

# Deviating from Absolute Priority

## *Secured Creditors*

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# Topics

- Underlying presumption reorganization
- ‘No creditor worse off’ and secured creditors
- Gifting

# Underlying presumptions reorganization

## ■ Basic rules

- Class formation and voting
- Rights to offer and competing plans
- Cross class cram down
- No creditor worse off

## ■ Entire structure presumes not all value will go to shareholder anyway....

## ■ But.... in the Netherlands, (secured) shareholder loans are respected by trustees and supervisory judges

- McGregor: credit bid by existing secured shareholder
- Thermphos (2020): unsecured shareholder claim arising out loss finance fully allowed
- V&D secured shareholder loan:
  - and the 70 million will go to... Sun Capital

# Secured shareholder loans & reorganization

- Bill should only be adopted if shareholders cannot wipe out creditors using secured credit
  
- Otherwise, why not give court documents to Private Equity firms directly?
  
- See in English on Bill ‘highlights for shareholders’:
  - i) ... iv)
  - v) No subordination of shareholder debt.

No creditor worse off principle applied to secured creditors

# Three body problem

- Who is entitled to surplus if all assets are encumbered?
  
- Tabb:
  - *“Outside of bankruptcy, the secured lender may have considerable difficulty capturing anything above liquidation value. If the bankruptcy process itself allows the recovery of more value, why should all of that bankruptcy-enabled excess go to the secured lender?”*
  
- Need to strengthen position unsophisticated unsecured creditors vis-a-vis secured, Jonkers and Van Moorsel.
  - No creditor worse off also applies to secured credit
  
- Preferred – ordinary creditor conflict often used to argue for value transfers away from creditors to shareholders.

# Gifting

# Gifting

Assets (going c.)	Equity & Liab	Assets (going c.)	Equity & Liab
	Equity -12	2	EQUITY 2
15	BANK 17	13	BANK 13
	BOND 10		BOND 0
TOTAL 15	TOTAL 15	TOTAL 15	TOTAL 15

## Possible background

- LBO with initial debt of 10 and equity of 2
- After four years and 15% interest, debt is 17
- Debt reduced to 13
- Compound Interest for bank is still 4.6%
- Even if not explicitly agreed, outcome is undesirable



# US law on class skipping

## ■ ABI

- *“The Commission agreed that — in the nonconsensual (i.e., cramdown) context — the potential abuses of gifting outweighed any benefits in class-skipping, class-discriminating, and intra-class discriminating cases.”*

## ■ US Supreme Court held against class skipping in Jevic (2017)

- Again Sun Capital

## Gifting

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### Problems:

-distortion of valuation assets

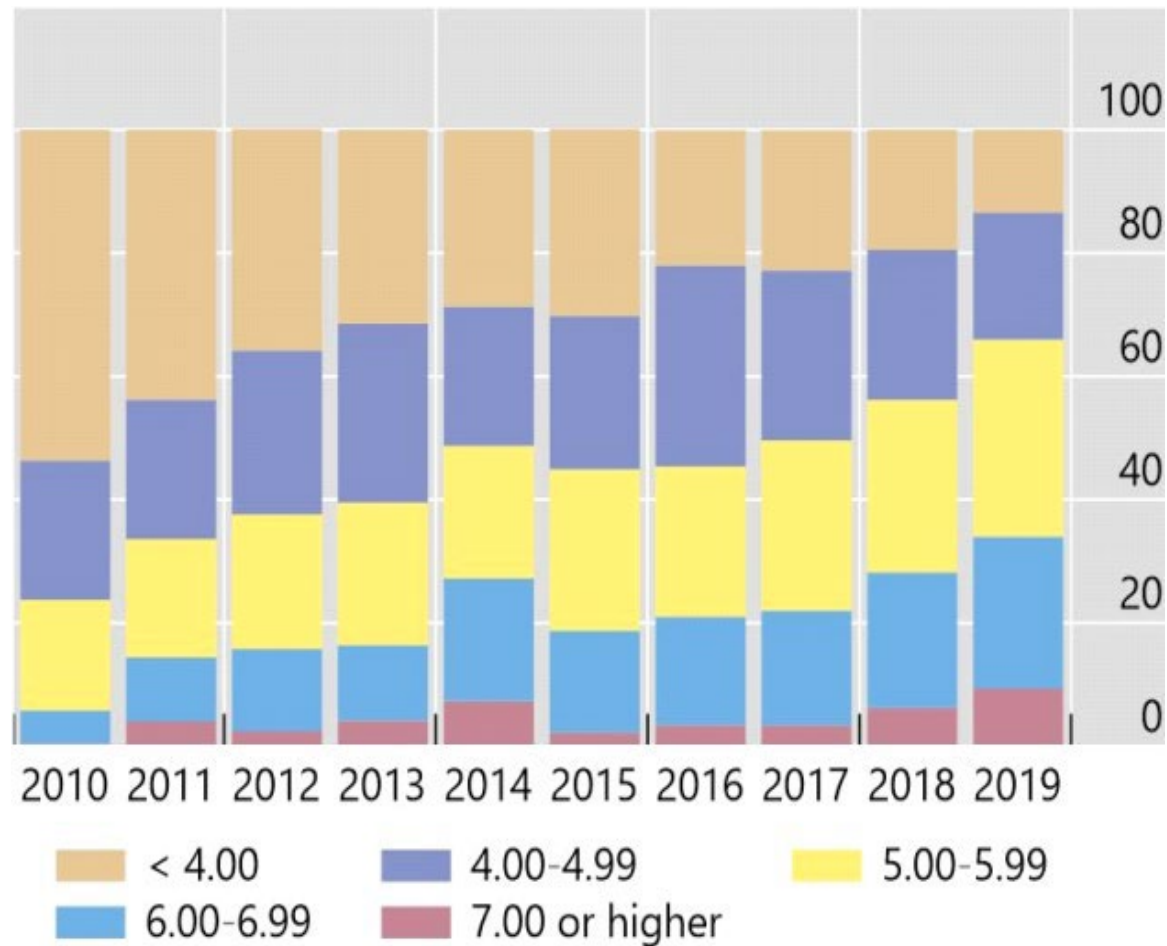
-distortion of valuation of secured debt

-collusion

See also D.G. Baird 2018

- We could develop an S(M)E equity retention regime:
  - SME Europe: < € 43 million in balance sheet total
  - SME in US: < USD 2.7 million in debt
  
- No need for allowing gifting in addition to a tailor made true S(M)E equity retention
  
- Hold out is not hold out if shareholder remains in place
  
- Most important protection unsecured creditors is assurance that shareholders do not remain in place without their consent
  - Often a better guarantee than security rights themselves

# Increasing leverage



# Gifting

Do we allow the parties responsible for setting up the overleveraged structure, (banks and shareholders) to divide the value amongst each other?