimizing who the aggrieved party is but also minimizing that spread differential between who’s on the in and who’s on the out.”

Despite the shift, aggressive LMEs haven’t gone away entirely, meaning there are still plenty of transactions where a challenge makes sense.

The ad hoc group of **DISH DBS** bondholders advised by **Milbank** and **Lazard** have been vociferously against the various maneuvers orchestrated by **Echostar** chairman Charlie Ergen, who recombined DISH Network (which includes the DBS business) and Echostar, then moved around a bunch of assets, struck a deal with separate groups of creditors to finance near-term maturities, pushed out maturities and raised a ton of cash at Echostar, while leaving DBS bondholders to negotiate with TPG Angelo Gordon on its conditional acquisition of the DISH DBS assets to combine with DIRECTV, of which TPG just completed the full purchase.

It’s important to note that so far, the DISH litigation hasn’t done much to prevent maneuvering on Ergen’s part, as the DBS group filed a lawsuit mainly alleging Ergen and the relevant entities’ actions gave rise to fraudulent transfer claims. The group subsequently amended the complaint to add **DISH Network**, bringing in more claims stemming from the recent [deal](#).

Meanwhile, first lien lenders left out of AMC’s LME transaction earlier this year — a dropdown that went largely through the second lien debt in an unusual twist on a now-familiar formula — are likewise making a public fuss aimed at getting a better deal in the wake of a complex LME executed by a public company. Rather than targeting a breach in the credit agreement, they’re targeting a violation of the intercreditor agreement, which dictates conduct between creditors. Like the LME it’s targeting, it’s a different take on a classic approach.

Lastly, Del Monte represents an effort by creditors to create leverage not by challenging the transaction directly, but by claiming the LME resulted in a default that allowed them to take action against the board. The creditors followed up on that move by going to Delaware Chancery Court in [October](#) when the company refused to engage. While unusual, the move is “very clever and creative,” said Fliman, the Paul Hastings lawyer.

“They're going to get their day in court a lot faster,” he said.

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