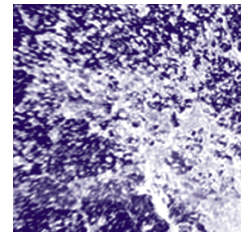
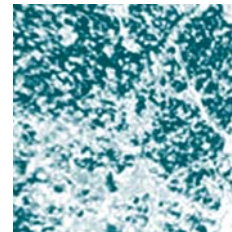


DISTRESSED DEBT CREDITOR INSIGHT

A Bracewell & Giuliani LLP Thought Leadership Study
in conjunction with Debtwire

DECEMBER 2007



CONTENTS

FOREWORD	1
METHODOLOGY	2
SURVEY FINDINGS	3
CASE STUDY	18
NOTES	23
CONTACTS	24

FOREWORD

The US equity market has long been the tail that wags the lumbering debt market dog. Well, every dog has its day, and judging by responses to Debtwire's Distressed Debt Creditor Insight study commissioned by Bracewell & Giuliani, the time has finally come for fixed income to set the pace.

Participants in the study clearly anticipate the credit market correction that began in Q3 07 to continue into 2008 as both subprime-related transactions and the glut of LBO loans underperform. That mirrors the resounding consensus of over two-thirds of respondents that US GDP growth will decline over the next year.

More than 90% of those asked expect mortgage default-related fund liquidations to intensify in 2008 and a majority believes the credit correction marks the first stages of a continuing downturn rather than a short-term dip.

The days of easy money for financings with double-digit leverage are over, according to participants: 85% expressed concern about LBO refinancings and 60% said they expect to increase allocations toward rescue financings in the next six months.

Granted, distressed debt specialists are more apt to see the glass half empty. But as stock market volatility surges and the knee-jerk bullishness of stock market pundits starts to fray around the edges, the distressed investors' dark forecast for the capital markets appears to be gaining traction.

Which isn't to say that distressed investors are sitting on the sidelines by any means – they're just picking their battles.

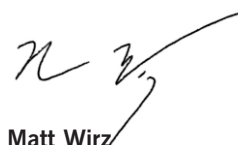
Respondents seem far more eager to buy debt at a discount in the secondary markets with almost 60% comfortable buying debt under 85% of face value and only 20% typically willing to pay par. Credit fundamentals are also back in vogue as almost 75% of participants said they would be uncomfortable holding equity CLOs and 65% said tighter covenant protection is more important than pricing when making new investments.

Investors are still willing to buy new issues, just not at the hyper-aggressive leverage multiples witnessed in late 2006 and the first half of 2007. Only 13% of respondents said they would be comfortable buying deals leveraged over 7x, while 24% expressed interest in deals levered over 4x and 33% said they'd buy over 5x.

Combine these conservative buying strategies with the generally bearish tone of the responses to our study and the message is clear – Look out below! The path of least resistance is still down and asset prices have a ways to drop before they stabilize.



Evan D. Flaschen
Chair, Financial Restructuring Group
Bracewell & Giuliani LLP

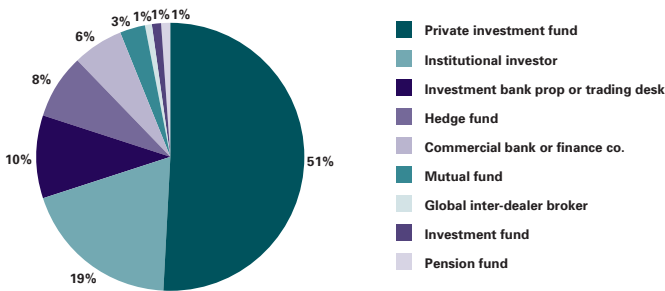


Matt Wirz
Editor-in-Chief
Debtwire

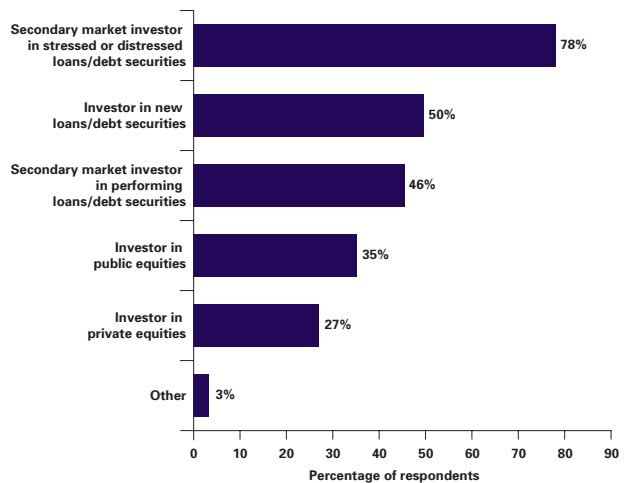
METHODOLOGY

Bracewell & Giuliani LLP commissioned Debtwire to conduct a study of fund managers, institutional investors, prop and trading desks and commercial lenders regarding their attitudes on creditor specific issues in the distressed debt market. A total of 101 telephone interviews were conducted during August and September 2007. As the charts below illustrate, the demographics of the survey respondents ensure that many different distressed and par perspectives throughout the capital structure have contributed to making this a truly representative sampling of today's distressed, leveraged, high yield and equity investment communities.

Which of the following best describes your firm?



Which of the following best describes your position (check all that apply)?

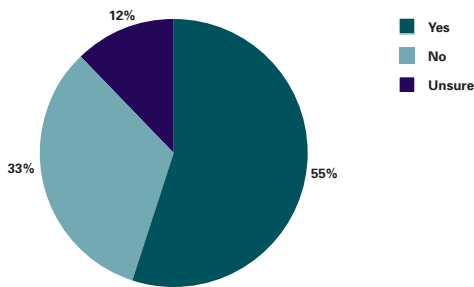


SURVEY FINDINGS

General Investment

More than half of respondents believe the credit correction signals a long-term downturn in the leveraged finance market

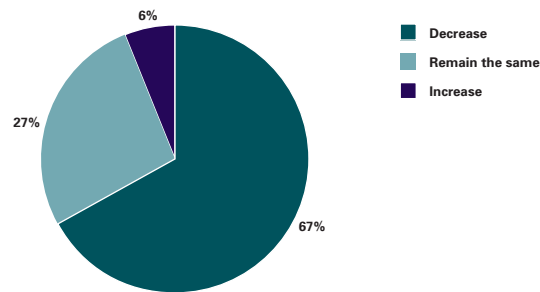
Is the recent backup in the primary leveraged loan and high yield markets a signal of a long-term downturn in the leveraged finance market?



- The debt party is over. Equity markets may have recovered to new highs in October but debt investors are battenning down the hatches. Over half of those questioned believe the leveraged finance markets are entering a long-term downturn and of the 33% that disagreed, several conceded that the market is undergoing a correction that will significantly reprice risk.
- Technical indicators confirm this bearish long-term view. The sub-prime mortgage defaults that prompted lenders to tighten liquidity this summer will continue until 2009 based on the schedule of rate adjustments for existing loans. That jibes with Moody's Investors Service expectations that the US corporate default rate will more than double to 3.5% by September of 2008.

67% of respondents believe that US GDP growth will decrease in the next twelve months

What do you expect to happen to the US GDP growth rate, currently at 2.5%, over the next 12 months?



- Over two-thirds of respondents believe the US economy will slow over the next 12 months while only 6% think it will pick up over the same period. Blame it on credit market contagion, declining home sales, flagging consumer demand or the soaring price of oil – the signs of a downturn in GDP growth are abundant.

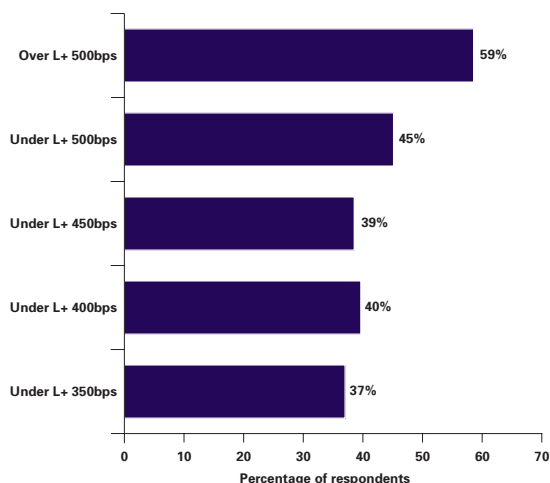
“While it would appear that one party is over, another is about to begin. The tremendous amount of aggressive financings that occurred during the recent bull market created a robust inventory of leveraged transactions that must be refinanced over the next two years. If the leveraged finance market correction persists, many of these transactions will require more comprehensive restructurings and opportunities will abound for distressed investors. In other words, one investor's leveraged finance problem is another investor's leveraged finance opportunity.”

Evan Flaschen, Bracewell & Giuliani, financial restructuring

SURVEY FINDINGS

Respondents favor higher yielding loans in the primary market

At what price do you buy loans in the primary market (check all that apply)?



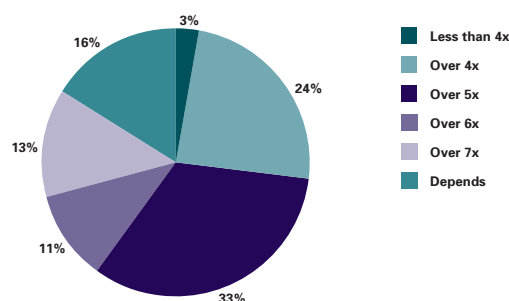
- Despite recent market volatility, primary market loan buyers remain focused on yield, according to study participants, 59% of which said they buy loans at more than L+ 500bps. That reflects, in part, Debtwire's readership in the distressed investing community but is also representative of a broader trend.
- A clear shift in the balance of power took place in recent years as hedge funds and CLOs replaced commercial banks in the new loan market. That schism became even more pronounced in Q3 07 as CLOs essentially stopped buying, creating a bipolar market with traditional lenders on one side and yield-hungry funds on the other.
- The diversification of the investor base will allow some credits to continue borrowing but they will need to hit a higher price point in yield terms to secure the hedge fund bid.

"It used to be that investors could chase quality or they could chase yield. In the last two years, however, even "high yield" debt did not provide much of a risk premium, thus driving investors into the second lien market and even the first lien market. The good news is that, finally, yield is becoming more commensurate with risk."

Jonathan Wry, Bracewell & Giuliani, leveraged finance and restructuring

Majority (81%) of respondents are comfortable with leverage levels of at least 4x in the primary market

What are the leverage levels you are comfortable buying in deals?



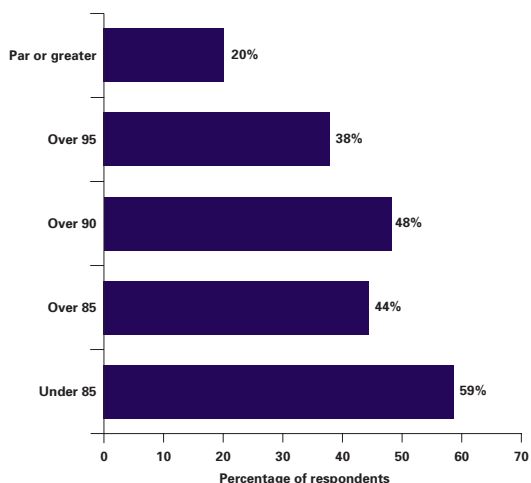
- Responses to this question reflect the resilient risk appetite of the alternative investors now dominating the primary market. A clear majority remain willing to buy deals over 5x levered. Nevertheless, the days of double-digit or high single-digit levered LBOs has passed with only 24% of respondents willing to buy new debt levered at 6x or more.

"By any measure, investors are still willing to risk heavy leverage in exchange for increased return. The good news is that "heavy leverage" these days is no longer at the "absurd leverage" levels of just a few months ago. Our lenders understand leverage and they understand risk and they are now forcing the issuers and borrowers into more rational financing models."

Mark Joachim, Bracewell & Giuliani, leveraged finance and restructuring

Only 20% of participants said they would buy secondary loans at par

What types of loans in the secondary market do you typically buy?



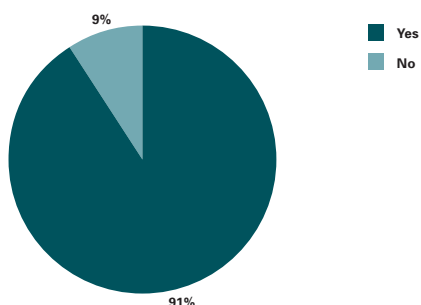
- Trading levels of leveraged loans continue to underprice risk, according to respondents of the survey, almost 60% of which said they typically trade loans under 85% of face value.

“The feeding frenzy for stressed and distressed debt investments shows no signs of abating. However, supply is just now starting to return, and while we think distressed pricing continues to be aggressive, it is clear that the opportunities are multiplying for achieving true distressed returns even in this hyper-demand market. The three most important factors are, Timing, Timing, Timing. The most astute investors are either spotting opportunities before the general market tunes in or, conversely, patiently waiting out the first wave of buyers with the expectation that disillusioned investors will create a second buying opportunity at lower price points.”

Mark Palmer, Bracewell & Giuliani, private investments and distressed M&A

91% of respondents expect more liquidations of investment vehicles exposed to the housing market

Do you expect to see a marked increase in the volume of liquidations of investment vehicles that are especially prone to rising housing default rates in the next 6-12 months?



- It ain't over yet. The overwhelming majority of respondents are still waiting for the other shoe to drop when it comes to subprime-related fund liquidations.

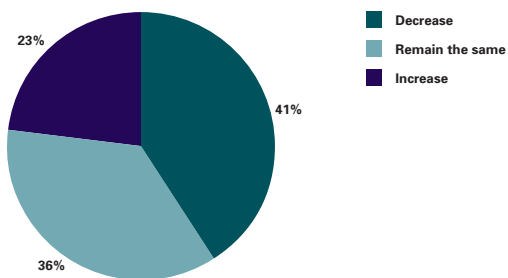
“Every day is an adventure in the current capital markets. The Dow is up 200 points one day and down 300 the next. Subprime investment vehicles print money one day and they hemorrhage money the next. The markets are like Darwin on steroids and it is clear that too many subprime vehicles and their investors were looking only at the bulging muscles and not at the decaying tissue underneath.”

David Albalah, Bracewell & Giuliani, financial restructuring and mediation

SURVEY FINDINGS

Respondents are evenly divided over fate of credit derivatives market in next 6-12 months

Do you believe the credit-related derivatives market will become less liquid over the next 6-12 months?



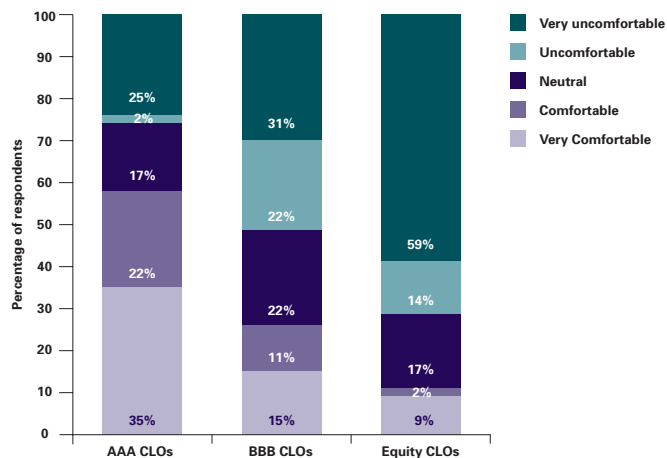
- Supply of credit hedging derivatives by bulge-bracket firms plays a crucial role in supporting investment in new issues. Respondents proved evenly split when asked whether the market for credit related derivatives would be more or less liquid in the year to come. While opinion remains divided on that front, several investors questioned on the matter said they anticipate volatility in credit derivatives to increase.

“From the perspective of lawyers who represent lender and noteholder groups, credit derivatives can have a hidden but significant effect upon investor behavior and group dynamics. Is a member of the group really a typical holder or is s/he long or short an LCDS or CDS, or even a CDS investor elsewhere in the capital structure? More than ever before, lender and investor group lawyers must be as expert in the intricacies of the derivatives market as they are in the minutiae of Chapter 11. It is no place for the inexperienced or the faint of heart!”

Andrew Schouler, Bracewell & Giuliani, private investments and distressed M&A

Know what you own. Only 11% of holders said that they would be willing to buy CLO equity

How comfortable are you holding the following?



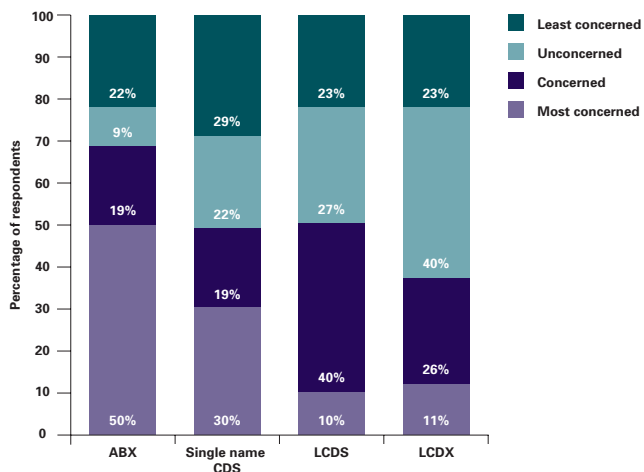
- In the wake of the 2007 credit correction, investors want to know what they own. Credit fundamentals are back in vogue and while fund managers may still want leverage when priced appropriately (prior question), that doesn't extend to the riskier tranches of CLOs despite the diversification they offer.
- Only 11% of respondents said they would be comfortable investing in equity CLOs while roughly one-quarter expressed willingness to buy CLOs rated BBB. Even the safest of CLOs – rated AAA – only drew demand from 57% of respondents.

“An investor actually said to me recently, ‘Remember when AAA meant something?’ If we could compare these 2007 responses with similar responses from just two years ago, we would likely see that, in 2005, only 35% of respondents were not ‘very comfortable’ with AAA CLOs.”

Robin Miles, Bracewell & Giuliani, finance and securities

ABX, a thing of the past

What area of the credit derivatives market are you most concerned with?

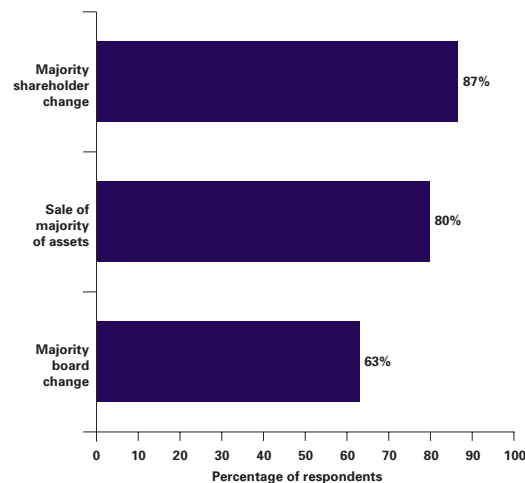


- No surprise here. The collapse in mortgage securitizations and related CDOs both in primary and secondary markets has sucked liquidity out of the ABX and a clear majority of respondents – 69% – expressed concern about the derivative index.

Change of Control

Reading (covenants) is fundamental

Which of the following events qualify as a change of control in your view?



- Transfers of more than 50% of a credit's equity or assets clearly constitutes a change of control to over 80% of those asked in this survey. Majority board changes elicited a less unanimous response with only 63% deeming such events changes of control. Regardless of investors' views on the issue, many of those asked pointed out that ultimately, a change of control event is defined by the governing debt documents. Put bluntly: "Read the covenants!"

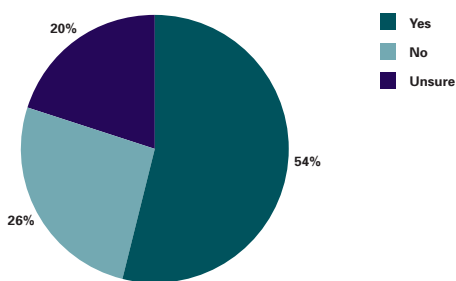
"Contractually defined COC triggers can be remarkably limited and even counterintuitive. Even when they expressly cover an event, such as a sale of 'substantially all assets' of the issuer, there can still be a wide range of views regarding what such seemingly straightforward language means in practice. Interpreting COC and other covenants is a bread-and-butter component of our practice and a significant part of how we meet our clients' day-to-day needs."

Bob Carey, Bracewell & Giuliani, securities finance and restructuring

SURVEY FINDINGS

Roughly half of respondents expect more aggressive interpretation to avoid change of control provisions in coming months

Do you expect to see more issuers use aggressive interpretations to avoid the change of control provisions built into leveraged financial instruments in the next six months?



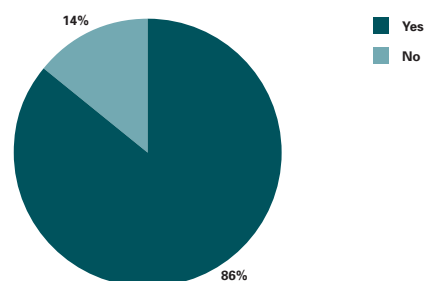
- Of course, covenants are subject to interpretation. The recent surge in acquisitions coincided with a steep decline in defaults, spurring distressed investors to develop alternative strategies to boost returns, including the aggressive enforcement of covenants governing asset transfers. Now that hedge funds and their advisors have developed that skill set, they will continue to use it.

"These responses confirm that distressed debt investors are more sophisticated than ever and they are analyzing investments not only for their intrinsic value but also for the possibility that covenants and definitions can impose obstacles (or provide leverage) entirely apart from underlying credit quality."

Greg Nye, Bracewell & Giuliani, commercial and bankruptcy litigation

Almost 15% of respondents admitted they don't read COC provisions before buying new debt

Do you look at a financial instrument's change of control provision before buying?



- Until very recently, many investors were more concerned with finding places to park their cash than valuing the existing assets in their portfolios.
- The brazen 14% of respondents who admitted they don't read COC provisions before buying new debt hints at even higher number that do the same but didn't come clean.

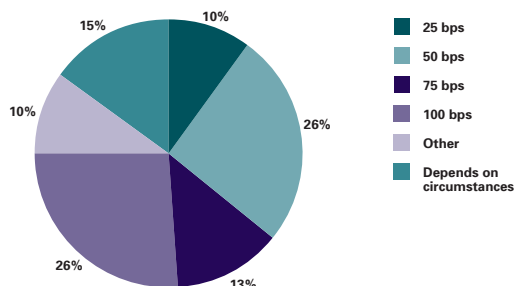
"We wonder whether more investors fail to inspect covenants than will admit to that omission. Either way, investors are now clearly refocusing on the nitty gritty of bond and loan indentures as liquidity tightens."

Renée Dailey, Bracewell & Giuliani, financial restructuring

Covenants

Let the punishment fit the crime.
Responses vary on reporting violation fees

What is an equitable fee for an indenture financial reporting default after 6 months?



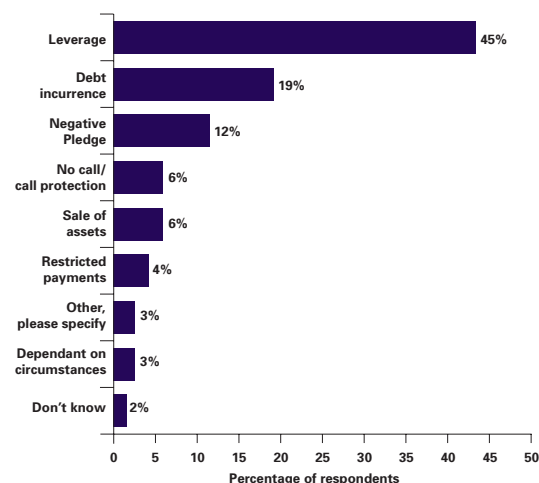
- While many borrowers – and their traditional lenders – would like to characterize bondholders’ newfound willingness to enforce financial reporting covenants as a form of greenmail, the diverse answers to this question tell a different story. Only one-quarter of those asked believe that a borrower should pay 100 bps for failing to provide earnings after six months, while 13% opted for 75 bps and 36% picked 50 bps or less. A significant minority of 15% expressed the opinion that the fee should depend on the circumstances.

“This is a slippery slope. Often, a reporting delay can be easily explained and is more valuable as a consent fee opportunity than as a warning sign. But the Trust Indenture Act mandates full and timely financial reporting for a reason, and when an issuer is unable to fulfill its statutory reporting obligation, investors are well served to pause for a moment to consider whether they are only seeing the tip of the iceberg of the issuer’s internal difficulties. When in doubt, our advice is to consider temporary consents, that is, the consent fee should buy the issuer only 3 months to get its reporting act together. If it cannot, another fee should be built in for another 3 months, and at that point, perhaps all bets should be off.”

Evan Flaschen, Bracewell & Giuliani, financial restructuring

Leverage is the single most important covenant in public or widely-syndicated transaction

What is the single most important covenant to you in a public or widely syndicated transaction?



- Investors remain focused on performance when it comes to financial covenants. A large number of study participants picked leverage as the most important type of protective covenant, although a good number also mentioned debt incurrence as important. This is likely consistent with the difference between a syndicated second loan position and a high yield bond holding.

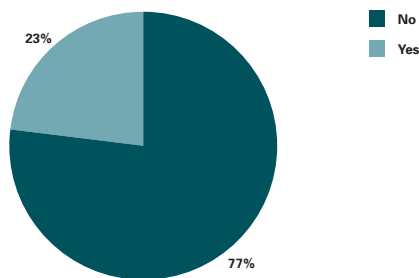
“It is hard to dispute that breach of a leverage covenant is one of the most serious signals of financial distress. Interestingly, however, clients most often complain to us about debt incurrence covenants. This typically arises when a debtor seeks to layer a massive amount of new debt on to a capital structure but is able to sidestep neatly the leverage and debt incurrence covenants through creative structuring often involving new intermediate HoldCo’s, structural subordination and asset-rich subsidiaries that have suddenly been redesignated as unrestricted. One of our most painful tasks as lawyers can be, when a client screams, ‘They can’t do that!!’, to be forced to respond, ‘Oh yes they can.’”

Arik Preis, Bracewell & Giuliani, leveraged finance and restructuring

SURVEY FINDINGS

Covenant-lite fad falls out of fashion

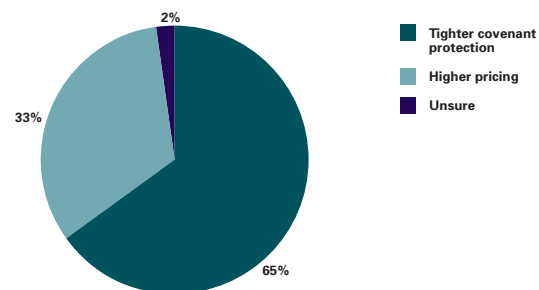
Do you buy covenant-lite deals in the primary market?



- Leveraged loan investors will think twice before buying into new covenant-lite deals with over three-quarters of respondents saying they boycott the structure. That reflects both the heightened risk of restructurings in the years to come and the stark under-performance of covenant-lite loans in the recent sell off relative to their more traditional counterparts.

Caveat emptor: the majority of respondents (65%) picked tighter covenant protection as more important than pricing when buying in the primary market

What is more important to you going forward, higher pricing or tighter covenant protection?



- Covenant protection plays a more prominent role in primary markets than secondary trades – where risk is perhaps more accurately priced. Nevertheless, a clear majority of respondents (65%) value legalistic covenant-based protections over pricing.

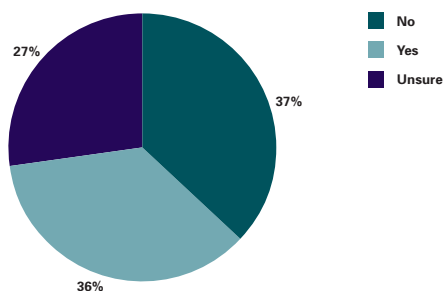
“The sobering events of the debt markets this summer have clearly readjusted investor focus. Pricing has now taken a more rational position alongside of covenant protection, rather than way out in front of it. Remember the mantra that you should never assume a covenant means what you think it means – you really need to read the fine print.”

Sam Stricklin, Bracewell & Giuliani, financial restructuring

Refinancing

Respondents are divided over whether a shift from restructuring to refinancing disadvantages small firms

Are smaller funds disadvantaged by the shift from restructuring to refinancing?



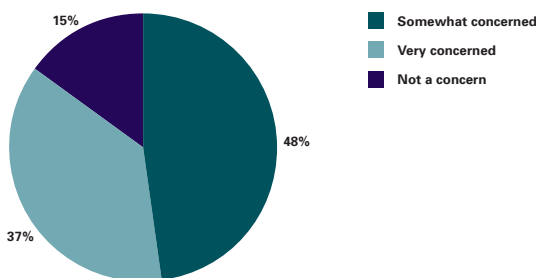
- The jury is still out on whether the liquidity flood of recent years and the current unwind of that trend will handicap smaller funds going forward with respondents evenly divided on the question.

“In our experience, size doesn’t matter. Small funds and large funds both make money and both lose money. The tougher question is whether smaller funds can do as well at capital raising now that the institutional, municipal and pension fund managers are being scrutinized more closely as to where they invest mom and pop’s money.”

Jon Gill, Bracewell & Giuliani, private investment funds

Refinancing the LBOs of recent years is a matter of concern for 85% of study participants

Are you concerned about refinancing options for leveraged issuers with maturities upcoming in 2008?



- The bigger they come the harder they fall may be a cliché but it holds true in this case. The mammoth wave of high yield bond and leveraged loan issuance since 2003 created a massive credit overhang and 85% of those asked expressed concern about refinancing risk in 2008.

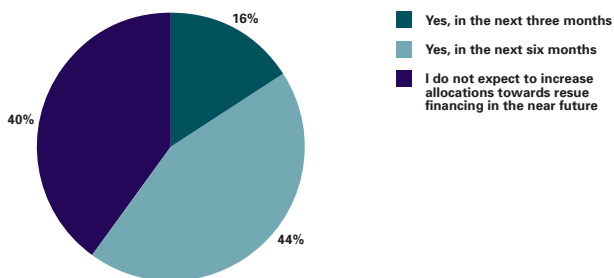
“We are already hearing significant concern expressed regarding the ability to refinance some large companies and about potential major bankruptcy filings in the homebuilding, forest products and retail sectors. These may only be the tip of the iceberg. As the iceberg melts, the capital markets will need more and more liquidity from the distressed community and, perhaps, supply will finally come into closer balance with demand.”

Trey Wood, Bracewell & Giuliani, financial restructuring

SURVEY FINDINGS

60% of respondents expect to increase allocations towards rescue financing in the next six months

Do you expect to increase allocation towards rescue financing?

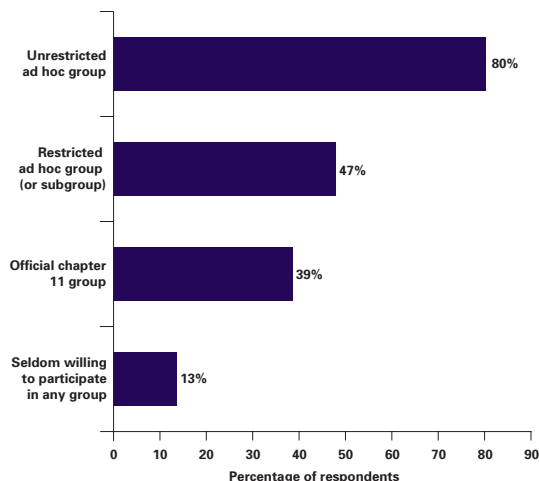


- This will present opportunities to those with cash reserves and high risk tolerance as evidenced by the majority of respondents who expect to increase their investment in rescue loans in the next six months. Of the 40% who don't expect to increase rescue lending in the next six months, several said they would boost their allocation to the strategy in the next 12 months.

Ad Hoc Groups/Committees

Respondents are most willing to participate on an unrestricted ad hoc group – 80% – when they are a larger holder in a class

When you are a larger holder in a class, which of the following are you generally willing to participate on?



- When debt investors organize, they like to keep it on the down low, according to study responses. 80% of those asked said they would serve on unrestricted ad-hoc groups when they are a larger holder in a class while only half that number expressed willingness to sit on official Chapter 11 committees.

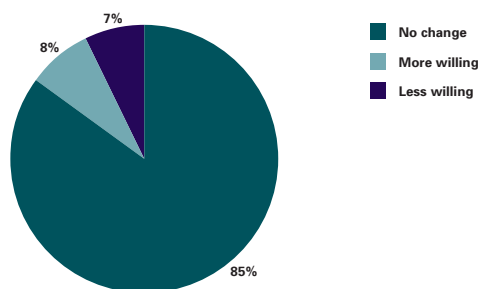
“First, you will note that we have worded these questions in terms of “groups” rather than “committees” – we have the Northwest Airlines Bankruptcy Rule 2019 decision to thank for that, although by no means has that battle been lost just yet.

Second, when it comes to ad hoc group formation, two concerns predominate: confidentiality of holding/trading information and the ability to remain unrestricted to participate in the public markets. When we represent ad hoc lender and noteholder groups, we are typically the only party that knows the individual group members’ holdings. Further, the group often depends upon us to sign a confidentiality agreement to assess the MNPI while permitting the group members to remain unrestricted until a deal is near at hand (and sometimes through the entire process).”

Kurt Mayr, Bracewell & Giuliani, financial restructuring

A majority (85%) of respondents have not changed their attitudes towards ad hoc groups in the past 12 months

Are you more willing to participate on ad hoc group than you were 12 months ago, less willing or the same?



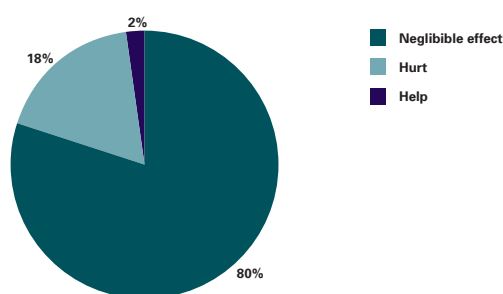
- Calls for increased disclosure by unofficial creditor groups in bankruptcy court this year made little impact on the preference of study participants, with only 7% less willing to partake in such groups.

“When there are public debt securities or widely syndicated loans, activist investors and lenders are seldom comfortable leaving the heavy lifting to the indenture trustee or administrative agent. They want someone who is in their corner and who is answerable to their needs alone, which is why ad hoc groups have become an absolute necessity in most restructuring situations today.”

Robb Tretter, Bracewell & Giuliani, investments and restructuring

The preponderance of respondents do not expect Rule 2019 requirements to have effect on demand for distressed securities

Do you think that the disclosure requirement of Rule 2019 enforced in Northwest Airlines will help, hurt or have a negligible effect on your demand for distressed securities?



- While enforcement of Rule 2019 dampened investor demand for distressed securities on the margin, the clear majority of respondents shrugged off the Northwest precedent as irrelevant.

“Rule 2019 was enacted 70 years ago to protect against insider-dominated “protective committees” from taking advantage of unwary public investors. The Northwest Airlines decision notwithstanding, we fervently believe that Rule 2019 simply does not apply to the typical ad hoc groups that exist today. Collective creditor action is a good and efficient construct, not the “secret veil of evil” that debtors decry when seeking leverage against a determined adversary. Ad hoc groups should be encouraged as a matter of bankruptcy policy and common sense because, like it or not, creditors get to vote on plans and large creditor groups should be entitled to exercise their voting leverage. We will continue to fight the good fight on this topic.”

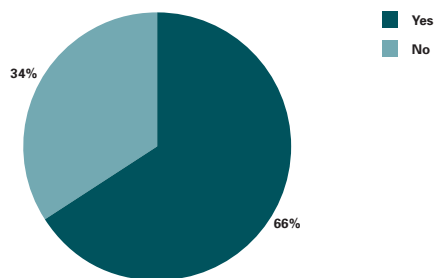
Marcy Kurtz, Bracewell & Giuliani, restructuring and bankruptcy litigation

SURVEY FINDINGS

Rights offerings

As second lien financing pushes down on unsecured bonds, investors push back with rights offerings

Do you invest in rights offerings?

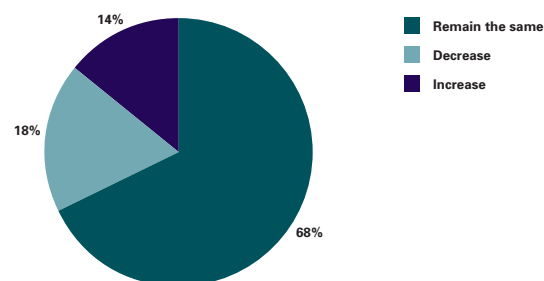


"Rights offerings have become the restructuring device du jour to permit the lower levels of a debtor's capital structure to maintain an option on the upside in the enterprise. The prevalence of second lien and mezzanine financings have pushed the typical fulcrum security of the unsecured bondholder class further to the fringe of the enterprise value to be distributed. Rights offerings permit unsecured investors to inject some additional capital in order to, in essence, buy back their place as the fulcrum security. We expect that rights offerings will continue to play a significant role in restructurings going forward."

Jennifer Feldsher, private investments and distressed M&A

Of those that invest in rights offerings, the majority (68%) expect to keep their investment constant over the next six months

If you invest in rights offerings do you expect to increase, decrease or keep the level of capital allocated to rights offerings the same over the next six months?

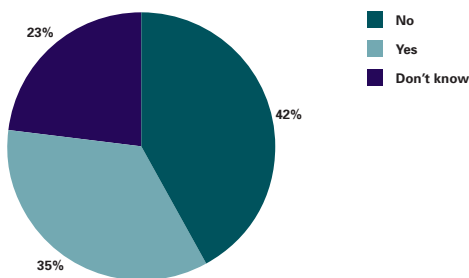


-
- Among those respondents actively investing in rights offerings, 68% expect the level of capital they allocate to remain the same over the next six months.

"Rights offerings are an intriguing and risky bet on the future. The existing senior creditors who cannot be cashed out in full typically want a combination of cash, new debt and straight equity. More junior classes, on the other hand, are willing to place a bigger bet on the future via a rights offering. It will be interesting several years from now to look back on all of the rights offerings from the past several years to see whether the rewards exceeded the risks."

Mark Joachim, Bracewell & Giuliani, leveraged finance and restructuring

Has the equity you received from your participation in rights offerings been helped by company efforts at increased attention following the restructuring?



- Management's attention to investor relations post-bankruptcy plays a negligible role in most study participants' decision to invest in rights offerings. Roughly one-quarter of respondents said they were ambivalent on the issue while over 40% said it had no impact on their strategy.

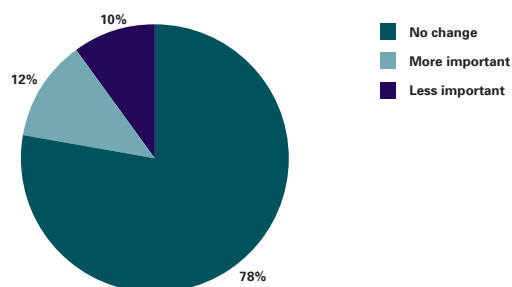
“Whether reorganized equity is obtained via a traditional debt-for-equity conversion or through a rights offering, management will be management. Rights offering participants should not expect any different treatment post-restructuring simply because they infused new capital rather than exchanging their existing debt. The key, as it always has been, is to carefully select the ongoing management team during the restructuring process and to remain active in your investment post-restructuring to see your investment strategy through.”

Mark Palmer, Bracewell & Giuliani, private investments and distressed M&A

Advisors and Sponsors

Majority of respondents (78%) feel that financial advisors are equally as important to creditors as before

Given the the decline in court driven restructurings in 2005-2007 are financial advisors less important, more important, or equally important to creditors?



- Financial advisors remain a sine qua non in the restructuring arena, despite the shift of many negotiations out of court. Bankers and consultants play a key role as intermediaries between creditors and borrowers and between investors themselves that 90% of respondents think is equally or more important now than in the first half of the decade.

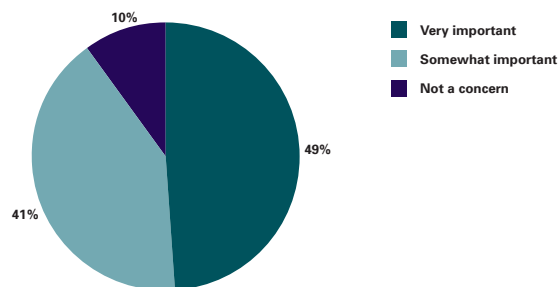
“In light of most investors’ desire to remain unrestricted for as long as possible, the role of financial advisors and counsel have, in our view, become more important than ever. An ad hoc group often relies heavily upon the judgment of its advisors who will assess MNPI and negotiate the initial outline of a restructuring while the group’s members are free to remain active in the public market. Investors seem less and less inclined to go restricted, and when they do, it is often only at the last moment. In this context, carefully selecting advisors – the right horse for the course – is of utmost importance.”

Kurt Mayr, Bracewell & Giuliani, financial restructuring

SURVEY FINDINGS

49% of respondents believe the track record of an equity sponsor is very important when investing in a primary loan

How important is the track record of an equity sponsor to you when investing in a primary loan?



- Fully 90% of respondents believe the track record of an equity sponsor is important when investing in a primary loan.

“While this question is particularly focused on a sponsor’s financial track record, it is also clear that a sponsor’s reputational track record is important. This latter point is emphasized when an investment does not yield financial success. Is the sponsor as supportive and communicative in a bad situation as in a good one? Does the sponsor stay with the investment and reinforce its commitment at critical junctures or does it leave investors holding the bag? We are not saying that sponsors should ignore their own financial losses by any means. However, investors look to sponsors not only for their investment savvy but also for their leadership and responsibility, and the best sponsors prove time and again that, while they can never guarantee results, they will remember who “brung them to the dance” even when the music stops playing.”

Bob Carey, Bracewell & Giuliani, securities and financial restructuring

We get it. We get it done.

When default hits, we get it. Our integrated team of restructuring, finance and litigation lawyers knows your business needs and understands the deal dynamics. And, when it comes to developing and executing on strategy, we get it done. Whether you are a bondholder, lender or investor, Bracewell & Giuliani LLP has the experience, depth and determination to maximize your recoveries.

BRACEWELL
& GIULIANI

Financial Restructuring

CASE STUDY:

DURA AUTOMOTIVE SYSTEMS, INC.: SECOND LIEN LENDERS IN A FIRST LIEN WORLD

INTRODUCTION: DURA'S OPERATIONS AND THE AUTO INDUSTRY TURMOIL

Dura Automotive Systems, Inc. is a leading designer and manufacturer of driver control systems and a leading supplier of door modules, glass systems, seat mechanisms, seat structures and engineered assemblies. Dura's customers include every major North American, European and Asian automotive original equipment manufacturer (OEM), such as Ford, General Motors, DaimlerChrysler, Volkswagen, Renault-Nissan, Honda and BMW. Dura manufactures products for many of the most popular car, light truck, and sport utility vehicle models in North America and Europe. Dura's manufacturing and product development facilities are located throughout North America, Brazil, China and Europe.

In recent years, Dura has confronted many of the challenges of the troubled auto industry. Dura's revenues and profit margins decreased significantly when declining sales and rising production costs caused North American OEM's to decrease their orders from suppliers like Dura and to seek price reductions from such suppliers. Dura has also faced record-high aluminum prices and increases in the price of steel and other raw materials that Dura could not pass to its customers, which had already pressured Dura for further price reductions. Consequently, by Spring 2006 Dura was facing serious liquidity constraints that were hampering its ability to effectuate an operational restructuring plan intended to keep Dura competitive, grow the business and improve the balance sheet.

Debt structure

Dura's funded debt obligations consisted of:

- \$175 million first lien asset-based revolving credit facility
- \$225 million senior secured second lien term loan
- \$400 million of 8.625% Senior Notes due 2012
- \$536 million of 9% Senior Subordinated Notes due 2009
- \$55.25 million of Trust Preferred Securities

The road to Chapter 11

Dura's liquidity constraints were aggravated by the debt service requirements of its highly-leveraged balance sheet. Dura found itself unable to make certain capital expenditures necessary to secure new business with its major customers. As Dura's cash flow situation worsened, Dura realized that it would be unable to continue making all of its debt service payments, leading to Dura's Delaware chapter 11 filing on October 30, 2006. The filing included substantially all of Dura's domestic subsidiaries but excluded Dura's foreign subsidiaries.

Protecting the position of the Second Lien Lenders

Evan Flaschen, Mark Joachim, David Albalah, Kurt Mayr and Ilia O'Hearn of Bracewell & Giuliani LLP represented Dura's Second Lien Lender Group (which held a substantial majority in amount of the Second Lien) both in the prepetition DIP financing discussions and throughout the chapter 11 case. At the end of the day, Dura's chapter 11 plan provided for payment in full of the Second Lien Loans. Along the way, however, there were several major legal skirmishes.

The adequate protection and intercreditor agreement battles

Dura's first lien and second lien capital raising included, inevitably, an intercreditor agreement (ICA). As is customary, the ICA provided for lien subordination and also limited the ability of the Second Lien Lenders to pursue the common collateral, to seek adequate protection, and to oppose various decisions made by the first lien lenders.

Importantly, however, as much as most ICA's "look alike," there are often real substantive differences in the details which can materially aid or hinder second lien efforts to negotiate their position in a chapter 11 case, particularly in the areas of DIP financing and adequate protection. Dura and the creditors' committee argued strenuously that the Dura ICA both permitted unlimited priming DIP financing and prohibited cash adequate protection payments to the Second Lien Lenders.

The Second Lien Group pushed back on several grounds. First, the Group argued that, because the DIP financing was cashing out in full the prepetition First Lien Loans, the ICA would terminate in accordance with its terms. Second, the Group argued that, by cross-referencing to the second lien credit agreement, the ICA did, in fact, contemplate a cap on DIP financing in an amount equal to the maximum permitted first lien indebtedness under the second lien credit agreement debt incurrence covenant. Third, the Group argued that the ICA was a private agreement between the First Lien Lenders and the Second Lien Lenders and, therefore, neither Dura nor the creditors' committee had standing to enforce the ICA. Fourth, the Group argued as a business matter that they would be willing to waive the default rate of interest and any prepayment premium in exchange for current payment of interest, so it was a benefit to the estate to make current payments. Fifth, the Group made it clear that it would vigorously oppose the DIP in court if an agreement could not be reached.

The negotiations among the Second Lien Lenders, Dura, the First Lien Lenders and the DIP financing providers had actually started prepetition. There was no comprehensive agreement at the time of the interim order so the parties agreed to continue the discussions. The Second Lien Lenders, Dura and the creditors' committee each filed pleadings setting forth their respective positions, but then Dura and the Second Lien Lenders reached agreement shortly before the final hearing. The creditors' committee still opposed but the court approved the agreement over the committee's objection.

The essential terms of the agreement were that Dura would pay monthly interest (even though the contract was quarterly) and the Second Lien Group's professional fees, subject to a right to seek to discontinue interest payments after six months if Dura encountered cash flow difficulties. In exchange, the Second Lien Lenders agreed to waive the default rate of interest and, if Dura continued to make interest payments for a full twelve months, to waive the prepayment premium. This was considered to be a very favorable result for the Second Lien Lenders and the market traded up accordingly.

The potential avoidance action

Dura's First Lien Loans and Second Lien Loans were secured by separate grants of liens on substantially all of the assets of Dura and its domestic subsidiaries, as well as a pledge of 65% of the stock of Dura's foreign subsidiaries. When the liens were granted in 2005, both sets of security documents named Bank of America as the collateral agent, even though Bank of America was the collateral agent only for the First Lien Loans. When this error was discovered in 2006, new financing statements were filed in the name of the actual second lien collateral agent. Because Dura's chapter 11 filing occurred within 90 days of the new filings, Dura's unsecured creditors argued that the new filings were avoidable preferential transfers.

The Second Lien Group argued against the preference claims on several legal and factual grounds, focusing on issues of statutory and contractual interpretation, legislative intent, agency principles, public notice, and valuation. The dispute was preserved in Dura's DIP financing order and, on several occasions, the parties agreed to extend the deadline for Dura or the creditors' committee to commence formally an avoidance action. Finally, the Second Lien Group opposed a further extension, asserting that it was time for Dura and the committee to "bring it on" if they really intended to pursue a challenge. However, in the face of the Second Lien Group's various arguments, Dura obtained a court order extending the challenge period again rather than commence the litigation.

Part of the Second Lien Group's strategy was focused on the value of their non-UCC collateral, including real property, the stock pledges and various notes receivable. The argument was that, even if the UCC liens were avoidable, the value of the remaining collateral was sufficient to fully secure the Second Lien Loans, and therefore there was no preference. As a result, it was clear to Dura and the creditors' committee that any avoidance litigation would involve a major valuation battle.

At the end of the day, Dura and the creditors' committee concluded that the fight would not be worth it and, as a result, Dura's chapter 11 plan provided for payment in full of the Second Lien Loans, including postpetition interest.

The impairment dispute

Dura's plan of reorganization proposed to treat the allowed claim of the Second Lien Lenders as unimpaired by paying the Second Lien Loans in full in cash on the effective date of the plan. As unimpaired, the Second Lien Lenders were therefore deemed to have accepted the plan. The underlying credit agreement provided that "payment in full" of the Second Lien Loans would include principal, professional fees, prepayment premium, and accrued interest calculated either at the default rate or at the base rate provided for in the second lien credit agreement. The plan, however, adopted the compromise set forth in the final DIP order, which did not provide for default interest or the prepayment premium.

The Second Lien Group had consistently maintained that its members were acting only in their own interests and did not purport to bind any other Second Lien Lenders. This was important in various contexts, including the Group's assertion that it was not a "committee" within the meaning of Bankruptcy Rule 2019. Thus, while the members of the Second Lien Group intended to vote in favor of the plan, they believed that the plan impaired the Second Lien Loans as a matter of law (because it did not pay default interest or the prepayment premium) and the other Second Lien Lenders should be entitled to vote on the plan for themselves. Accordingly, the Second Lien Group objected to the Disclosure Statement's description of the Second Lien Loans as "unimpaired" and, therefore, not entitled to vote.

On the eve of the Disclosure Statement hearing, Dura agreed that the Second Lien Lenders could vote on the plan on a "provisional" basis, meaning that Dura reserved the right at confirmation to argue that the Second Lien Loans were unimpaired if the class as a whole voted against the plan.

Conclusion: second liens should be second to no one

Second lien loans are a curious mix of secured obligations with unsecured rights. That is, second lien lenders are entitled to a junior bite out of the collateral package but, contractually, they typically have fewer rights (in their capacity as second lien lenders) than the unsecured creditors do to object to various actions by the first lien lenders and the debtor, such as proposals to sell collateral, incur priming DIP financing, limit adequate protection, and dictate plan treatment.

However, while the foregoing is what the contract may provide, it should not be the end of the discussion, only the starting point. Second lien lenders often have or can develop leverage outside of their contracts and can often obtain benefits through determined negotiation that would not initially appear to be achievable. As shown above, the Dura Second Lien Lenders arguably should have stayed silent throughout the entire chapter 11 case, receiving no adequate protection payments while enduring an unlimited priming DIP financing. The results achieved for the Dura Second Lien Lenders, therefore, are a testament to the determination and business savvy of the members of the Second Lien Group, and Bracewell & Giuliani is proud to have served as Second Lien Group counsel.

BRACEWELL & GIULIANI

FIRM OVERVIEW

Bracewell & Giuliani LLP is among the world's most prominent law firms. With more than 400 lawyers in Texas, New York, Washington DC, Connecticut, Dubai, Kazakhstan and London, we are well positioned to serve clients concentrated in the restructuring, investment, financial services and energy sectors worldwide.

OUR FINANCIAL RESTRUCTURING PRACTICE

With the recent addition of a team of world-class restructuring attorneys in our New York and Connecticut offices, the firm has increased its representation of funds, institutional investors, public bondholder groups, first and second lien lender groups and agents, private placement noteholder groups, chapter 11 committees and other investors and lenders throughout the United States and around the world. Members of our cross-disciplinary team have represented US investors in distressed situations in Africa, Asia, Australia, the Caspian Region, Europe, the Middle East, and North, Central and South America. Our industry experience is broad and deep, including homebuilding, timber products, automotive, energy and natural resources, electricity generation and transmission, mining and chemicals, telecommunications, entertainment, transportation, gaming, hospitality, subprime lending, retail, grocery, manufacturing, construction and healthcare.

OUR ATTORNEYS

Our lawyers have been repeatedly recognized and regularly honored in industry and peer surveys, including:

- Who's Who Legal's list of the 20 "Most Highly Regarded" insolvency lawyers in the world
- International Who's Who of Business Lawyers
- Euromoney's Top 25 "Best of the Best" Insolvency Lawyers in the World
- Chambers and Partners USA
- Legal 500
- Turnaround & Workouts' Top 12 "Outstanding Bankruptcy Attorneys"
- PLC's Which Lawyer?
- AsiaLaw Leading Lawyers
- K&A Register
- Who's Who in the World

COMMERCIAL LITIGATION

With restructurings becoming more complex and litigious each year, our clients turn to our skilled litigators as advocates in commercial, bankruptcy and appellate courts to enforce and defend their rights. We regularly handle complex matters of first impression, and creatively and effectively respond to the diverse issues affecting litigation recoveries. We have handled adversary proceedings, bankruptcy appeals and contested hearings throughout the US involving such issues as asset recovery, fraudulent conveyances and preferences, lender liability claims, make-whole disputes, recovery actions, contested plans of reorganization, valuation disputes, claim objections, Rule 2019 disputes, stay relief motions, adequate protection issues, cross-border insolvency disputes and executory contract issues.

SECOND LIEN AND BONDHOLDER GROUPS

Contentious second lien restructurings are often characterized by structural issues, intercreditor challenges, DIP financing fights, adequate protection negotiations, bondholder attacks and valuation disputes. Our second lien restructuring practice is led by restructuring, leveraged finance and bankruptcy litigation partners who work together to maximize the value of their combined finance experience and chapter 11 expertise. Current or recent second lien restructuring assignments led by our attorneys include representing the second lien lenders or second lien agent of TOUSA, DURA Automotive, Remy International, BHM Technologies, JL French, INTERMET and Liberty Electric.

Our attorneys have been leading ad hoc public bondholder and private noteholder committees for more than 20 years. With public debt securities, we understand not only the restructuring dynamics but also the securities laws, Trust Indenture Act, confidentiality, trading, reporting, fund, Rule 2019, industry and other issues critical to a comprehensive understanding of our clients' needs and objectives. With private placement notes, we understand the unique characteristics of NPAs, PPMs, NAIC requirements, non-LSTA trade docs and inter-noteholder dynamics, and we can calculate and litigate make-whole amounts with the passion of true believers.

SELECT DEALS

COMPANY	COUNTRY	CLIENT
Anchor Glass	US	Chapter 11 Creditors Committee
Asia Global Crossing	US/Bermuda/Asia	Chapter 11 Creditors Committee
AT&T Canada	Canada	Ad hoc Bondholders Group
BHM Technologies	US	Second Lien Lenders
DURA Automotive	US	Second Lien Lenders
Henry Walker Eltin	Australia	Private Placement Noteholders
Interstate Bakeries	US	Distressed Investment Group
INTERMET	US	Second Lien Lenders
JL French	US	Second Lien Lenders
Kaiser Aluminum	US	Ad hoc Bondholders Group
Liberty Electric	US	Tranche B Lenders
NRG Energy	US/Europe/Australia	Chapter 11 Creditors Committee
Parmalat	Italy/US	Ad hoc Bondholders Group
Pasminco	Australia	Ad hoc Bondholders Group
Piccadilly Cafeterias	US	Chapter 11 Creditors Committee
Pioneer Companies	US	Chapter 11 Creditors Committee
Pliant Corporation	US	Ad hoc Bondholders Group
Remy International	US	Second Lien Lenders
Satmex	Mexico	Ad hoc Bondholders Group
Scotia Pacific	US	Ad hoc Bondholders Group
Sons of Gwalia	Australia	Ad hoc Bondholders Group
Star Gas	US	Ad hoc Bondholders Group
Tembec Industries	Canada	Ad hoc Bondholders Group
TOUSA	US/Greece	Second Lien Lenders

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