

Wesco/Incora District Court Construes Debtholder Sacred Rights Narrowly and Raises Questions for Participant Lenders

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Over the past several years, out-of-court Liability Management Exercises (“LMEs”) have been utilized by struggling companies to mitigate financial distress, often by “uptiering” debt in order to gain access to augmented liquidity or to extend maturity runways. In a number of these situations, debtors have taken advantage of loose basket capacity and favorable non-pro rata and/or amendment provisions in credit agreements and indentures to subordinate older, existing credit facilities as well as a host of other disadvantages for non-participating minority lenders. This hostile dynamic has led to a number of protracted legal battles in the courtroom, including one commonly referred to as “Incora” – a contentious uptiering LME that has dominated lending headlines in recent years.

The latest December 2025 Incora decision issued by the United States District Court for the Southern District of Texas, offers lenders and noteholders and their counsels a cautionary tale on the extreme precision and utmost sensitivity needed in order to craft robust sacred rights and consent threshold provisions. Below we discuss in detail the Incora LME, the current status of the Incora litigation and key considerations for future credit agreements and indentures.

Background and Transaction Timeline

The aforementioned Incora LME and ensuing litigation initially arose from a liquidity crisis of Wesco Aircraft Holdings, Inc. (d/b/a Incora) following its acquisition of Pattonair, Ltd. in 2020 and the COVID-19 pandemic-driven contraction impacting much of the civilian aviation sector. Wesco financed its acquisition with secured and unsecured notes issued under three indentures: \$650 million of senior secured notes maturing in 2024 (the “2024 Notes”), \$900 million of senior secured notes maturing in 2026 (the “2026 Notes”), and \$525 million of unsecured notes maturing in 2027 (the “2027 Notes”). By late 2021, liquidity pressures escalated, and auditors indicated that a substantial cash infusion would be required to obtain a clean audit, propelling the company to pursue additional financing.

At the outset, it is important to note that the indentures governing the notes issued in 2020 contained the common requirement that most amendments were to be approved by a majority in principal amount of the outstanding notes. Critically, the indentures governing the 2024 Notes and 2026 Notes also required two-thirds of the existing noteholders holding such class of notes to agree before Wesco could release the liens on the collateral securing such class of notes. Finally, the indenture governing the 2026 Notes also prohibited any amendment that would “make any change to, or modify, the ranking of the 2026 Secured Notes in respect of right of payment that would adversely affect the Holders of the 2026 Secured Notes” without the consent of each adversely affected holder.

Utilizing the framework set forth above, in 2021, to address its liquidity difficulties, Wesco accepted a proposal under which a “Majority Group” of noteholders would provide \$250 million of new money financing. This financing would be accomplished in three steps. First, with the consent of at least a majority of the holders of the outstanding notes under each indenture, Wesco amended its indentures via “Third Supplemental Indentures” to permit issuance of additional 2026 Notes on a pari passu basis with the existing 2026 Notes. Second, Wesco issued \$250 million in 2026 Notes to the Majority Group. Third, once the Majority Group held more than two-thirds of the outstanding 2026 Notes (including the newly issued 2026 Notes), the parties executed “Fourth Supplemental Indentures” that released liens securing the original 2024 Notes and 2026 Notes, thereby enabling new 2026 Notes to become super-senior first-lien notes and super-senior second-lien notes benefitting from the collateral package that previously secured the 2024 Notes and preexisting 2026 Notes.

The parties sequenced the closings on a single day with conditionally released signature pages. The documents were drafted and closed so that each step had independent legal significance and was not conditioned on subsequent steps within the four corners of the supplemental indentures.

Most Recent District Court Decision: Sacred Rights Construed Narrowly

In the ensuing litigation, the plaintiffs comprising the holders of the now unsecured 2024 Notes and preexisting 2026 Notes (the “Minority Group”) asked the court to collapse the steps summarized above and find that the Third Supplemental Indentures, though approved by a majority of each class of noteholders and not themselves releasing any collateral, nevertheless “had the effect of” releasing collateral. The Minority Group argued that their downstream result, in combination with the later two-thirds vote, enabled a collateral release.

Most recently, the United States District Court for the Southern District of Texas issued a significant blow to the Minority Group, by rejecting the “effect of” theory and holding that the plain text of each indenture controls. The court construed language that would “have the effect of” to refer to the immediate, legal result of the amendment or waiver under review and not to potential downstream consequences that might follow from subsequent, separate actions requiring additional consents (even if those subsequent actions occurred on the same day and even though none of the subsequent actions would have happened independently). The court read the limitation in the indenture governing the 2026 Notes prohibiting amendments that would modify “ranking in right of payment” to only extend to contractual subordination of a right to payment, rather than lien or structural subordination; this meant that only the consent of majority noteholders rather than all affected noteholders was required to accomplish the transactions in question. As such, the court declared that 2021 financing transaction did not breach the indentures and dismissed the Minority Group plaintiffs’ breach of contract claims.

Practical Implications for Documentation and Liability Management

There are several key takeaways to be drawn from the latest Incora decision and reasoning in this case:

- In any credit agreement or indenture where there is a sacred right subject to a consent requirement that is less than all lenders (be it 75% or 66 2/3% or otherwise), the presence of incremental debt or incremental equivalent debt capacity, an accordion feature or “additional note” feature opens the door to would-be priming lenders increasing their hold amounts to overcome such consent thresholds.
- At the initial documentation stage, borrowers and issuers will likely successfully resist the imposition of all-lender (or all-holder) consent rights over increases to an incremental facility cap (or all-holder consent rights over the issuance of additional notes), so lenders and should be aware that a supermajority consent threshold may not be as protective as they might assume in a distressed scenario.
- If a borrower encounters financial difficulties and the existing definitive documentation includes supermajority consent thresholds or proposals are made to add supermajority consent thresholds in definitive documentation during the negotiation of a waiver or other workout-related amendment, participant lenders should push for an accompanying equivalent supermajority or all lender consent right over incurrences of future pari passu debt that could be utilized to overcome any supermajority consent threshold that exists or is being added.
- Given the court’s very narrow reading of the scope of the phrase “effect of” when construing the ambit of sacred rights, participating lenders should be wary of relying solely on “effect of” language in amendment sections of credit agreements and indentures when attempting to protect sacred rights. Lenders and noteholders would benefit from constructing incremental provisions to limit the ability of incremental DDTL creditors to vote unless their commitments have either actually been drawn and/or the conditions precedent to drawing such commitments could be met at the date of determination on which the vote is taking place.
- In order to avoid being on the wrong end of a non-pro rata LME, lenders and noteholders may seek to participate in formal cooperation agreements with majority lenders/noteholders. In recent years, cooperation agreements have been utilized by subsets of bank groups to negotiate with borrowers as a united front. Cooperation agreements often provide for pro rata treatment on the underlying transaction agreed upon for participating

lenders and noteholders. Such agreements may specify that during an “effective period”, participating lenders/noteholders will not enter into a potential transaction in respect of the borrower’s indebtedness that the majority group does not agree to. But while cooperation agreements may ultimately mitigate the risk of an Incora-type LME, it is important to note that there have been some recent borrower antitrust challenges to these agreements. Lenders and noteholders should thus carefully consider the risks and benefits of cooperation agreements for their particular transaction.

The Incora decision offers a cautionary tale highlighting the importance of carefully negotiating sacred rights provisions. The court held that Wesco’s 2022 financing transaction complied with indentures governing the 2024 Notes and 2026 Notes because the only Third Supplemental Indenture’s immediate legal effect was to authorize additional pari passu notes subject to only majority consent, while the later lien releases required—and received—two-thirds consent. For lenders, the message is practical and urgent. Where sacred rights can be overcome through subsequent majority-approved issuances that accrete voting power, supermajority standards may not deliver expected protection in a distressed scenario.

For More Information

We are available at any time to answer questions, discuss scenarios, and provide guidance. If you would like further information concerning the matters discussed in this article, please contact the Chapman attorney with whom you regularly work or visit us online at chapman.com.

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