

February 11, 2008

MEMORANDUM TO: Clients and Friends of the Firm

FROM: Patricia O'Prey
Craig NewmanRE: Recent Development Relating to MAC Clause – MAC
Clause Asserted to Prevent Liability for Exit Financing in
Solutia Bankruptcy Proceeding¹

Recently, a number of high profile cases have emerged involving the application of material adverse change (“MAC”) provisions, primarily in the context of leveraged buyouts.² This week, the application of MAC clauses to a financing commitment arose in the context of the Solutia Inc. (“Solutia”) bankruptcy proceeding. On February 6, 2008, Solutia filed an adversary proceeding against certain lenders (the “Lenders”)³ seeking to enforce a commitment to provide \$2 billion in exit financing. Beginning on January 20, 2008, the Lenders asserted by letter to Solutia that there has been a material adverse change in the credit markets that excused them from performance pursuant to a MAC provision in their financing commitment letter. On the same day that Solutia brought its claim against the Lenders, the Lenders filed a complaint seeking a declaratory judgment that “their funding obligations are conditioned upon satisfaction of the Adverse Market Change Provision” and that they were not in breach of the Commitment Letter (defined below).

The Commitment to Provide Exit Financing

On October 15, 2007, Solutia filed its Fifth Amended Joint Plan of Reorganization (the “Plan”). In connection with the Plan, Solutia sought exit financing to, among other things, replace Solutia’s debtor-in-possession (“DIP”) credit facility, and provide Solutia with working capital to operate its business going forward. A condition precedent to the bankruptcy court’s approval of the Plan was Solutia’s receipt of a commitment for the exit financing.

¹ In some jurisdictions, this memorandum may constitute attorney advertising. This memorandum was prepared as a service to clients and other friends of RK&O to report on recent developments that may be of interest to them. The information in it is therefore general, and should not be considered or relied upon as legal advice. RK&O does not represent any parties in the *Solutia Inc. v. Citigroup Global Markets, Inc.*, Adv. Pro. No. 08-01057, litigation.

² See, e.g., *United Rentals, Inc. v. RAM Holdings, Inc. and RAM Acquisition Corp.*, Case No. 3360-CC (Del. Ch. Ct. Dec. 21, 2007); *Genesco Inc. v. Finish Line, Inc., et al.*, Case No. 07-2137-II (III) (Tenn. Ch. Ct. filed Dec. 27, 2007); *Alliance Data Systems Corporation v. Aladdin Solutions Inc., et al.*, Case No. 3507 (Del. Ch. Ct. filed Jan. 29, 2008). See also our previous memorandum relating to MAC clauses at http://www.rkollp.com/2008/01/memorandum_delaware_chancery_c.php.

³ Citigroup Global Markets Inc., Goldman Sachs Credit Partners L.P., Deutsche Bank Securities Inc., and Deutsche Bank Trust Company Americas.

In a commitment letter dated October 25, 2007 (the “Commitment Letter”), the Lenders agreed to provide Solutia with \$2 billion in exit financing and, according to Solutia, agreed to hold the financing “on their balance sheets” if the loans could not be syndicated. Solutia alleges that, at the time, the Lenders were aware of the depressed state of the syndication market “which had tumbled in the summer of 2007” and that the Lenders’ firm commitment was the driving factor that led Solutia to lock itself into an exclusive financing package with the three banks.

The Material Adverse Change Clause

The MAC clause in the Commitment Letter provided that a condition of the Lenders’ obligation to fund was that there had been no

adverse change since the date of this Commitment Letter, October 25, 2007, in the loan syndication, financial or capital markets generally that, in the reasonable judgment of such [Lender], materially impairs syndication of the Facilities.

This MAC provision provides that the determination to be made by the Lender whether a MAC has occurred is to be made in its “reasonable judgment.” Solutia did not address the subjective aspect of the MAC clause in its Complaint. Instead, Solutia argued that it had agreed to include the MAC provision only because the Lenders allegedly assured Solutia that the provision was included as boilerplate to “comply with old-line ‘bank policy,’” explaining that the provision had commonly been used following the Russian ruble crisis of August 1998 and that one of the Lenders allegedly represented that it had brought back the provision as the “result of the ‘crunch’ suffered by the credit markets during the summer of 2007.”

Application of the MAC Clause to Loan Syndication

In its complaint, Solutia relies upon oral representations made by certain Lenders that they would simply retain the loans if they were unable to syndicate them. Solutia may have a difficult time avoiding the application of the MAC provision based upon its alleged reliance on the Lenders’ oral statements unless the court finds the MAC provision to be ambiguous and, therefore, admits evidence of the parties’ negotiations. Solutia will likely point to language in the Commitment Letter providing that “the [Lenders] agree that completion of . . . syndication is not a condition to the commitments hereunder.” Solutia will likely argue that there is an inconsistency, and therefore an ambiguity, between the MAC clause which explicitly incorporates an adverse change in “the loan syndication . . . markets” and the statement that the failure to complete syndication is not a condition to the parties’ funding obligation. One possible explanation is that the word “completion” with respect to syndication was meant to indicate that syndication might be in progress, but not yet completed, and that the exit financing could nonetheless close.

Did a MAC Occur?

Solutia could be left arguing that the situation in the credit markets did not deteriorate between October 25, 2007 and January 30, 2008, the date on which the Lenders called the MAC. As Solutia now argues, “[i]n light of the struggling state of the credit and syndication markets from the summer of 2007 onward . . . the [Lenders] recent invocation of the ‘adverse change’ provision is particularly without factual or legal basis.” In proving that point, Solutia may face a very difficult challenge. As the Lenders argue, “[t]here can be no doubt that the markets have changed adversely since October 25, 2007, a fact recognized by the Federal Reserve Board, and virtually every financial regulator, newspaper, commentator and practitioner in the world.” Indeed, during the relevant timeframe, the banking community has suffered unprecedented losses and write-offs as a result of the credit crisis.

Nonetheless, Solutia points to the fact that other exit financing deals closed successfully in the same market. For example, on February 1, 2008, less than two weeks after the Lenders refused to fund, Dana Corp. successfully emerged from its chapter 11 bankruptcy case, having received funding for its \$2 billion exit financing facility.

Solutia’s Exit from Bankruptcy May be Jeopardized

Whatever the result and arguments made, one thing is clear – Solutia is under significant time pressure and its exit from bankruptcy may be jeopardized by the collapse of its exit financing commitment. As a result, on Friday, the bankruptcy court set a February 21, 2008 trial date on Solutia's claims.

If you have any questions regarding this memo, please contact Craig A. Newman at (212) 530-1924 (or by email at cnewman@rkollp.com), or Patricia C. O’Prey at (212) 530-1969 (or by email at poprey@rkollp.com).