Inn of Court February 11, 2015 Presentation

Fact Pattern

CD Mania, Inc. is a Delaware corporation with is headquarters in Terra Haute, Indiana. It has been in financial distress for years; its main product -- as its name suggests -- is compact discs, a medium for recorded music which has plummeted for a decade since the iPod popularized the downloaded .MP3 format and in more recently due to the popularization of streaming of music. Once a company with a market cap of hundreds of millions of dollars, CD Mania has been insolvent for at least the last several years. Several rounds of cost cutting measures have proved to be insufficient, as every year fewer CDs are sold.

In 2012, CD Mania underwent a financial restructuring. The restructuring provided as follows:

- New $10 senior secured loan advanced by Aggressive Fund, Inc, which previously was only a junior lender.
- Existing 1st lien bond debt of $60M converted into 2d lien debt and otherwise reinstated. This debt is held by a disparate group of bondholders. The Indenture Trustee is Indenture Corp. The bonds do not come due until 2020.
- Aggressive Fund's existing 2d lien debt converted into 55% of the common stock of CD Mania and the right to appoint 3/5ths of the board of directors.

To effectuate this restructuring, the following took place:

1. The bond indenture was amended pursuant to its terms. It now contains a No Action Clause that provides:

Limitations on Suits by Securityholder. No holder of any Security shall have any right by virtue or by availing of any provision of this Indenture to institute any action or proceeding at law or in equity or in bankruptcy or otherwise upon or under or with respect to this Indenture, or for the appointment of a trustee, receiver, liquidator, custodian or other similar official or for any other remedy hereunder, unless such holder previously shall have given to the Trustee written notice of default in respect of the series of Securities held by such Securityholder and of the continuance thereof, as hereinbefore provided, and unless also the holders of not less than 50% of the aggregate principal amount of the relevant series of Securities at the time Outstanding shall have made written request upon the Trustee to institute such action or proceedings in its own name as trustee hereunder and shall have offered to the Trustee such reasonable indemnity as it may require against the costs, expenses and liabilities to be incurred therein or thereby and the Trustee for 60 days after its receipt of such notice, request and offer of indemnity shall have failed to institute any such action or proceedings and no direction inconsistent with such written request shall have been given to the Trustee within such 60 days.

2. Aggressive agreed to release its pre-existing 2d lien since the indebtedness was converted into stock. The CFO of CD Mania drafted a lien release and waiver and sent it to Aggressive. Aggressive executed the document and it was filed. The language of the release was very broad and can be read to release the newly issued first lien position, which was not the intent of the parties.

Unfortunately, the restructuring was insufficient. The company lost significantly more value as CD sales continued to plummet, and the company clearly is insolvent. Discounted cash flow models show a valuation range of $35M-$55M. Because inventory is high (in part because CDs manufactured years ago never have been sold, yet the internal team was so incompetent that they kept ordering more inventory for years), preliminary estimates are that the liquidation value is approximately the same as the DCF valuation

One day, while watching his 11 year old take 50 selfies on his iPhone (streaming music), the Chairman of Aggressive, Johnny Aggressive, had an epiphany: selfies, especially of 11 year olds, would be of far better quality if the phone could just be placed slightly further away from the body than an 11 year old's arms can manage. Thus was born a new product: the Selfie Stick (TM).

Mr. Aggressive decided that the Selfie Stick is "The Next Big Thing" and could make millions. His plan was to have CD Mania market and sell the Selfie Sticks, despite the total lack of synergy with CD sales. The rationale simply was that this product's net revenues could help return CD Mania to profitability.

Mr. Aggressive also realized something else: another of Aggressive's portfolio companies, Plastics Inc., manufactures the exact type of plastic molding needed to build a perfect Selfie Stick. He immediately, without shopping the price, caused CD Mania to enter into a long term contract with Plastics Inc. which guaranteed the purchase of $10M/year of plastic molding. The CEO of CD Mania objected, noting that the price was double the market rate for plastics. Mr. Aggressive immediately fired the CEO.

In order to begin selling Selfie Sticks, CD mania also needed to spend $15M immediately on a new plant, new employees, advertising, etc. It will take at least a year before CD Mania can sell a single Selfie Stick. Mr. Aggressive is not worried, because the bond debt is not due until 2020, so while the company is balance sheet insolvent today, he figures he has time for his Selfie Stick to become a hit -- and for Plastics to make plenty of money from the contract in the interim.

Upon seeing a press release that CD Mania was going into the Selfie Stick business, the holder of $10M of the bonds, Outraged, Inc., was in disbelief. He argued that this venture was only being contemplated because Aggressive was swinging for the fences while it was insolvent, and also to line the pockets of Plastics, Aggressive's portfolio company. He threatened to sue.

Indenture Corp. took no position. The Company's position is that it need not pay attention to Outrage because it has no right to sue under the No Action Clause. Outrage, however, says that its suit will not be a claim under the Indenture but under common law -- for breach of fiduciary duty -- and therefore it has rights irrespective of Indenture's position.