

New York State Supreme Court Allows Claims by Minority Lenders Not Participating in Uptier Debt Exchange to Survive Motion to Dismiss

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Abstract

On October 17, 2022, New York Supreme Court Justice Andrea Masley denied motions to dismiss claims of breach of contract and breach of the covenant of good faith and fair dealing brought by minority lenders challenging a non-pro rata uptier exchange transaction involving Boardriders, Inc. (“Boardriders”).

This transaction is one of a number of “uptier” debt exchange transactions that have recently been challenged by non-participating minority lenders.

In a typical uptier debt exchange transaction, a borrower incurs new “super-priority” loans provided by a group of its existing lenders. The new “super-priority” loans consist of both a “new money” component and, typically, an exchange or “roll up” of existing debt held by participating lenders into the new “super-priority” loan (sometimes, at a discount). In this transaction, the existing loans of non-participating lenders are, effectively, subordinated to the new “super-priority” loan.

This decision marks the third time a New York state or federal court has permitted minority lenders’ claims to proceed against majority lenders and borrowers engaged in uptier exchange transactions. In August 2021, New York Supreme Court Justice Joel Cohen allowed minority lenders’ breach of contract claims to proceed to discovery in the TriMark USA, LLC non-pro rata uptier exchange litigation. On March 29, 2022, U.S. District Judge Katherine Failla denied Serta Simmons’s motion to dismiss an action brought by minority lenders challenging the company’s non-pro rata uptier exchange transaction.

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Background

On August 31, 2020, Boardriders, a California-based surfing and skateboarding apparel maker, completed a non-pro rata debt exchange transaction with a majority of its existing term lenders (the “Participating Lenders”), which resulted in Boardriders obtaining \$467 million in priming loans consisting of \$135 million in “new money” contributed by the Participating Lenders along with a rollup of \$332 million of their existing term loan debt (the “Priming Debt”). Certain minority lenders were not offered an opportunity to participate in this transaction and their term loan debt was subordinated to the Priming Debt.

On August 31, 2020, Boardriders closed the uptier exchange transaction with the consent of Participating Lenders holding \$321 million in first-lien term loan debt under its existing \$450 million term loan credit agreement (the “Credit Agreement”). A group of non-participating minority lenders holding \$85 million of term loans (the “Plaintiffs”) filed suit in New York State Supreme Court (the “Court”) against Boardriders, its equity sponsor and the Participating Lenders (collectively, the “Defendants”).

To implement the transaction, Boardriders relied on the majority lender consent provisions in the Credit Agreement to allow for the incurrence of superpriority debt and to eliminate most of the Credit Agreement’s affirmative and negative covenants. Boardriders repurchased certain of the Participating Lenders’ then existing first lien term loans through what the company described as “open market” purchases under the Credit Agreement.

In challenging the transaction, the Plaintiffs argued that the debt-for-debt exchange was not truly an “open market purchase” because Boardriders did not provide cash consideration, the purchases were not made at market prices and the purchases were only available to the Participating Lenders. The Plaintiffs argued that the debt-for-debt exchange constituted a voluntary

prepayment in violation of the pro rata sharing provisions of the Credit Agreement.

Because the Credit Agreement required unanimous lender consent with respect to amendments that have the effect of subordinating the existing lenders’ liens or reducing the principal amount of any lender’s loans (so called “sacred rights”), the Plaintiffs also argued that Boardriders breached these requirements by failing to obtain the consent of all lenders.

Additionally, the Plaintiffs made a number of arguments regarding Boardriders’ entry into intercreditor agreements governing the relationship between the new super-priority debt and the existing debt under the Credit Agreement.

The New York State Supreme Court Decision

Plaintiffs asserted the following causes of action in their complaint against Defendants: (i) breach of contract with respect to the Credit Agreement, (ii) breach of implied covenant of good faith and fair dealing, and (iii) tortious interference with the Credit Agreement against Boardriders’ equity sponsor. Defendants filed motions to dismiss these claims. On October 17, 2022, New York Supreme Court Justice Andrea Masley largely denied the motions to dismiss, finding that the Plaintiffs had standing to bring their claims and allowing the breach of contract and breach of implied covenant of good faith and fair dealing claims to proceed.¹ Justice Masley granted the Defendants’ motion to dismiss the tortious interference claim.

Lack of Standing

Defendants’ first argument in the motions to dismiss was that Plaintiffs breached the Credit Agreement’s amended “no-action” clause which prohibited Plaintiffs from taking legal action without the prior authorization of the administration agent. The Court, however, found that because the amendment to the no-action provision was added as part of the uptier

¹ *ICG Global Loan Fund I DAC v. Boardriders, Inc.*, No. 655175/2020 (N.Y. Sup. Ct. Oct. 17, 2022).

transaction, and because the Plaintiffs did not consent to the addition of the no-action clause, the clause was “heavily disputed” and the Defendants did not establish a prima facie case that the Plaintiffs lacked standing.²

Breach of Contract Claims

Defendants also argued that the amendments to the Credit Agreement did not implicate a “sacred right” that required the consent of all lenders.³ Justice Masley rejected a literal reading of this provision, noting that, “[w]hile there is nothing in the sacred rights provision that expressly prohibits the subordination of any lenders’ liens, the court rejects the... narrow reading of the ...provision. Accepting the Company’s argument would essentially vitiate the equal repayment provisions set forth [in the Credit Agreement] and be contrary to the court’s obligation to consider the context of the entire contract and not in isolation of particular words - or in this case, the absence of particular words.”⁴

Defendants also claimed that the uptier exchange transaction did not result in a reduction or forgiveness of the principal amount of the Participating Lenders’ term loans and thus similarly did not implicate any “sacred rights” under the Credit Agreement not to reduce the principal amount of loans without the consent of all lenders. While Defendants argued that the Plaintiffs’ term loans were not affected, the Court noted that the Plaintiffs “posited a reasonable interpretation” that the Participating Lenders’ loans were forgiven via repurchase in violation of the Credit Agreement’s sacred rights provision.⁵ The Court also rejected that Defendants argument that the exchange was an “open market transaction”, allowing the Plaintiffs’ claim to survive noting that the term was ambiguous and could be ‘susceptible of more than one interpretation’⁶. Justice Masley thus held that Plaintiffs’ breach of contract claim was sufficiently pled to survive a motion to dismiss.

Breach of Implied Covenant of Good Faith and Fair Dealing

Justice Masley similarly denied dismissal of the Plaintiffs’ breach of the implied covenant of good faith and fair dealing claim. The Court found the allegations that the Defendants worked in concert and in secret to deprive Plaintiffs of the benefit of their bargain sufficient for the claim to move forward.

Tortious Interference

Justice Masley dismissed the Plaintiffs’ tortious interference claims against the equity sponsor. The Court was persuaded that the economic interest defense applied. This defense provides that if an entity has a valid legal or economic interest to protect, the entity is entitled to interfere with a contract, in the absence of fraud, malice, or illegality. Justice Masley held that the equity sponsor “acted to protect its own legal or financial stake” and therefore granted its motion to dismiss this claim.

Conclusion

In denying the Defendants’ motions to dismiss with respect to all but the intentional interference claim, Judge Masley left room for arguments about the meaning of its various provisions. It remains to be seen whether Plaintiffs will ultimately prevail on their claims.

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² *Id.* at 16.

³ *Id.* at 18.

⁴ *Id.* at 19.

⁵ *Id.* at 20.

⁶ *Id.* at 23.