



## Neiman Marcus Capitalizes on Weak Covenant Package to Transfer Valuable Assets Beyond the Reach of Certain Creditors

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On September 21, 2018, Marble Ridge Capital (“Marble Ridge”) issued a press release indicating that Marble Ridge had sent a letter to the board of directors of Neiman Marcus alleging that certain transactions entered into by Neiman Marcus violated the company’s loan agreement and certain indentures, and that such transactions could be subject to avoidance as fraudulent transfers.<sup>1</sup>

Marble Ridge’s letter was sent in its capacity as holder of (a) 8.0% senior cash pay notes issued pursuant to an Indenture dated October 21, 2013 (the “Cash Pay Indenture”), (b) 8.75%/9.5% PIK toggle notes issued pursuant to an Indenture dated October 21, 2013 (the “PIK Toggle Indenture” and together with the Cash Pay Indenture, the “Indentures”), and (c) term loans issued pursuant to a Term Loan Credit Agreement dated October 25, 2013 (the “Credit Agreement”).

On or about March 10, 2017, Neiman Marcus designated certain of its subsidiaries as “Unrestricted Subsidiaries” for purposes of the Indentures and the Credit Agreement.<sup>2</sup> These newly-identified Unrestricted Subsidiaries included certain subsidiaries that owned the “MyTheresa” business of Neiman Marcus, as well as real property related thereto.

At the time of the designation of the MyTheresa entities as Unrestricted Subsidiaries, those entities were owned by NMG International LLC (“NMG Sub”). In the Form 10-K annual report filed by Neiman Marcus on September 18, 2018, the company disclosed that substantially all of the holdings of NMG Sub had been distributed to Neiman Marcus Group, Inc. (“Parent”). The distributions appear to have been made in a series of steps up the Neiman Marcus corporate chain: from NMG Sub to its direct parent, The Neiman Marcus Group LLC (“NMG”), from NMG to Neiman Marcus Group Ltd. LLC (the “Company”), from the Company to Mariposa Intermediate Holdings LLC (“Holdings”), and finally from Holdings to Parent.

Prior to this series of transactions, the MyTheresa entities were indirect subsidiaries of NMG, which is a guarantor of the debt issued pursuant to the Indentures and the Credit Agreement. Following this series of transactions, however, the MyTheresa entities are direct subsidiaries of Parent. Parent is not a guarantor under the Indentures or the Credit Agreement. In this manner, Neiman Marcus appears to have distributed these valuable assets upstream through the capital structure, and outside the reach of Marble Ridge and the other holders of the notes and loans issued pursuant to the Indentures and Credit Agreement.

The Indentures and the Credit Agreement each restrict the ability of Neiman Marcus to make restricted payments (i.e., the making of dividends, distributions, and other payments to its equity holders), subject to certain negotiated carve-outs. Importantly, the Indentures and the Credit Agreement each provides for a carve-out to the restricted payment negative covenant to allow for the distribution, as a dividend or otherwise, of the capital stock of any Unrestricted Subsidiaries (other than Unrestricted Subsidiaries the

<sup>1</sup> <https://www.prnewswire.com/news-releases/marble-ridge-capital-lp-sends-letter-to-neiman-marcus-group-board-challenging-the-validity-of-self-interested-asset-transfers-and-asserting-company-is-in-default-under-bond-indentures-300716847.html>

<sup>2</sup> <https://www.sec.gov/Archives/edgar/data/1358651/000135865117000004/q2fy17201712810q.htm>



primary assets of which are cash). In this manner, Neiman Marcus appears to have made the MyTheresa distributions in accordance with the terms of the Indentures and the Credit Agreement.<sup>3</sup>

Unable to point to a breach of the Indentures or Credit Agreement, Marble Ridge intimates that these transactions amount to a fraudulent transfer, and are subject to avoidance. But unless it can be established that Neiman Marcus is insolvent (on either a balance sheet, unreasonably small capital, or inability to pay debts as they come due basis), Marble Ridge does not have a very persuasive fraudulent transfer argument since solvent businesses are generally permitted to engage in affiliate transactions, and to issue dividends to equity holders. Marble Ridge could try to argue that the transaction was undertaken to hinder, delay or defraud creditors. However, Neiman Marcus would likely argue that the challenged actions are expressly authorized under the terms of the relevant credit documents.

Marble Ridge's real complaint is that Neiman Marcus has re-engineered its capital structure in a way that has impaired the creditworthiness of its operating subsidiaries, and in so doing complicated the recovery prospects of those entities' noteholders and lenders. Unfortunately for Marble Ridge, the Indentures and Credit Agreement under which this credit was extended appear to permit precisely this result. Neiman Marcus is certainly engaging in strategic behavior – designed to augment its bargaining power in the event of future financial distress or insolvency. The Neiman Marcus actions rely on different provisions of the financing documents but are analogous to the actions taken by J. Crew to move valuable trademark rights away from one collateral pool to the disadvantage of an existing creditor group in order to generate liquidity. We have previously reported on the J. Crew case.<sup>4</sup> Lenders and bond holders should review loan agreements and indentures for provisions that permit unintended collateral leakage.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the authors.

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<sup>3</sup> We note that the Marble Ridge letter raises certain questions regarding whether the designation of the MyTheresa entities as Unrestricted Subsidiaries in March 2017 was in fact permitted by the Indentures. At the time of such designation, Neiman Marcus was required to meet certain requirements, including compliance with a minimum Interest Coverage Ratio. Marble Ridge has requested back-up calculations from Neiman Marcus in order to verify that these minimum requirements were met.

<sup>4</sup> <https://www.lockelord.com/newsandevents/publications/2017/10/jcrew-group-inc>



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