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# Texas Bankruptcy Court Rules on Liability Management Transactions and "Required Lender" Status in *In re Robertshaw US Holding Corp.*

On June 20, 2024, the United States Bankruptcy Court for the Southern District of Texas (the "Court") issued a memorandum decision and order in the adversary proceeding involving Robertshaw US Holding Corp. ("Robertshaw"), its sponsor, One Rock (the "Sponsor") and certain of its secured lenders in the chapter 11 cases of Robertshaw and its affiliates.[1] The decision addressed several issues arising from a dispute over liability management transactions that shifted the "Required Lender" status under a super-priority credit agreement (the "Credit Agreement") from Invesco Senior Secured Management, Inc. and certain related funds ("Invesco") to a group of other lenders (collectively, the "Lender Plaintiffs"). Judge Lopez ruled that Robertshaw breached the Credit Agreement by incurring unauthorized indebtedness, but limited Invesco's remedy to monetary damages against Robertshaw's bankruptcy estate, rejecting equitable relief. The Court upheld the validity of Amendment No. 5 and determined that the Lender Plaintiffs did not breach the Credit Agreement or the implied covenant of good faith and fair dealing. Additionally, Judge Lopez found that the Sponsor did not tortiously interfere with the Credit Agreement and had a valid economic interest defense.

1. Background

In May 2023, Robertshaw, a global market leader in the design, engineering and manufacturing of flow control components, systems and technologies for the commercial and residential appliance and transportation industries, completed a liability management transaction pursuant to which certain of its lenders, including Invesco and the Lender Plaintiffs, provided super-priority first-out new-money loans and exchanged their existing first- and second-lien loans into new super-priority second- and third-out loans, respectively.[2] Following the transaction, Invesco obtained "Required Lender" status by acquiring a majority in principal amount of the aggregate outstanding first-out and second-out loans and over the following months entered into a number of amendments with Robertshaw to address the company's continuing liquidity issues and ultimately to prepare for a potential chapter 11 bankruptcy filing.

When the Lender Plaintiffs found out about these amendments, they quickly negotiated with Robertshaw, and, in December 2023, completed a series of transactions that shifted "Required Lender" status from Invesco to themselves. Pursuant to these December 2023 transactions, the Lender Plaintiffs made a new $228 million loan to a newly formed entity ("RS Funding") in which Robertshaw owned all of the economic interest but a parent entity of Robertshaw owned all of the voting interest. RS

1 Mem. Decision and Order, *In re Robertshaw US Holding Corp.*, Case No. 24-90052 (CL) (S.D.T.X. Bankr. June 20, 2024) [Dkt. No. 351].

2 *Id*. at 3.

Funding then distributed the proceeds of the new loan to Robertshaw, which used them to prepay the super-priority first-out loans in an amount sufficient to divest Invesco of "Required Lender" status.[3] The Lender Plaintiffs, who now constituted Required Lenders, amended the Credit Agreement to, among other things, permit Robertshaw to incur $228 million of additional debt to repay the loan to RS Funding. The reason for this structure was to allow Robertshaw to obtain the funds needed for the prepayment without violating a covenant in the Credit Agreement that prohibited Robertshaw and its "Subsidiaries" from incurring additional debt. Because Robertshaw owned none of the voting equity interests in the new entity, Robertshaw and the Lender Plaintiffs would later argue, the entity did not qualify as a "Subsidiary" within the meaning of the covenant.

Following the December 2023 transactions, Invesco sued the Lender Plaintiffs and the Sponsor in New York State Court in December 2023.[4] On February 15, 2024, Robertshaw filed for chapter 11 bankruptcy (resulting in the New York State Court litigation being stayed) and, along with the Lender Plaintiffs and its Sponsor, filed an adversary proceeding against Invesco.[5] Invesco filed two counterclaims seeking declaratory judgments that (i) Robertshaw breached the Credit Agreement and (ii) Invesco is still the "Required Lender" under the Credit Agreement.[6]

2. The Bankruptcy Court's Decision

(a) Robertshaw Breached the Credit Agreement

As an initial matter, Judge Lopez found that the loan to RS Funding breached the Credit Agreement.[7] In reaching this conclusion, Judge Lopez rejected Robertshaw's argument that RS Funding was not a "Subsidiary" for purposes of the Credit Agreement. While the Credit Agreement included in the definition of "Subsidiary" any entity over which Robertshaw had voting control – as is typical in leveraged loans and high-yield bond indentures – it also included within the definition "any subsidiary of [Robertshaw] other than an Unrestricted Subsidiary," which Judge Lopez interpreted to include RS Funding due to Robertshaw's economic ownership. Judge Lopez rejected Robertshaw's argument that the latter portion of the definition was a mere "scrivener's error," as the Credit Agreement was negotiated between "sophisticated parties" and there was no "clear evidence" to the contrary.[8]

(b) Invesco Not Entitled to "Required Lender" Status or Other Equitable Relief

Nevertheless, the Court limited Invesco's remedy to a prepetition claim for money damages against Robertshaw's bankruptcy estates, rejecting Invesco's arguments for rescinding the transactions, restoring its "Required Lender" status or other equitable remedies.[9] Noting that the debt covenant did not include a "default blocker" or provide for actions taken in violation to be "null and void,"[10] and that the Credit Agreement included a customary provision requiring the borrower to prepay the loans using all proceeds of any debt incurred in violation of the debt covenant, Judge Lopez determined that "[t]here is no need to look for remedies outside the four corners of the [Credit Agreement]."[11] The Court rejected Invesco's argument that money damages would be an inadequate remedy for the breach because Invesco's claims that absent the breach Robertshaw would have filed for bankruptcy sooner and Invesco would have been selected to provide debtor-in-possession financing and a stalking horse bid

3 *Id*. at 2–3.

4 *Id*. at 10.

5 *Id*. at 2.

6 *Id*. at 10.

7 *Id*. at 14–15.

8 *Id*. at 13–14.

9 *Id*. at 15–16.

10 *Id.* at 18.

11 *Id.* at 15.

for the company were "all based on speculation and a perception of total control because of Required Lender status."[12] The Court further found that the facts of the case "do not warrant even consideration of an equitable remedy like subordination."[13]

Importantly, the Court also found that the relevant provisions of the Credit Agreement did not impose any obligations on the lenders, so that the Lender Plaintiffs did not breach the agreement and Invesco had no remedy against them.

At a hearing following Judge Lopez's decision, Invesco indicated that it estimated its damages and indemnification claims at approximately $40 million and took the position that those claims are secured with higher priority than the first-out loans. Robertshaw has taken the position that Invesco's damages would be deficiency claims entitled to a recovery of approximately 3% under their amended plan.[14]

(c) Additional Findings by the Bankruptcy Court

The Court also found that the Sponsor did not tortiously interfere with the Credit Agreement by participating in the transactions with the Lender Plaintiffs.[15] Rather, the Court held that the Sponsor did not intentionally procure any breach of the agreement and was not the "but-for" cause of any such breach by Robertshaw or the Lender Plaintiffs.[16] Indeed, the Court concluded that a declaratory judgment in the Sponsor's favor was warranted, but "even if a prima facie showing of tortious interference could be established . . . the economic interest defense would overcome any such claim."[17] Here, the Court noted that the Sponsor acted to protect its equity stake in Robertshaw and to avoid a value-destructive bankruptcy filing.[18]

Lastly, Judge Lopez dismissed the claim under the implied covenant of good faith and fair dealing based on his weighing of the equities—namely, because Invesco had, in his view, undertaken the same kind of conduct that it sought to attack through this claim. This is in contrast with holdings in some recent litigations involving uptier transactions, including the Mitel and Trimark transactions, where courts dismissed such implied covenant claims under New York law because the conduct alleged underlying such claim was duplicative of that involved with the alleged breach of contract and the plaintiffs did not, as New York law requires, allege an independent wrong distinct from the breach of contract.

Conclusion

While Judge Lopez stated that his decision in *Robertshaw* is "limited to the unique facts" of the case, the decision could have implications for other liability management transactions. First, while Judge Lopez found that RS Funding was a "Subsidiary" subject to the covenants in the Credit Agreement, he did so based on unusual language specific to the Credit Agreement, leaving open the possibility that other issuers with more typical debt documents may attempt similar maneuvers to engage in transactions that would otherwise violate their agreements.

Second, Judge Lopez's refusal to grant equitable relief, and the expected dispute over the security and priority of Invesco's money damages, could affect market participants' perception of the litigation risk presented by liability management transactions. Judge Lopez's opinion suggests that "default blockers" and "null and void" provisions could have given rise to alternative remedies, but they are typically not applicable to every covenant breach. If the prospects for equitable relief or a

12 *Id.* at 16–17.

13 *Id.* at 16 n.91.

14 *See Robertshaw Credit-Bid Sale Approved, Subject to Confirmation of Liquidating Plan; Debtors Warn Allowance of Invesco's $40M in Secured Damages Claims Could 'Blow Up' Plan,* Reorg Research (Jun. 21, 2024).

15 *Id*. at 19.

16 *Id*. at 20.

17 *Id*. at 21.

18 *Id*.

priority lien are diminished, non-participating creditors may determine that they are unlikely to be compensated for their losses even if successful in pursuing litigation, while distressed borrowers and transacting creditors may perceive that there is less downside to pursuing a liability management transaction as money damages can be discharged in a future bankruptcy.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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