ALERTS

S.D. Texas Bankruptcy Court Finds LME Transactions Violated Credit Agreement, but Limits Recovery to Potential Claim in *Robertshaw* Litigation

July 8, 2024

On June 20, 2024, Judge Christopher Lopez of the United States Bankruptcy Court for the Southern District of Texas issued a highly anticipated decision rejecting one lender's ("Lender Defendant") request to void a prepayment made by the borrower, Robertshaw, to Lender Defendant in December 2023. In the decision, Judge Lopez addressed a narrow contractual dispute centered around a series of liability management transactions conducted by Robertshaw and certain of its secured lenders ("Lender Plaintiffs") to the exclusion of the Lender Defendant. Judge Lopez found that a prepayment of term loan debt violated the plain terms of the credit agreement, but that the other transactions should stand and Lender Defendant's sole remedy is a claim against Robertshaw for breach of contract. *See* Memorandum Decision and Order [ECF No. 351], *In re Robertshaw US Holding Corp., et al.*, No. 24-90052 (Bankr. S.D. Tex. June 20, 2024).

Background

In late 2022, Robertshaw, began experiencing financial difficulties. To alleviate its financial stress, Robertshaw executed an uptiering transaction with certain of its secured creditors who had joined together to provide "Required Lender" consent (i.e., the support of lenders holding more than 50 percent of the outstanding principal) under an existing credit agreement in May 2023.

The New Credit Agreement

In May 2023, Robertshaw and certain of the secured lenders amended the original credit agreement to (i) execute a new super-priority credit agreement governed under New York law, (ii) provide $95 million of new first-out new money term loans and (iii) allow the participating lenders to exchange existing first- and second-out term loans under the original credit agreement into second-out and third-out term loans under the new credit agreement.

While the new loan incorporated many of the terms of the original credit agreement, it implemented changes intended to curtail the parties' ability to engage in future liability management transactions. The new loan also incorporated the original credit agreement's definition of "Required Lender,"—which defined "Required Lender" as "[l]enders having Loans representing more than 50.0% of the sum of the total First-Out New Money Term Loans and Second-Out Term Loans at such time."

Subsequent Amendments to the New Credit Agreement

In Spring 2023, Lender Defendant held more than 50 percent of the debt under the new loan —sufficient for it to constitute the Required Lender on its own. The Lender Defendant and Robertshaw then amended the new credit agreement four times — waiving various payment defaults and extending Robertshaw's runway in exchange for, among other things, additional liquidity. The Lender Plaintiffs learned of these amendments only shortly after execution of the fourth amendment.

The Lender Plaintiffs Take Action

In December 2023, the Lender Plaintiffs, Robertshaw and its sponsor, One Rock, executed a series of liability management transactions that provided new financing to Robertshaw, while serving to prepay and dilute Lender Defendant's position.

- *First*, Robertshaw's ultimate parent, Range Investor LLC, formed RS Funding Holdings, LLC ("RS Funding").
- *Second*, the Lender Plaintiffs and One Rock loaned ~$228 million to RS Funding.
- *Third*, Holdings instructed RS Funding to distribute the proceeds of the ~$228 million loan to Robertshaw.

- *Fourth*, Robertshaw used the funds to, among other things, voluntarily prepay $117.6 million of the outstanding first-out term loans — including paying more than $90 million to Lender Defendant. After the prepayment, the Lender Plaintiffs now held more than 50.0% of the outstanding debt.

- *Fifth*, the Lender Plaintiffs, as Required Lenders, executed an amendment to the new credit agreement, authorizing Robertshaw to issue $228 million in incremental debt.

- *Sixth*, Robertshaw issued $218 million in new loans and then returned an equivalent amount to RS Funding, which repaid the loan.

See Memorandum Opinion at 8-9.

In late December 2023, Lender Defendant filed a complaint in the Supreme Court of the State of New York against Robertshaw, One Rock and the Lender Plaintiffs, alleging claims that included breach of the new credit agreement, breach of the covenant of good faith and fair dealing and tortious interference with a contract.

Lender Defendant also sought a preliminary injunction prohibiting both the $90+ million prepayment and the effects of any actions taken by the Lender Plaintiffs in their purported capacity as Required Lenders.

Robertshaw filed for chapter 11 bankruptcy on Feb. 15, 2024. On the same date, Robertshaw, the Lender Plaintiffs and One Rock commenced an adversary proceeding seeking to, among other things, a declaration that the December 2023 transactions are valid under the new credit agreement. In response, Lender Defendant filed two counterclaims seeking declaratory judgment (i) against Robertshaw that Robertshaw breached the new credit agreement and (ii) that the Lender Defendant was still the Required Lender.

The Decision

Judge Lopez held that the Lender Plaintiffs violated the terms of the new credit agreement but Lender Defendant's sole remedy is a prepetition breach of contract claim against Robertshaw. Judge Lopez also held that Lender Defendant was not entitled to injunctive relief voiding the December 2023 transactions which would have had the effect of restoring the Lender Defendant as the Required Lender. Further, Judge Lopez found that (i) One Rock did not tortiously interfere with Lender

Defendant's contractual rights under the new credit agreement and (ii) none of the Lender Plaintiffs, One Rock or Robertshaw breached New York's implied covenant of good faith and fair dealing.

To arrive at these conclusions, Judge Lopez looked to the plain language of the new credit agreement. He first analyzed whether the transactions resulting in the December 2023 amendment caused a "Subsidiary" to incur indebtedness in violation of the new credit agreement. Section 2.11 of the new credit agreement requires that Robertshaw make a mandatory prepayment of the "Net Proceeds from the issuance or incurrence of Indebtedness of … any Subsidiary" if such incurrence is prohibited by the terms of the new credit agreement. Relying on fundamental principles of New York contract law, he held that "RS Funding is a 'Subsidiary' that incurred 'Indebtedness' in violation of" the new credit agreement because, in the ordinary sense of the word, RS Funding is a subsidiary of Holdings. He further held that "[b]ecause Robertshaw failed to pay 100% of the Net Proceeds as a mandatory prepayment, it breached Section 2.11(b)(iii) of the [new credit agreement] only by not paying all the proceeds."

Despite ruling that Robertshaw violated the plain terms of the new credit agreement with the December 2023 transactions, Judge Lopez declined to restore Lender Defendant's Required Lender status because "the [new credit agreement] does not mandate that result." The court explained that there was "no need to look for remedies outside the four corners of the [loan]" because the "mandatory prepayment provisions… specifically deal[] with unauthorized incurrence of Indebtedness. Had the payment been made in full, the result would still be that Lender Defendant was no longer Required Lender." *Id.*

Judge Lopez also held that One Rock did not tortiously interfere with the Lender Defendant's rights because "One Rock did not intentionally procure any breach of the [new credit agreement], and One Rock was not the but for cause of any such breach by Robertshaw or the Lender Plaintiffs" and that neither the Lender Plaintiffs nor Robertshaw violated New York's implied contractual duty of good faith and fair dealing. *Id.* at 19-21.

Takeaways

- The *Robertshaw* opinion confronts a narrow issue of contract interpretation. This is not a case deciding the propriety of an uptiering transaction like *Serta*. *See* Memorandum Opinion [ECF No.1045], *In re*

Serta Simmons Bedding, LLC, No. 23-90020 (Bankr. S.D. Tex. June 6, 2023). *Serta* is currently on appeal to the 5th Circuit, so investors will need to wait until the 5th Circuit releases its opinion for further guidance on that issue. Indeed, Judge Lopez concludes that the liability management transaction in fact violated the terms of the new credit agreement here.

- Judge Lopez's ultimate decision to "enforce the [new credit agreement] as written" because it was "negotiated between sophisticated parties," and "on its own terms … does not lead to illogical or absurd interpretations of text" is consistent with the 2023 *Serta* In *Serta*, former Judge David Jones, also of the Bankruptcy Court for the Southern District of Texas, held that equity has no role where sophisticated parties negotiate, contract and participate in credit agreements that include the potential for liability management transactions. Many courts have followed a similarly strict four-corners approach when interpreting credit agreements in the context of liability management transactions.

- The *Robertshaw* decision is also consistent with other holdings declining to hold sponsors liable for tortious interference because the actions the sponsors engage in are done with the objective of preserving their investment. The decision is also consistent with other decisions finding that the borrower did not violate New York's implied covenant of good faith and fair dealing — which both bankruptcy courts and New York State courts have generally agreed on.

- The *Robertshaw* opinion, like *Serta*, came after a full trial, which provides greater guidance than other decisions in the context of a motion to dismiss such as *Murray Energy*, *TriMark* or *Boardriders*, where the legal standard requires the court to assess whether the plaintiff stated a plausible claim for relief.[1]

    - However, because these are decisions issued by the Bankruptcy Court for the Southern District of Texas with respect to New York State law, it is unclear whether they may carry great weight in New York State courts.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] *In re Murray Energy Holdings Co.*, 616 B.R. 84 (Bankr. S.D. Ohio 2020); *Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp.*, No. 565123/2020 (N.Y.S. Aug. 16, 2021); *ICG Global Loan Fund 1 DAC v. Boardriders, Inc.*, No. 655175/2020 (N.Y. Sup. Ct. Oct. 9, 2020) (D.I. 160).

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