SOLUTIA[1] FILES LAWSUIT AGAINST EXIT LENDERS TO COMPEL THEM TO HONOR FUNDING COMMITMENT

On February 6, 2008, Solutia Inc. ("Solutia"), which has been operating as a debtor-in-possession for the past four years, filed a complaint in the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court"), where Solutia's plan of reorganization had been confirmed in its chapter 11 cases not two months earlier. In order to fund the consummation of its plan of reorganization, Solutia required approximately $2 billion of exit financing. In its complaint, Solutia alleged, among other things, that Citigroup Global Markets Inc., Goldman Sachs Credit Partners LP, Deutsche Bank Securities Inc. and Deutsche Bank Trust Company Americas (collectively, the "Commitment Parties") had breached their commitment to provide Solutia with its required exit financing and fraudulently induced Solutia into entering into the financing arrangement.[2] The complaint seeks either to enforce specific performance or to recover $2.25 billion in damages, and was filed in response to the Commitment Parties' announcement on January 23, 2008, that they were invoking a "Market-MAC" provision included in the Commitment Parties' Commitment Letter (defined below) and were withdrawing their commitment to provide the exit financing necessary to fund Solutia's emergence from chapter 11.

Solutia, a specialty chemicals company, filed for chapter 11 protection in December 2003. In October 2007, the company filed the sixth iteration of its plan of reorganization—the culmination of several years of litigation and negotiations over retiree benefits, environmental claims, and tort liability. On October 25, 2007, the Commitment Parties executed a firm commitment (the "Commitment Letter") to fund a $2 billion long-term exit financing arrangement. On November 20, 2007, Solutia sought and obtained Bankruptcy Court approval of the exit financing arrangement, including the Commitment Letter. Nine days later, the Bankruptcy Court found the Solutia plan of reorganization feasible, based in large part on its exit financing arrangement, and confirmed the plan.[3]

Notwithstanding the tumultuous credit market of the summer and fall of 2007, Solutia was able to obtain the commitment from the Commitment Parties. Aware of the then-current market

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1 Although Willkie Farr & Gallagher LLP has represented a substantial party-in-interest in the Solutia case, Mr. Feldman has not had any material involvement in such representation.

2 *Solutia Inc., v. Citigroup Global Markets Inc., Goldman Sachs Credit Partners L.P., Duetsche Bank Securities Inc., and Deutsche Bank Trust Company Americas (In re Solutia Inc., et al.)*, Complaint, Adv. Pro. No. 08- 01057 (Bankr. S.D.N.Y. 2008) (the "Complaint").

3 Compaint ¶ 4. This date is likely to be critical in any analysis regarding whether a Market MAC has occurred. At best, the Commitment Parties will have to argue that such Market-MAC occurred between this date and January 23, 2008, an approximately seven-week period.

conditions, Solutia allegedly refused to go forward with the Commitment Parties unless the financing was based on a commitment that was not contingent upon a successful syndication (a so-called best efforts commitment), but was rather, if necessary, an agreement by the Commitment Parties to make the loan themselves (a so-called balance sheet loan).[4] Specifically, the Commitment Letter provided, in relevant part, that "the Commitment Parties agree that completion of such syndications is not a condition to their commitments hereunder or the initial funding under the [Exit Financing]. . . ."[5] Notwithstanding this provision of the Commitment Letter, the parties also agreed that a material adverse change permitting the Commitment Parties to walk away from the deal would be defined as follows:

> "any adverse change since the date of [the] Commitment Letter in the loan syndication, financial, or capital markets generally that, in the reasonable judgment of such Commitment Party, materially impairs syndication" (the "Market-MAC").[6]

After completing the road show to market the syndication, and just days before the scheduled closing, the Commitment Parties notified Solutia that they intended on enforcing the Market-MAC.[7] If the Commitment Parties, either voluntarily or involuntarily, do not honor the commitment by February 28, 2008, Solutia will lose the backing on a $250 million rights offering and will remain in chapter 11, back at the bargaining table with its myriad parties-in-interest.

Initially, Solutia alleges in its complaint that the Market-MAC was characterized by the Commitment Parties as a pro-forma firm policy that had never been exercised in prior arrangements. Put differently, Solutia suggests that notwithstanding the language in the Commitment Letter, it reasonably relied to its detriment on the oral representations of the Commitment Parties. Solutia also offers a second argument that there has been no material adverse change to the markets since the Commitment Parties entered into the Commitment Letter in October 2007. Failure to syndicate the exit facilities, it asserts, was based on the Commitment Parties' attempts at "reeducating the market" by introducing the syndication at an excessive floor syndication price not conducive to market conditions and ignoring the availability of certain "Flex Provisions" in the commitment that would allow the Commitment Parties to adjust the terms of the exit facilities in order to effect a successful syndication.[8] The Commitment Parties

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4 Complaint ¶¶ 22-25.

5 Complaint ¶ 23.

6 Complaint ¶ 26.

7 Dana Corp., *et al*., which filed for bankruptcy protection in 2006, successfully emerged from chapter 11 on January 31, 2008, with a $790 million capital infusion lead by Centerbridge Capital Partners. The arrangement between Centerbridge and Dana was similarly negotiated during the summer and fall of 2007. No Market-MACs were included in their financing arrangement.

8 Complaint ¶ 50-51.

filed an answer to the Solutia complaint the same day, emphasizing the market destabilizing events that had occurred throughout January 2008, and raising their own set of counterclaims against Solutia, seeking a declaratory judgment that (1) their funding obligations are conditioned upon the absence of a Market-MAC; (2) they are not in breach of the Commitment Letter because not all conditions to closing have been met; and (3) Solutia is required by the terms of the Commitment Letter to indemnify the Commitment Parties in connection with any investigation, litigation, or proceeding relating to the Commitment Letter and/or the transactions contemplated thereby.[9]

Market-MACs give buyers and lenders a right to terminate their obligations when the market conditions between commitment and closing take a turn for the worse and render the purchase or investment uneconomic for the purchaser or lender. Market-MACs were common several years ago when the financial markets were relatively volatile. Over the past several years, as market conditions stabilized and private equity firms gained enormous leverage over their lenders as competition for their business grew fierce, Market-MACs all but disappeared from the lending landscape. While the reemergence of the Market-MAC may incent investors to lend and invest with significant downside protection, the Solutia papers filed in the Bankruptcy Court raise the question of whether a Market-MAC will be enforceable when lenders are issuing commitments in an unstable credit market. In particular, how will a court of equity balance the need for lenders to be willing to invest in companies in bankruptcy against the debilitating risk of losing financing the day before closing and after confirmation of a plan of reorganization?

Delaware courts have previously resisted enforcement of broad sweeping material adverse change ("MAC") provisions. In *IBP, Inc, v. Tyson Foods, Inc. (In re IBP, Inc. Shareholders Litigation)*, a Delaware Court compelled specific performance of a merger agreement between meat producers Tyson and IBP, after Tyson tried to back out of the merger, asserting the occurrence of a material adverse change in the economic health of IBP.[10] The merger agreement between Tyson and IBP provided a general business MAC, allowing the seller to walk away if there was a material adverse effect "on the condition (financial or otherwise), business, assets, liabilities or results of operations of [IBP] and [its] Subsidiaries taken as whole. . . ."[11] In enforcing specific performance of the merger, the Delaware court found:

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9 *Solutia Inc., v. Citigroup Global Markets Inc., Goldman Sachs Credit Partners L.P., Duetsche Bank Securities Inc., and Deutsche Bank Trust Company Americas (In re Solutia Inc., et al.)*, Answer, Affirmative Defenses and Counterclaims of Citigroup Global Markets Inc., Goldman Sachs Credit Partners L.P., Duetsche Bank Securities Inc., and Deutsche Bank Trust Company Americas, Adv. Pro. No. 08-01057 (Bankr. S.D.N.Y. 2008) (the "Answer").

10 *In re IBP, Inc. Shareholders Litigation*, 789 A.2d 14, 65 (Del. Ch. 2001); see also *Frontier Oil Corp. v. Holly Corp., C.A.* No. 20502, 2005 Del. Ch. LEXIS 57 (Del. Ch. April 29, 2005) (granting specific performance notwithstanding business-MAC, where acquiror failed to prove beyond a preponderance of the evidence that litigation against seller's subsidiary alleging that oil wells were a source of cancer clusters was a material adverse change).

11 *In re IBP,* 789 A.2d at 65.

> that a New York court would incline toward the view that a buyer ought to have to make a strong showing to invoke a Material Adverse Effect exception to its obligation to close. Merger contracts are heavily negotiated and cover a large number of specific risks explicitly. As a result, even where a Material Adverse Effect condition is as broadly written as the one in the Merger Agreement, that provision is best read as a backstop protecting the acquiror from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally significant manner. A short-term hiccup in earnings should not suffice; rather the Material Adverse Effect should be material when viewed from the longer-term perspective of a reasonable acquiror.[12]

Whether the Commitment Parties experienced buyer's remorse following the road show for the loan, or whether the current market crisis is "material when viewed in the longer-term perspective of a reasonable [lender]," will affect not only Solutia's ability to emerge from chapter 11, but also the ability of troubled companies generally to access credit markets during this period of uncertainty. The first indication of the direction of this dispute may be revealed at the trial on this matter to be heard by Judge Beatty on February 21, 2008.

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If you have any questions regarding this memorandum, please contact Matthew A. Feldman (212-728-8651, mfeldman@willkie.com) or the attorney with whom you regularly work.

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February 12, 2008

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[12] *In re IBP,* at 68.