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Texas Bankruptcy Court Finds Incora's Uptier Exchange Is a Bust

By Thomas Kessler and John Veraja*

In this article, the authors review a decision by a bankruptcy court in Texas that is one of only a handful of on-the-merits decisions on contested liability management situations.

The U.S. Bankruptcy Court for the Southern District of Texas has issued a decision in the hotly contested dispute over the 2022 liability management transaction involving Wesco Aircraft Hardware Corp. d.b.a. Incora (Incora or the Company) and a group of its noteholders. This opinion is one of only a handful of on-the-merits decisions on contested liability management situations.

BACKGROUND

Incora was created by a 2019 combination of PattonAir and Wesco Aircraft. The Company operates in the aerospace industry and provides supply chain solutions and distributes parts and services. The Company's capital structure primarily consisted of three series of notes worth approximately $2.175 billion and, by early 2022, it is was reported that Incora was considering a possible uptier exchange to address its debt burden and to shore up liquidity.

UPTIER LIABILITY MANAGEMENT TRANSACTION

In February 2022, Incora started to work with a group of noteholders led by PIMCO and Silver Point Capital (the PSP Group) on a potential uptiering transaction. Pursuant to the transaction, the PSP Group would provide $250 million of "new money" to Incora in exchange for Incora modifying the priority of certain collateral supporting their existing notes (through releasing liens) so such collateral could be diverted to support new first lien notes issued to the PSP Group. To release the collateral with respect to the existing notes, 66.67% of noteholders in each series of notes would be required to vote in favor of the release of liens.

At least one group of existing noteholders holding secured notes due 2026 (the 2026 Notes) became aware of the potential uptier transaction by the PSP Group and organized an ad hoc group of holders (the Non-Participating Ad Hoc Group). The Non-Participating Ad Hoc Group amassed around 40% of

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the 2026 Notes in what such holders thought would be a blocking position to prevent the PSP Group from reaching the requisite 66.67% threshold for releasing the liens on the collateral securing the 2026 Notes.

Realizing they did not hold enough of the 2026 Notes to meet the 66.67% threshold, the PSP Group and the Company devised a transaction where Incora would issue and distribute additional 2026 Notes to the PSP Group (which it believed it could do with the approval of a bare majority of holders, i.e., the PSP Group themselves), in order to increase the PSP Group's share of the outstanding notes to the requisite 66.67% threshold. The issuance of additional 2026 Notes occurred virtually simultaneously with the closing of the underlying liability management transaction and the issuance of the additional 2026 Notes enabled the PSP Group, along with certain other holders, to satisfy the 66.67% threshold to release the liens securing Incora's existing 2026 Notes.

As a result of the transactions, two new series of bonds were added to Incora's capital structure above all other existing notes. The 2026 Notes that were held by the PSP Group (but not the 2026 Notes held by the Non-Participating Ad Hoc Group and others) and certain 2024 notes also held by the PSP Group were exchanged for $1.273 billion in new first lien notes due 2026 (the New 2026 Notes). The New 2026 Notes were secured by the previously released collateral and the Non-Participating Ad Hoc Group was left behind with the old 2026 Notes that were now newly unsecured. The Company also exchanged certain unsecured 2027 notes owned by a group led by Carlyle/Platinum into $497 million of 1 ¼ lien notes due 2027 (the New 2027 Notes). Like the New 2026 Notes, the New 2027 Notes were secured by the previously released collateral that had secured the existing notes.

CHAPTER 11 BANKRUPTCY FILING AND ADVERSARY PROCEEDING

In October 2022, a group of non-participating noteholders sued the Company, the trustee for the notes and the participating noteholders in New York Supreme Court (the New York State Court Litigation) challenging the stripping of their liens and the issuance of the New 2026 Notes and the New 2027 Notes through the uptier exchange. The action sought to unwind the uptier transaction and the plaintiffs also sought compensatory and punitive damages in amounts to be determined, together with pre- and post-judgment interest.

Despite the completion of the uptier transaction, which resulted in the infusion of $250 million of new money from the PSP Group into Incora, the Company filed for Chapter 11 in the U.S. Bankruptcy Court for the Southern District of Texas (the Bankruptcy Court) in June 2023. The New York State

Court Litigation was effective moved to the Bankruptcy Court following the Company's Chapter 11 filing where the case proceeded to a 30-day trial.

NON-PARTICIPATING HOLDERS' ARGUMENTS

The non-participating holders, including members of the Non-Participating Ad Hoc Group, argued that, in form and substance, each step in the uptier transaction was part of a single transaction designed to strip liens from non-participating lenders and give the collateral to the PSP Group. More specifically, the non participating lenders argued that, even if the issuance of additional notes were permissible with a bare majority in some cases, the Company could not validly issue the additional 2026 Notes to the PSP Group as part of the Uptier Transaction without supermajority consent, because those notes' function was to adversely affect non-participating holders' liens on the collateral.

In support of this claim, the group pointed to a provision of the relevant indenture, which required supermajority consent for any amendment, supplement or waiver that "may . . . have the effect of releasing all or substantially all of the Collateral from the Liens created pursuant to the Security Documents. . . ." The non-participating noteholders argued that the breadth of the provision is evident from the plain meaning of its terms and that the function of the additional 2026 Notes issued to the PSP Group was simply to cause the release of the liens and create new unpermitted liens in favor of the New 2026 Notes (thus the entire transaction should require a 66.67% majority voting threshold).

PARTICIPATING HOLDERS' AND COMPANY'S ARGUMENTS

The participating holders, including the members of the PSP Group, and the Company, argued that that Incora did not breach the its indenture in executing the amendments and agreements required to complete the uptier transaction.

The Company argued that, pursuant to the indentures, only majority consent of each series of notes outstanding was required to amend the original indentures to expand the Company's debt capacity to permit the issuance of additional 2026 Notes to the PSP Group. The PSP Group held a majority position (but not 66.67%). When the Company authorized the issuance of additional 2026 Notes through majority vote, as required per the indenture, it issued those additional 2026 Notes to the PSP Group and received $250 million in new money from the PSP Group. On account of the additional 2026 Notes, the PSP Group had greater than a 66.67% voting position, and with the consent of the PSP Group and each series of secured notes then-outstanding, the parties then had the required voting power to release the liens securing

Incora's existing notes. The Company then exchanged the notes held by the PSP Group for New 2026 Notes secured by the previously released collateral.

The Company argued that each step of the uptier transaction complied with the underlying indenture and noted further that the transaction provided significant benefits to the Company, including substantial debt service relief and maturity extensions (although, the transaction did not prevent bankruptcy).

DECISION AND REMEDIES

Judge Isgur issued an oral ruling from the bench on July 10, 2024, and declared that the uptier transaction violated the terms of the 2026 Notes indenture. Judge Isgur's decision effectively unwound the uptier transaction in that the Bankruptcy Court restored all "rights, liens and interests" of the holders of the original 2026 Notes (including those originally held by the PSP Group before the additional 2026 Notes were issued). Judge Isgur found that the additional 2026 Notes that the Company issued to the PSP Group simultaneously with the closing of the uptier transaction in order to increase the PSP Group's voting power to over 66.67% were never issued (because such issuance required consent from 66.67% of holders (rather than simple majority consent)).

Specifically, Judge Isgur noted that he viewed the entire transaction as "domino agreement" – the amendment that authorized the issuance of the additional 2026 Notes to give the PSP Group a supermajority voting position was the first domino and all the other steps in the transaction were "inevitable," including the amendments that occurred virtually simultaneously with the amendment that authorized the issuance of the additional 2026 Notes and had the effect of stripping the liens on the 2026 Notes.

Judge Isgur noted that because the additional 2026 Notes were not validly issued, the PSP Group only has an unsecured claim for the $250 million in new money that they provided to the Company. On December 5, 2024 the debtors filed their latest proposed Chapter 11 plan. While the parties noted in a status conference on the same day that the proposed plan is still subject to negotiation with respect to "significant issues," the proposed plan provides that the debtors' reorganized equity and $420 million in convertible take-back notes would initially be allocated approximately 76% to participating noteholders and approximately 24% to the non-participating 2026 noteholders.

The plan also provides that the appellate courts or the Bankruptcy Court would determine any reallocation of reorganized equity or take-back notes if Judge Isgur's decision is reversed on appeal.

CONCLUSION

Given this is one of the first on-the-merits decisions with respect to a contested liability management transaction it will remain to be seen how the Bankruptcy Court's decision affects the red-hot market for liability management transactions. While some may think the Bankruptcy Court's decision signals a willingness to push back against overly-sharp readings of indentures, others view Judge Isgur's decision as narrowly focused on the specific language in the indenture and view the opinion with perhaps a bit less precedential value. Time (including any appellate decisions that result from this transaction) will tell!