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Pari Passu In Name Only: How Restructurings Split Recoveries

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Over the past months, we have examined how modern liability management exercises (LMEs) use legal and structural tools to reallocate value within the capital structure – often without formal insolvency. In this edition, we shift focus from how these tools work to what they mean for investors: same bonds, same rank, but dramatically different outcomes.

What emerges is a clear pattern: recoveries are no longer determined solely by legal seniority, but increasingly by investor behavior – who joins early, who funds, who controls the terms. In this landscape, access trumps rank.

Whether through uptiering, double dips, or selective new money transactions, active participants can elevate their position and secure outsized recoveries. Passive holders – often institutions, CLOs, or retail funds – are left with structurally inferior outcomes, even when they hold the same instrument.

This divergence directly impacts required compensation: the spread needed to justify a credit investment now depends heavily on an investor's ability to influence recovery. Two investors holding the same bond may require entirely different returns – because only one can steer the outcome.

This dynamic reframes how credit risk must be assessed. In today's market, outcomes are no longer defined by instruments alone, but by each investor's ability to shape the restructuring. Legal form may be equal – but economic substance depends on who you are, what you know, and how early you act.

Unequal by Design: The Disappearing "Equal Treatment" Principle

In traditional credit restructurings, the principle of pari passu – equal treatment among creditors of the same seniority – was foundational. Today, that principle is routinely circumvented through liability management exercises (LMEs) that reshape outcomes without formal insolvency.

High-profile restructurings like Serta Simmons, Intrum, Adler, and now Selecta reveal a consistent pattern: same bonds, same seniority, radically unequal treatment. Select groups of creditors – typically those who coordinate early and contribute new money – secure elevated positions. Others are diluted or subordinated, often without formal insolvency.

The new capital markets landscape is one of structured divergence. Legal form remains uniform, but economic substance now diverges based on involvement.

Case Study: Selecta – The Recovery Gap in Action

Selecta Group, Europe's largest operator of vending machines and coffee services, is no stranger to financial distress. After a first restructuring in 2020 aimed at addressing its high leverage, the company again found itself in trouble by 2024. Despite earlier debt reductions, it burned through liquidity as inflation, supply disruptions, and sluggish office traffic weighed on margins. By

early 2025, Selecta faced another cash crunch – and creditors were called back to the table.

But this second restructuring didn't affect all creditors equally.

The company was restructured under the Dutch WHOA regime, a court-supervised framework similar to the UK Restructuring Plan. At first glance, all first-lien bondholders were offered participation in the solution. But a closer look revealed two very different outcomes – depending on whether you were part of the Coordination Committee (CoCom).

The CoCom, composed of select insiders, played an active role in structuring and funding the deal:

- > Injected €330 million of new money
- > Took control of the company's equity via a BidCo structure they controlled
- > Received first-out and second-out secured debt (i.e., new senior tranches ranking ahead of legacy first-lien claims), placing them at the top of the recovery stack.
- > Secured rights to amend key terms with only 50% lender consent for 12 months

Meanwhile, the non-CoCom bondholders – despite holding legally equal first-lien notes – faced a different reality. They were offered:

- > Subordinated third-out notes at 85% of face value, plus
- > 15.3% equity in the new BidCo

Alternatively, they could swap into the new first-out debt – but only on terms dictated by the CoCom, including restricted governance rights and limited downside protection.

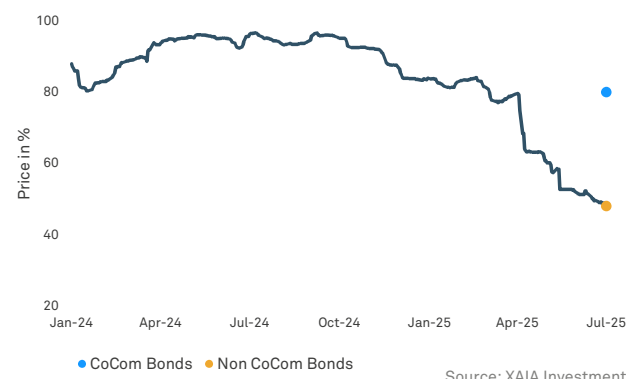
This left outside holders in a bind: either accept an inferior recovery, or agree to a coercive structure controlled by insiders.

Same instrument. Same seniority. Completely different economics.

The Selecta transaction illustrates a broader shift in European restructurings: access to the deal – not rank – determines outcome. Legal tools like WHOA enable majorities to bind minorities, and sponsors increasingly use this to reward cooperative capital while subordinating passive holders. Selecta's 1L bond prices highlight the split: while the bond trades around 50 cents, the package secured by CoCom members implies an intrinsic value closer to 80 – a 30-point gap driven purely by structure and participation.

FIGURE 1: “ONE BOND, TWO REALITIES” – HOW STRUCTURE DRIVES PRICE

Price development of Selecta's 1L bond



The Credit Triangle: Spread, Default, Recovery – And Now, Position

Credit investing traditionally rests on three interlinked variables:

- > Spread (S) – the compensation for taking credit risk
- > Default Probability (D) – the chance the issuer will default
- > Recovery Rate (R) – how much you get back in a default

Simplified, the expected loss (EL) on a credit instrument is:

$$EL = D \times (1 - R)$$

In an efficient market, the credit spread should approximately reflect this expected loss:

$$Spread \approx D \times (1 - R)$$

In other words:

$$Spread \approx \text{Probability of Default} \times \text{Loss Given Default}$$

Assuming a 5% probability of default and a 40% recovery rate, the expected loss is:

$$EL = 5\% \times (1 - 0.40) = 3.0\%$$

In this case, a 300 basis point spread merely compensates for the expected credit loss. To achieve a net excess return of 1%, the investor would require a spread of approximately 400 basis points.

TABLE 1: SAME BOND, DIFFERENT RECOVERIES – HIGHER RISK DEMANDS HIGHER SPREAD

Break-even spread required at different recovery levels assuming 5% default probability.

Investor Type	Recovery Assumption	Expected Loss (EL)	Required Spread to Break Even
Strong Insider	90%	$5\% \times (1 - 0.90) = 0.5\%$	0.5%
Passive Investor	30%	$5\% \times (1 - 0.30) = 3.5\%$	3.5%

However, this relationship breaks down when recoveries diverge across creditors — as has become increasingly common in modern restructurings.

If two investors receive the same 400 basis point spread but face different recoveries, their outcomes diverge materially. The insider, benefiting from structural protections or active participation in the process, may realize a 90% recovery. In that case, the expected loss is only 0.5%, resulting in an excess return of 3.5%. In contrast, a passive or excluded investor recovering just 30% faces an expected loss of 3.5% — leaving little to no return.

The implication is clear: spread alone is no longer a sufficient signal of risk or return. Understanding one's position in the capital structure and negotiation process is now essential.

In today's credit markets, recovery is not a fixed assumption — it is a variable, increasingly shaped by legal structure and strategic participation. The credit triangle remains valid, but it now requires a fourth dimension: position.

Legal Architecture: What Our Recent Letters Have Shown

In our recent editions, we examined how modern liability management tools reshape recoveries — not through insolvency, but through documentation, coordination, and jurisdiction.

Here's what we've covered:

- > Drop-downs (March): move assets into unrestricted subsidiaries and raise structurally senior debt
- > Double dips (April): provide lenders with dual claims on the same collateral pool without adding new capital
- > Uptiering (May): select lenders receive super-senior status via exit consents and amendment votes (e.g. Serta)

These transactions exploit structural and legal flexibility to elevate cooperative creditors and subordinate others, even when everyone starts with pari passu claims.

In the Selecta case, the use of the Dutch WHOA process allowed a simple majority of creditors to enforce a value transfer across the entire class — without unanimous

consent or formal insolvency. The CoCom not only structured the deal but also embedded control provisions (like 50% amendment rights), consolidating their position.

Key legal enablers include:

- > Low consent thresholds (often just 50.1%), allowing small majorities to reshape creditor rights
- > Covenant-lite terms, with broad baskets for new debt, intercompany transfers, and priming
- > Jurisdictional arbitrage, such as issuing under New York law to sidestep stronger EU protections and implement U.S.-style tactics in European credits

These aren't legal footnotes — they're the mechanics behind modern value transfer. In this landscape, legal architecture is no longer a formality — it's a core return variable.

Strategic Takeaways for Investors – The Playbook of the Strong Investor

In today's credit market, legal seniority is no longer a guarantee of return. Your place in the negotiation — not the term sheet — is what matters.

To stay ahead:

- > *Join early:*
Early coordination in ad hoc groups secures access to economics and process control.
- > *Negotiate upfront:*
Demand tighter documentation and pro-rata sharing terms in new financings.
- > *Evaluate amendment risk:*
Scrutinize credit docs for low consent thresholds and unrestricted basket size.
- > *Be structurally flexible:*
Use mandates that allow you to participate in restructurings, provide DIP financing, and engage in governance.
- > *Know the law:*
Understand which legal frameworks govern your instruments — and how they can be used against you.

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Philipp Graxenberger and Josef Pschorn oversee Alternative Credit Strategies at XAIA Investment, specializing in identifying inefficiencies in the credit market, particularly within complex capital structures and special situations. Their expertise spans credit arbitrage, relative value, special situations, and restructurings.

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