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The Southern District of New York's Norske Skog Decision: What Constitutes A Refinancing May Be In The Eye of The Beholder

March 29, 2016

The recent decision by the United States District Court for the Southern District of New York in *Citibank, N.A. v. Norske Skogindustrier ASA*[1] could be an important consideration for future drafting and interpretation of debt agreements. While the Court's decision is in the context of a preliminary injunction motion, the opinion provides useful guidance for parties potentially undertaking a refinancing exchange offer, and for parties who may seek to challenge such an exchange. Given the increasing need for companies in distressed industries to exchange debt and extend maturities, parties facing a potential debt exchange should consider the *Norske Skog* court's indenture analysis.

The Proposed *Norske Skog* Exchange Offer

Norske Skogindustrier ASA ("**Parent**") and Norske Skog As (the "**Company**"), through their operating subsidiaries, operate a global publication paper company that produces newsprint and magazine paper, with paper mills around the world. As of September 30, 2015, Parent and the Company had approximately €990,000,000 of debt.

Parent is the issuer of two series of senior unsecured notes: €121,421,000 senior notes due 2016 (the "**2016 Notes**") and €218,106,000 senior notes due 2017 (the "**2017 Notes**" and together with the 2016 Notes, the "**Parent Notes**"). In addition, in February 2015 the Company issued €290,000,000 senior secured notes due 2019 (the "**Secured Notes**"). The Parent Notes do not have the benefit of any collateral or guarantees and have no obligors other than the Parent. The Secured Notes benefit from guarantees of Parent and certain subsidiaries of the Company and are secured by all share capital issued by any subsidiary that is a guarantor and certain assets of the subsidiary guarantors.

In January 2016, after struggling to execute on earlier attempts to refinance the Parent Notes given their near-term maturities, Parent and the Company launched an exchange offer (the "**QSF Exchange Offer**") to the holders of the Parent Notes. Among other things, the consideration

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[1] *Citibank, N.A. v. Norske Skogindustrier ASA*, No. 16-cv-850, 2016 WL 1052888 (S.D.N.Y. Mar. 8, 2016) (Sullivan, J.).

payable in exchange for each series of Parent Notes included new senior secured notes to be issued by the Company in aggregate principal amount of €110,000,000 (the "**QSF Exchange Notes**"). The QSF Exchange Notes were to be guaranteed by Parent and would be secured by certain receivables of the subsidiary guarantors that do not otherwise secure the Secured Notes.[2]

The Trustee's Complaint

The trustee for holders of the Secured Notes (the "**Trustee**") filed suit against Parent, Company and the subsidiary guarantors initially seeking a preliminary injunction against the QSF Exchange Offer. The Trustee alleged that (1) consummating and closing the transactions contemplated by the QSF Exchange Offer would cause irreparable harm to holders of the Secured Notes, and (2) the Secured Notes trustee would more likely than not succeed on the merits in a claim that the Exchange Offer and the issuance of the QSF Notes violates the terms of the indenture governing the Secured Notes.

The Trustee focused on the covenant in the indenture that prohibits the Company from incurring additional debt. While the debt covenant has 22 specific "baskets", and a general exception allowing unlimited debt if the Company is in compliance with a minimum fixed charge coverage ratio ("**Ratio Debt**"), the Trustee argued that the QSF Exchange Notes did not fit into any of these exceptions.[3]

However, one of the exceptions in the debt covenant permits "Indebtedness incurred in any Qualified Securitization Financing."[4] The Company intended to issue the QSF Exchange Notes under this basket and characterize the new secured notes as a Qualified Securitization Financing. A Qualified Securitization Financing is defined in the indenture as "'***any financing*** pursuant to which the Issuer or any Guarantor may sell, convey or otherwise transfer to ***any other Person*** or grant a security interest in, any Securitization Assets (and related assets) in any aggregate principal amount equivalent to the Fair Market Value of such Securitization Assets (and related assets) of the Issuer or any of its Restricted Subsidiaries . . . .'"[5] The remainder of the definition focuses on what the terms of the financing must be (*i.e.*, market covenants, events of default and other provisions, market interest rate and non-recourse to the Company and its subsidiaries subject to customary exceptions).

The Trustee argued that the QSF Exchange Notes did not meet the definition of a Qualified Securitization Financing. First, despite the indenture's use of the phrase "any financing", the Trustee argued that the issuance of the QSF Exchange Notes "is not a 'financing'" at all; "it is a

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2 *Id.* at *1-2.

3 *Id.* at *2-3.

4 *Id.* at *3.

5 *Id.* at *3 (*quoting* Indenture § 1.01) (bold emphasis added).

refinancing" because defendants are "exchang[ing] old debt for new debt" rather than raising new capital.[6] Second, the Trustee claimed that even if viewed as a "'financing,'" the QSF Exchange Notes could not constitute a "'Qualified Securitization Financing'" as defined in the indenture, because, among other things, (i) they are not being issued on market terms, (ii) they include above-market interest rates; and (iii) the principal amount is not equivalent to the fair market value of the QSF Exchange Notes Collateral.[7]

The QSF Exchange Notes arguably could have been issued under the basket permitting the incurrence of new debt "in exchange for" or "to refinance" certain existing debt so long as the new debt satisfies the definition of "Permitted Refinancing Indebtedness." However, that defined term in the indenture specifically states that "such Permitted Refinancing Indebtedness shall not include . . . Indebtedness of a Restricted Subsidiary of the Parent Guarantor that refinances the Existing Parent Notes."[8] The Trustee pointed to this exclusion to argue that since the QSF Exchange Notes cannot be "Permitted Refinancing Indebtedness", the Company must be violating the indenture by issuing them, even if the issuance was via the Qualified Securitization Financing basket.[9]

The Company's Response

The Company pointed to its disclosure in the Secured Notes offering memorandum that made it "perfectly clear to the SSN Holders at the time they purchased their notes that the collateral now comprising the QSF Exchange Collateral would be available for other uses."[10] The Company disclosed that the Secured Notes were only secured up to the value of the collateral securing those Secured Notes and not by "certain receivables . . . under our existing and future factoring and securitization programs."[11] The Description of Notes also set out 22 different categories of Permitted Debt, including Qualified Securitization Financing.

The Company maintained that a refinancing is "simply a subset of financing", consistent with the indenture's use of the phrase "any financing."[12] The Company also relied upon Section 4.09(c) of the indenture, which permitted an incurrence of indebtedness to be allocated among multiple

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6 Memorandum of Law in Support of Plaintiff's Order to Show Cause for (I) a Temporary Restraining Order and Preliminary Injunction and (II) Expedited Discovery (ECF No. 47-14) at 13-14 & n.9.

7 *Id.* at 14-17.

8 Indenture § 1.01.

9 The issuance of the QSF Exchange Notes implicated other Indenture covenants including the prohibitions on liens, transactions with affiliates and restrictions on asset sales. Each of these covenants has a carveout or basket for a Qualified Securitization Financing. Therefore, none of these covenants would be violated if the QSF Exchange constitutes a Qualified Securitization Financing. Conversely, if the QSF Exchange does not meet the requirements set forth in the definition of "Qualified Securitization Financing", then not only the debt covenant would be breached but other covenants as well.

10 Memorandum of Law in Opposition to Plaintiff's Motion for a Preliminary Injunction (ECF No. 32) at 1.

11 *Id.* at 3-4.

12 *Id.* at 13.

categories of permitted debt and/or Ratio Debt.[13] This provision, the Company contended, supports the interpretation that a limitation on one basket in the indenture should not foreclose that same debt from being incurred under another basket.

Finally, in opposing the motion for an injunction, the Company noted that the covenant prohibiting Restricted Payments includes a restriction on prepayment of certain debt. However, there is an unlimited basket to repurchase, redeem, or retire the Parent Notes without any limitation on how such restricted payment is made or the source of funds (if any) used to do so (which is in contrast to the payment of subordinated debt, which can only be repurchased, redeemed or retired with Permitted Refinancing Indebtedness). If the intent of the debt covenant was to only permit the refinancing of the Parent Notes with Permitted Refinancing Indebtedness, the corresponding restricted payments basket should have included a similar limitation.[14]

The Court's Ruling

The Court denied the bondholder's motion for a preliminary injunction on the basis of a lack of irreparable harm to the Norske Skog Secured Noteholders if the QSF Exchange was allowed to proceed.[15] The court found that the evidence was conflicting on whether the Company would be forced into bankruptcy if the exchange could not proceed. The Court further found that the Trustee had failed to show that enjoining the QSF Exchange would improve the Company's financial condition or the bondholders' ability to be repaid. In fact, the Trustee seemed to have conceded that without the QSF Exchange, the Company's condition might actually get worse.[16] Further and perhaps most significantly, the Court noted that the Trustee failed to rebut evidence that the Secured Notes had more than sufficient collateral coverage and thus, any contention by the Trustee as to loss of priority over assets was "highly speculative".[17]

As to the "success on the merits" requirement for injunctive relief, the Court was "skeptical of Defendant's proposed interpretation of the term 'financing' to include the very type of refinancing that is explicitly prohibited by Section 4.09(b)(5)"[18] and therefore agreed with the Trustee that the QSF Exchange Offer is explicitly prohibited by the indenture. Since the definition of "Permitted

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[13] *Id.* at 14. Section 4.09(c) of the indenture states "[T]he Parent Guarantor, in its sole discretion, will be permitted to classify such item of Indebtedness on the date of its incurrence and will only be required to include the amount and type of such Indebtedness in one of such clauses and will be permitted on the date of such incurrence to divide and classify an item of Indebtedness in more than one of the types of Indebtedness described in Sections 4.09(a) and 4.09(b) hereof and from time to time to reclassify all or a portion of such item of Indebtedness, in any manner that complies with this Section 4.09."

[14] *Id.* at 13-15 & nn.9-12.

[15] 2016 WL 1052888, at *7.

[16] *Id.* at *5-6.

[17] *Id.* at *6.

[18] *Id.* at *4. Section 4.09(b)(5) is the debt covenant basket allowing "Permitted Refinancing Indebtedness."

Refinancing Indebtedness" refers to debt being "renewed, refunded, refinanced, replaced, exchanged, defeased or discharged", and in contrast the definition of "Qualified Securitization Financing" refers to "any financing", the Court concluded that the Company's argument that a refinancing is a subset of "any financing" was not tenable. Furthermore, since "Permitted Refinancing Indebtedness" cannot include a refinancing of the Parent Notes with debt of a Restricted Subsidiary, allowing the incurrence of the QSF Exchange Notes under a different basket would be "an end-run around the indenture's explicit prohibition against the refinancing of the Parent Notes set forth in the definition."[19] The Court stated that allowing the Company's interpretation of "any financing" to mean "any financing or refinancing" would effectively render meaningless the restriction in "Permitted Refinancing Indebtedness" and would allow any refinancing through the "back door of the QSF Provision."[20]

Lingering Questions After *Norkse Skog*

"End-Around" of Permitted Refinancing Indebtedness Restriction through "Back-Door" QSF

The *Norske Skog* court agreed with the Trustee that incurring a Qualified Securitization Financing would constitute an "end around" or "back door" way of averting the intent of the Permitted Refinancing Indebtedness covenant. However, market practice is clear that individual baskets, unless explicitly connected to each other, stand alone and can be utilized individually - irrespective of the availability of any other basket. Thus, there is a question whether the Court's decision is consistent with market participants' practice and commonly held understanding. Many other baskets in debt documents have limitations on use of proceeds. For example, a traditional indenture would often have both a "general" dollar basket to be used for any purpose and also a capital lease/purchase money basket, which can be used only for debt used to finance the purchase price of certain assets. The purchase money basket also might contain a limitation on the time between the purchase of the asset and the incurrence of the debt. Applying the *Norske Skog* court's rationale to these provisions, since the purchase money basket limits the use of proceeds to the purchase of assets within (for example) 180 days, if an obligor wanted to incur debt under the general basket to finance an asset being purchased after 270 days, would such an incurrence be permitted? Or is it an "end-around" of the purchase money debt basket restriction? Because many parties entering into these agreements interpret each basket to provide additional capacity and flexibility for the obligor, future financing parties will need to keep the *Norske Skog* analysis in mind.

[19] *Id.*

[20] *Id.*

"Any financing" versus "refinancing"

It is not clear that the *Norske Skog* court had before it evidence of the parties' intent in using the phrase "any financing". Was it to limit the availability of the basket to a transaction only involving the inflow of actual cash proceeds? In differentiating between the term "refinancing" in other parts of the indenture and the use of "financing" in this definition, the *Norske Skog* decision does not point to the parties' negotiations over this term or any mutual understanding on limitations of "financing". It is possible that in negotiating the terms of the Secured Notes, the parties viewed this as "boilerplate" and absent any discussion of negotiations over the phrase, the record is unclear whether this was a specifically-negotiated point. However, certain courts previously have emphasized that when considering such "boilerplate" provisions of debt documents, courts should "endeavor to apply the plain terms of such provision in a uniform manner to promote market stability."[21] It remains to be seen how the *Norske Skog* decision will be interpreted with such precedent.

Possible Implications of the Norske Skog Ruling

In light of the Court's decision and interpretation of the indenture, companies should carefully consider the terms of their existing debt agreements (indentures, credit agreements, etc. not being refinanced) to evaluate whether the negative covenant baskets on which they are relying arguably could prohibit a "refinancing" agreement. If accepted by other courts, the *Norske Skog* Court's rationale could require usage of certain baskets to be limited to new money financings and prohibit the common practice of "cashless roll" of a debt instrument into a new one (which often provides greater flexibility for syndication of financings to a larger group of institutions). In putting new financings in place and negotiating credit agreements and/or indentures, debt finance parties should take care to draft incurrence baskets as broadly as possible to avoid any limiting interpretation similar to the *Norske Skog* Court's decision.

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[21] *Bank of N.Y. Mellon Trust Co., N.A. v. Liberty Media Corp.*, 29 A.3d 225, 241 (Del. 2011).