

INSIGHTS

In re TPC Group Inc: Delaware Bankruptcy Court Determines that Issuance of Priming Senior Notes is Not Prohibited Absent Express Anti-Subordination Provision

July 8, 2022

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Following a July 6, 2022 memorandum opinion from the United States Bankruptcy Court for the District of Delaware, lenders and noteholders seeking to preserve the priority of their liens must make any desired subordination protections explicit in their security documents. Judge Craig T. Goldblatt's decision in *In re TPC Group Inc.* upholds a prepetition "uptier" transaction and narrows the issues before the Bankruptcy Court regarding TPC Group Inc.'s desired entry into a debtor-in-possession loan with an ad hoc group of noteholders over the dissent of minority holders. The decision highlights the importance of delineating simple majority or supermajority consent rights versus the so-called "sacred rights" afforded individual noteholders surrounding issues such as lien subordination.

Judge Goldblatt's decision turned on whether the Bankruptcy Court should apply a strict, technical construction of individual sections of the operative loan documents or consider the documents as a whole in conjunction with commercial norms. The Bankruptcy Court chose the latter approach, holding that a 2019 Indenture permitted the subordination of senior secured 10.50% Notes issued by TPC Group Inc. by a 2021 Indenture (and related intercreditor agreement) for senior secured 10.875% Notes. The ruling cleared a major hurdle to final approval of a debtor-in-possession financing seeking to roll up the \$238 million outstanding under the 10.875% Notes.¹ The Bankruptcy Court based its decision entirely on contractual interpretation of the relevant indentures and security documents (all governed by New York law), holding that, absent any specific directive or prohibition in an indenture, loan agreement, or intercreditor agreement, the original 2019 Indenture permitted majority holders of the 10.50% Notes to amend the 2019 Indenture to provide for subordination of the 10.50% Notes to the new 10.875% Notes, over the objection of minority holders of the 10.50% Notes, because subordination was not one of the "sacred rights" in the 2019 Indenture requiring consent of all holders of the 10.50% Notes. As Judge Goldblatt put it bluntly, "[t]here is nothing in the law that requires holders of syndicated debt to behave as Musketeers. To the extent such holders want to be protected against self-interested actions by borrowers and other holders, they must include such protections in the terms of their agreements."²

As background, in August 2019, the TPC Group Inc. ("TPC" and, together with its debtor affiliates, the "Debtors"), raised \$930 million by issuing senior secured notes due 2024 with an

interest rate of 10.50% (the “10.50% Notes” and such indenture, the “2019 Indenture”) secured by a first lien on substantially all of the Debtors’ assets. The minority holders of the 10.50% Notes (“Plaintiffs”) held approximately 10% of the 10.50% Notes. Several provisions of the 2019 Indenture are of note:

- Section 6.05 of the 2019 Indenture provided that holders “of a majority in aggregate principal amount of the then outstanding Notes may direct at the time, place and method of conducting any proceeding for exercising any remedy available to the Trustee or exercising any trust or power conferred on it.”
- Section 9.02(a) of the 2019 Indenture provided that, subject to certain exceptions, “the Issuer, the Guarantors and the Trustee . . . may amend or supplement this Indenture . . . and the Notes . . . with the consent of the Holders of at least a majority in the aggregate principal amount of the then outstanding Notes voting as a single class . . . [A]ny existing Default or Event of Default . . . or compliance with any provision of this Indenture . . . may be waived with the consent of the Holders of a majority in aggregate principal amount of the then outstanding Notes voting as a single class.”
- Section 9.02(e) of the 2019 Indenture provided exceptions to Section 9.02(a), including that any “amendment to, or waiver of, the provisions of this Indenture . . . that has the effect of releasing all or substantially all of the Collateral from the Liens securing the Notes . . . will require the consent of the holders of at least [two thirds] in aggregate principal amount of the Notes.”
- Section 9.02(d)(10) of the 2019 Indenture provided for what the Bankruptcy Court described as certain “sacred rights” pursuant to which, without consent of each affected party, “an amendment, supplement or waiver under this Section 9.02 may not . . . (10) make any change in the provisions in the Intercreditor Agreement or this Indenture dealing with the application of proceeds of Collateral that would adversely affect the Holders.”

Additionally, in 2019, TPC entered into an asset-based revolving loan facility (the “ABL Facility”) with availability of up to \$200 million, secured by a first lien on accounts receivable, deposit accounts, inventory, and other assets, and a second lien on assets securing the 10.50% Notes. The holders of the 10.50% Notes and the lenders under the ABL Facility subsequently entered into an intercreditor agreement, pursuant to which the holders of the 10.50% Notes would be paid first out of the proceeds of the collateral as to which they had a senior lien and the lenders under the ABL Facility would be paid first from accounts receivable, deposit accounts, inventory, and other assets for which they had a senior lien.

In February 2021, TPC issued \$153 million in new notes due 2024 with an interest rate of 10.875% and the parties entered into a new intercreditor agreement (the “2021 Intercreditor Agreement”). TPC subsequently issued an additional tranche of 10.875% notes in the amount of \$51.5 million (together with the \$153 million issuance, the “10.875% Notes”). Each tranche was secured by the same collateral securing the 10.50% Notes, but with a lien senior to that securing the 10.50% Notes. Importantly, the holders of the 10.875% Notes also held a supermajority (more than 67%) of the 10.50% Notes and, unlike other “uptier” transactions, did not sell their share of the 10.50% Notes back to TPC. Plaintiffs, however, were not issued any of the 10.875% Notes.

The Debtors filed for bankruptcy on June 1, 2022 and immediately sought entry into a debtor-in-possession financing loan (the “DIP”) with the same group of noteholders holding the 10.875% Notes. The proposed DIP consists of \$85 million in new money and a roll-up of the \$238 million outstanding under the 10.875% Notes. As the Bankruptcy Court noted, the effect of the proposed roll-up hinges largely on whether the 10.875% Notes were indeed senior to the 10.50% Notes. If the 10.875% Notes were senior, then the proposed roll-up would be little more than a “belt and suspenders” provision intended to protect the ad hoc group of noteholders through the course of the bankruptcy and any plan confirmation process. However, if the 10.875% Notes were determined to be junior to the 10.50% Notes, the roll-up would change the economics of the DIP significantly.³ Plaintiffs filed a complaint seeking a declaratory judgment that the 10.875% Notes were junior to the 10.50% Notes, and the Bankruptcy Court agreed to an expedited schedule to hear summary judgment motions prior to a scheduled July 15, 2022 final hearing on the DIP. Arguments were heard on June 29, 2022 and the Bankruptcy Court issued its memorandum opinion (the “Opinion”) on July 6, 2022.

In the Opinion, the Bankruptcy Court makes clear that the dispute was a contractual issue to be decided under New York law⁴ and is quick to distinguish the “uptier” financing in the instant transaction from other more “aggressive” transactions in which the lenders or noteholders in the subsequent transaction sold or otherwise exited their junior positions.⁵ As an additional preliminary point, the Bankruptcy Court held that section 6.06(a)(2) of the 2019 Indenture, which on its face precludes any lawsuit brought by a holder of 10.50% Notes in the absence of consent of holders of at least 25% of the 10.50% Notes to pursue such a claim, did not preclude Plaintiffs from bringing the instant action, as “the case law expresses a strong skepticism towards reading a no-action clause to preclude the enforcement of rights that an agreement expressly grants to individual holders.”⁶

Despite the Bankruptcy Court’s ruling that Plaintiffs had standing to file the complaint (despite holding only 10% of the 10.50% Notes), the Bankruptcy Court denied Plaintiff’s summary judgment motion and held the 10.50% Notes could be subordinated to the 10.875% Notes because the “sacred rights” that required unanimous consent of all affected holder of 10.50% Notes did not include lien subordination. Specifically, the Bankruptcy Court found that the issuance of the 10.875% Notes comported with the language of the 2019 Indenture and the original intercreditor agreement and that section 9.02(d)(10) of the 2019 Indenture prohibited neither subordination of the 10.50% Notes nor the adoption of the Supplemental Indenture and 2021 Intercreditor Agreement. Key to the Bankruptcy Court’s analysis was the language in section 9.02(d)(10) “dealing with the application of proceeds of Collateral.” The Bankruptcy Court eschewed Plaintiffs’ broad interpretation (that any change that would put new debt ahead of the 10.50% Notes with respect to the right to recover out of their collateral would implicate this section) in favor of the Debtors’ narrower read (that the only provision of the 2019 Indenture “dealing with the application of proceeds of Collateral” was section 6.10, which addresses the waterfall for how the trustee under the 2019 Indenture should ratably distribute the proceeds it receives).

Diverging from the New York Supreme Court’s approach in *Trimark*,⁷ where the Court denied a motion to dismiss a similar claim to the issue in *In re TPC Group Inc.* after looking solely at contractual language without reference to commercial norms, the Bankruptcy Court noted that “[i]n the context of an indenture, the Court believes that the inclusion of express anti-subordination clauses are sufficiently commonplace that, under the customs and usages that

are common in the trade, a provision providing for ratable distribution (in the absence of an express anti-subordination clause) would more naturally apply to distributions *within* a class, and not prohibit subordination of an entire class to another, different class.”⁸ Further, the Bankruptcy Court found the hierarchy of rights laid out in the 2019 Indenture to be instructive – most notably, it makes little sense to read subordination into the “sacred rights” under section 9.02(d)(10) which require consent from every affected party where a release of all or substantially all of the collateral securing the 10.50% Notes (a far more drastic action in the Bankruptcy Court’s view) would merely require a two-thirds majority under section 9.02(e) of the 2019 Indenture.⁹

Accordingly, the Bankruptcy Court declined to invalidate the challenged transactions and upheld the subordination of the 10.50% Notes to the 10.875% Notes under the 2019 Indenture. While the Bankruptcy Court did not expressly provide final approval for the Debtors’ proposed DIP, the Opinion does remove a major hurdle to such approval (and the proposed roll-up of the 10.875% Notes under the DIP) in advance of the July 15, 2022 hearing and further smooths the path toward the eventual confirmation of the Debtors’ chapter 11 plan, which is premised on the 10.875% Notes’ seniority. The Opinion is the latest example of the importance of unequivocal drafting regarding issues such as subordination provisions in any loan and security documents.

1. The Bankruptcy Court approved a partial roll-up of \$59 million of the 10.875% Notes in connection with interim DIP approval at the first day hearing on June 2, 2022, subject to a reservation of all parties’ rights to later challenge the roll-up. The balance of the 10.875% Notes claims would be rolled up upon final DIP approval.

2. *Bayside Capital Inc. and Cerberus Capital Management, L.P. v. TPC Group Inc. (In re TPC Group Inc.)*, Adv. Case No. 22-50372 (CTG) at * 28 (Bankr. D. Del. July 6, 2022).

3. *Id.* at 11.

4. *Id.* at 16-17 (“The current dispute [] does not turn at all on whether one or another party might be cast as sympathetic or opportunistic. It simply calls for the Court to read and enforce the parties’ agreements in accordance with their terms.”).

5. *Id.* at 2.

6. *Id.* at 18. As further evidence against this argument, the Bankruptcy Court took note of the “sacred rights” granted in the 2019 Indenture and reasoned that these cannot be taken away via an amendment to the 2019 Indenture, “regardless of how large or small those individual holders’ share of the total outstanding indebtedness may be.” *Id.*

7. *Trimark (Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp.)*, No. 565123/2020 (JMC), 2021 WL 3671541 (N.Y. Sup. Ct. Aug. 16, 2021)

8. Opinion at 24-25 (emphasis in original). The Court further found it further compelling that the Supplemental Indenture indeed contained such an express subordination prohibition. *Id.*

9. *Id.* at 26.

A version of this Update was also published by Law360 on July 19, 2022.