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Minority Holders’ Challenge to Wesco’s Multi-Step Uptiering Transaction Largely Survives Summary Judgment

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Executive Summary

In two opinions issued earlier this month, Judge Marvin Isgur of the Bankruptcy Court of the South District of Texas denied motions for summary judgment. The movants sought to ratify and validate Wesco's uptiering transaction that resulted in the payment, subordination and lien stripping of Wesco's existing pre-exchange notes. The Court will focus at trial on whether or not the multi-step transaction should be treated as one integrated transaction and how to interpret certain ambiguous provisions of Wesco's note indentures. See *In re Wesco Aircraft Holdings, Inc., et al. v. SSD Investments Ltd.*, No. 23-90611, 2024 WL 156211 (Bankr. S.D. Tex. Jan. 14, 2024).

Background

Wesco Aircraft (d/b/a Incora), an aerospace hardware and service company, issued approximately \$2 billion in notes under three Indentures – the 2024 Secured Indenture, the 2026 Secured Indenture and the 2027 Unsecured Indenture. The notes financed its 2019 leveraged buyout. By late 2021, the company needed more liquidity due to business setbacks related to COVID.

To address this need, certain of Wesco's existing noteholders offered new financing through an uptiering transaction. However, the participating noteholders did not have the two-thirds supermajority necessary to amend the 2026 Secured Indenture and authorize the uptiering. The Indentures did, however, permit the issuance of new notes by a simple majority vote. Therefore, Wesco and the participating noteholders implemented the uptiering transaction by:

1. Amending the Indentures by majority vote to allow for the issuance of additional notes under the 2026 Indenture (the "3rd Supplemental Indentures");
2. Wesco's issuance of the additional notes to the participating noteholders under a Note Purchase Agreement;
3. Amending the Indentures again (the "4th Supplemental Indentures"), this time with two-thirds supermajority vote due to the participating noteholders' purchase of the additional notes, to authorize the exchange of the participating noteholders' existing notes for new notes with higher-priority liens and strip liens from the remaining 2024 Notes and 2026 Notes held by non-participating noteholders; and
4. Consummating the exchange by the Exchange Agreement.

Non-participating (formerly secured) noteholders under the 2024 and 2026 Secured Indentures and Langur Maize, a non-participating noteholder under the 2027 Unsecured Indenture, filed lawsuits in New York state court against Wesco, the participating noteholders and Wilmington Savings Fund Society, FSB ("WSFS"), as the trustee under the Indentures, challenging the uptiering transaction on numerous grounds, including breach of contract, tortious interference with contract and fraudulent conveyance.



In June 2023, Wesco filed for bankruptcy in the Bankruptcy Court for the Southern District of Texas. Wesco then filed an adversary proceeding against the non-participating noteholders seeking a declaratory judgment that, among other things, the uptiering transaction was valid. The non-participating noteholders filed a counter-complaint reasserting many of the claims asserted in the New York state court actions. All parties moved for summary judgment.

Summary Judgment Decision

On Jan. 14, 2024, Judge Isgur issued his decision on the summary judgment motions. He then supplemented this opinion on Jan. 23, 2024.

Courts grant summary judgment only if the moving party shows that there is no genuine dispute of material fact and that the moving party is entitled to judgment as a matter of law. Otherwise, the Court should preserve those issues for a trial on the merits.

Judge Isgur denied summary judgment on most of the causes of action alleged by the minority noteholders against Wesco and the participating noteholders, clearing the way for a trial on whether the uptiering transaction was valid. The Court granted summary judgment and dismissed the causes of action alleging (i) breach of the implied covenant of good faith and fair dealing as being duplicative of the breach of contract claims, (ii) conversion, because there was no property that could have been converted, (iii) breach of contract against WSFS, as trustee, because it was contractually protected from liability under the Indentures and (iv) unjust enrichment claims, because the Indentures are valid contracts.

The Court cited two principal grounds to support denial of summary judgment on the causes of action that will proceed to trial. First, the Court denied summary judgment of the breach of contract claims and the tortious interference of contract claims (a component of which is a finding of breach of contract) because disputed facts exist regarding whether the agreements implementing the uptiering transaction should be treated as a single, integrated transaction and, if so, whether that would result in one or more breaches of the Indentures. The integrated transaction doctrine provides that when different components, or steps, of a transaction are sufficiently interrelated, they should all be considered within the same transaction, rather than distinct from one another. The doctrine permits a court to elevate substance over formal labels of the agreements based on the intent of the parties and the net effect of the transaction as a whole.

Specifically, the Court held that whether the uptiering transaction improperly modified the minority noteholders' collateral in a manner adverse to them depends on whether it could be considered an integrated transaction, as opposed to multiple transactions. Similarly, the Court held that whether the additional notes authorized by the 3rd Supplemental Indenture constituted a breach of contract:

depends on whether the 2022 Transaction should be considered a single transaction. If the 2022 Transaction was one transaction, Wesco *appears* to have violated the Indentures when Wesco amended the Secured Indentures without a two-thirds vote of the outstanding notes. If each transaction should be viewed separately, then there was no apparent violation.

The Court's language, emphasized above, does not provide certainty that it would find that Wesco breached the Indentures, even if the integrated transaction doctrine does apply. However, the Court certainly leaves the door open for this outcome. The Court held that resolution of the integrated transaction issue "will be based on the parties' intentions" regarding the uptiering transactions.

Second, the Court denied summary judgment on the breach of contract claims, including the question of whether the uptiering transaction breached the *pro rata* redemption provisions of the Indentures, on the



ground that the Indentures are ambiguous. Thus, the Court will need extrinsic evidence at trial to determine the meaning of certain provisions of the Indentures. Most notably, Wesco and the majority noteholders argue that the transaction was not a redemption but, instead, an exchange pursuant to “an open market or privately negotiated transaction”, which is not required to be *pro rata* among noteholders. The court ruled that there is a “genuine dispute” regarding whether the uptiering transaction constituted a redemption or an exchange.

Takeaways

- Courts generally have not “rubber-stamped” uptiering and similar transactions. Disputes largely turn on the facts of a given case – and thus warrant a full trial typically.
- Courts continue to focus on whether each transaction complies with the terms of the governing agreement. What may be permissible under one agreement may be prohibited by another.
- Most courts presiding over uptiering lawsuits have rejected claims for breach of the implied covenant of good faith and fair dealing and have focused more on whether the transaction complied with the indenture or credit agreement. Similarly, arguments that uptiering transactions violate open market purchase provisions have largely been unsuccessful.
- As these trends emerge, minority noteholders are being more creative in their arguments to challenge uptiering transactions. For instance, here, the minority noteholders have argued that the exchange was actually a redemption, which can only be done *pro rata* under the Wesco Indentures – rather than challenging whether the exchange complied with the “privately negotiated transaction” provision.
- While precedent can be instructive, any institution seeking to protect itself from being left behind in an uptiering transaction should carefully read the governing debt documents and understand the potential for a borrower to implement a liability management transaction.

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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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