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## WEATHERING THE STORM

### **Charter Communications Decision Allows Reinstatement of Debt**

Many companies secured their financing several years ago when the credit market featured advantageous pricing and loose loan covenants. Because these favorable terms would be impossible for borrowers to obtain in today's lending environment, many viable companies with highly leveraged capital structures are looking for strategies to remove debt *and, at the same time*, to preserve, or "reinststate," the favorable financing deals they secured before the markets crashed.

In order to undo the acceleration of pre-petition debt and to reinstate such debt through a chapter 11 bankruptcy, a debtor's plan must reinstate the original maturity applicable to the debt, and cure any defaults that may have occurred. 11 U.S.C. §1124(2). The bankruptcy court must determine whether defaults have occurred or will occur under the applicable credit agreement by carefully analyzing the credit agreement itself and the evidence regarding the debtor's value and sources of liquidity. On November 17, 2009, New York Bankruptcy Judge James Peck issued an unprecedented opinion reinstating \$11 billion dollars of debt over the vociferous objections of Charter's senior lenders. Key to the Bankruptcy Court's ruling are the holdings that (i) the credit agreement did not create defaults for a prospective inability to pay debts as they become due, and (ii) there was no prohibited "change of control" as a result of the Plan.

#### **The Charter Communications Decision**

Charter Communications ("Charter"), the country's fourth largest cable television company, took a gamble during, arguably, the most challenging period in the modern era of global corporate finance. After entering into calculated pre-bankruptcy agreements with its junior lenders *without* any negotiation with its senior lenders, Charter filed bankruptcy seeking confirmation of a plan of reorganization ("Plan") that proposed to (i) eliminate \$8 billion of debt from its highly leveraged capital structure; (ii) raise \$1.6 billion in new equity through a rights offering back-stopped by certain bondholders; and (iii) reinstate \$11.8 billion in senior secured debt to preserve favorable existing credit terms and save hundreds of millions of dollars in interest payments that would otherwise be payable if such debt had to be replaced at current market pricing.

JPMorgan Chase Bank, N.A., as agent for a syndicate of senior lenders (the "Senior Lenders") objected to the Plan on the grounds that Charter had defaulted under many covenants in its credit agreement with the Senior Lenders. The Court rejected the Senior Lenders' argument that certain holding companies of Charter could not prospectively pay their debts as they came due on the grounds that (i) the credit agreement covenants did not address the holding companies' *prospective* inability to pay debts, and (ii) the Senior Lenders' evidence failed to conclusively demonstrate an event of default under the credit agreement.

The Senior Lenders also challenged reinstatement on the grounds that a change of control would occur on the effective date of the Plan, and that such change of control was a default under the credit agreement. While the Bankruptcy Court noted that the change of control issue was the "most challenging problem" for the Debtors in seeking reinstatement, it ultimately found no change of control. The change of control inquiry required an examination of relevant covenants of the credit agreement related to the percentage of voting power that must be held by Paul Allen ("Allen"), who had invested eight billion dollars in Charter. Pursuant to the credit agreement no "change of control" would trigger if Allen's economic interests were eliminated *as long as* Allen held a minimum

voting percentage of 35%. In order to make this work, the Debtor's Plan (i) provided that Allen would receive nothing on account of his equity investment; but (ii) proposed a settlement with Allen in order to retain his voting participation so as to not trigger a change of control. Pursuant to the settlement, the Debtors paid Allen \$375 million in consideration for his continued voting participation. In return, the Court found the Debtors received \$3.5 billion in benefits including the hundreds of millions saved by reinstating the Senior Lenders' debt at a below-market interest rate, and \$1.14 billion in cash tax savings associated with preservation of net operating losses.

The Court further held that although the three large bondholders supporting the Plan and the conversion of their debt to equity "worked collectively and in a coordinated fashion" in securing control of the debtors, they were not a "group," as defined by Section 13(d) of the Securities Exchange Act, because they never entered an agreement to act jointly. Accordingly, the Court held that their efforts did not violate the change of control provisions of the credit agreement.

Finally, the Senior Lenders argued that the bankruptcy petitions of the holding companies accelerated certain indentures outstanding against them and triggered an event of default; specifically, a "cross-default" under the credit agreement. Section 1124 of the Bankruptcy Code provides that any default relating to the insolvency or financial condition of a debtor, or "*ipso facto*" defaults, need not be cured for reinstatement. Although the Senior Lenders argued that the cross-default was not an *ipso facto* default because the borrowing entity under the relevant credit agreement was technically solvent, the Bankruptcy Court was not persuaded on this point. Observing Charter to be an "integrated enterprise," where "the financial condition of one affiliate affects the others," Judge Peck held Charter's cross default under the credit agreement to be *ipso facto* and therefore not a bar to reinstatement.

The "gamble" paid off for the debtors (and the junior lenders) in *Charter*. Pending appeals are likely being mooted as the Debtors begin to implement their Plan. It remains to be seen whether other courts will follow the *Charter* precedent and allow other overleveraged companies to convert debt to equity, alter the ownership structure of the company, and at the same time reinstate favorable financing.

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