



# **Overview and Enforceability of Intercreditor Arrangements**

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# **Agenda**

- 1. Overview of Primary Intercreditor Arrangements**
- 2. Key Points of Negotiation**
- 3. Enforceability Considerations**

# **OVERVIEW OF PRIMARY INTERCREDITOR ARRANGEMENTS**

# What Circumstances Raise Intercreditor Considerations?

- Multiple creditors plus
- Different underlying indebtedness or obligations plus
- Common collateral and/or common obligors

# Types of Intercreditor Arrangements

- Lien Subordination
  - First Lien/Second Lien Intercreditor Arrangements
  - Split Collateral Intercreditor Arrangements
- Payment Subordination (aka Debt Subordination)
- Mixed Debt and Lien Subordination

# Lien Subordination vs. Payment Subordination

- **Lien Subordination:**
  - One creditor agrees that its lien on the common collateral is subordinate/junior to that of the other creditor on the common collateral.
- **Payment Subordination (AKA Debt Subordination):**
  - One creditor agrees to postpone payment of all or some of the amounts it is owed until the other creditor has been paid in full.
    - Payment subordination can be accomplished contractually or structurally.

# Where Lien Subordination and Payment Subordination Intersect

- **Similarities:** In lien subordination, proceeds of enforcement actions against the common collateral are required to be applied to pay the first lien obligations before the second lien obligations.
- **Distinctions:** In lien subordination, other payments are not required to be applied first to the first lien obligations.
  - If the payment is from a source other than proceeds of common collateral (such as unencumbered assets), that payment could be retained by the second lien lender in a lien subordination arrangement.
  - In a payment subordination arrangement, that amount may be required to be turned over to the first lien lender.
- The distinction between lien subordination and payment subordination is most significant in situations where there is a material amount of assets that are not collateral.

# Where Lien Subordination and Payment Subordination Intersect

- When does lien subordination become payment subordination?
  - Absolute priority rule vs. relative priority rule
  - *In re Ion Media Networks, Inc.*, 419 B.R. 585 (Bankr. S.D.N.Y. 2009)
  - Disallowed post-petition interest
  - Turnover provisions
  - Restrictions on voluntary and/or mandatory prepayments to the second lien lenders and payment blockages



# Intercreditor Agreement vs. Subordination Agreement vs. AAL

## Intercreditor Agreement:

- Two separate lenders (or creditor classes) agree on relative lien priorities relative to a common pool of assets
- The agreement sets forth each group of lenders' rights and obligations regarding the loan parties and the collateral upon a default or bankruptcy by the loan parties
- In 2006, the Business Law Section of the American Bar Association started a Model Intercreditor Agreement Taskforce to develop a balanced Intercreditor Agreement form. The Model Agreement, which includes alternative and optional provisions as well as commentary, is published in the May 2010 edition of "The Business Lawyer". The form is available on the ABA website at <http://apps.americanbar.org/dch/committee.cfm?com=CL190029>.
- Intercreditor Agreements in syndicated transactions differ meaningfully from club transactions and the Intercreditor Agreement is more highly negotiated in club transactions
- Dual lien arrangements may be 1st lien/2nd lien arrangements or split collateral arrangements.

# Intercreditor Agreement vs. Subordination Agreement vs. AAL

## Subordination Agreement:

- The senior and subordinated lenders negotiate and enter into an intercreditor agreement whereby the subordinated debt is contractually subordinated in right of payment to the senior debt.
- The subordinated lenders agree to restrictions on payment of their subordinated debt in certain circumstances until the senior lenders are paid in full and they also agree to turn over any payments received by them to the senior lender. This is referred to as payment subordination.
- The subordinated lenders also typically agree to a remedy standstill period during which subordinated lenders will not exercise any remedies.
- Provides an additional source of repayment to the senior secured lender through a “bankruptcy dividend”

# Intercreditor Agreement vs. Subordination Agreement vs. AAL

## Agreement Among Lenders:

- This agreement is used when a group of lenders within one credit facility wants to bifurcate certain rights (rights to payment, voting, exercise of remedies, etc.) among separate tranches of debt within the same facility.
- The agreement among lenders may:
  - Separate the debt into first out and last out pools. It provides for the arrangements regarding application of payments and proceeds of collateral after certain triggering events via a waterfall.
  - Provide for complicated voting provisions
  - Adjust pricing through skims
  - Set forth the conditions under which the majority of each tranche can direct the exercise of remedies after a triggering event
  - Set forth certain of the lenders' rights and obligations upon defaults or a bankruptcy
- No “model forms” in the market
- Lenders with established precedent together can operate very efficiently; this is a key selling point

# Intercreditor Comparison Chart

	Feature	First Lien/Second Lien	Split Collateral	Subordination Agreement	Bifurcated Unitranche
1.	Structure/Documentation	2 sets of documents	2 sets of documents	2 sets of documents	1 set of documents
2.	Liens/Collateral	2 sets of liens on 1 pool of collateral	-2 sets of liens on 2 pools of collateral -Pool #1: A/R and inventory -Pool #2: equipment, intellectual property, stock, real estate, equity interests	Senior debt is usually secured  Mezzanine debt is usually unsecured, but sometimes is secured.	1 lien on 1 pool of collateral
3.	Debt Subordination	No	No	Yes for both unsecured mezzanine facilities and secured mezzanine facilities.	A waterfall upon triggering events that generally applies proceeds of collateral and payments to first out lenders "first" and last out lenders "last". There are exceptions.
4.	Lien Subordination	Yes	Yes	Only if the mezzanine debt is secured.	See above response relative to waterfall feature.
5.	Debt Caps	Yes for 1st Lien. Sometimes for 2nd Lien.	Yes for the ABL facility. Sometimes for the term loan facility.	Yes on senior debt. Sometimes for mezzanine debt	Generally yes.
6.	Exercise of Remedies/Standstill Period	Yes – for 2nd Lien (120 days to 180 days).	Yes. Sometimes it is permanent and sometimes it is limited to a certain number of days (120 days to 180 days).	Yes. Sometimes it is permanent and sometimes it is limited to a certain number of days.	<ul style="list-style-type: none"> <li>Yes for the last out lenders.</li> <li>Sometimes a brief standstill will also apply for the first out lenders.</li> <li>Sometimes the standstill for one of the tranches (e.g., the first out lenders) is indefinite until a triggering event has occurred.</li> </ul>
7.	Amendments and Waivers	Operate independently (short list of exceptions)	Operate independently (short list of exceptions)	Operate independently (short list of exceptions)	A variety of voting constructs
8.	Buyout Right	Yes. Typically, 2nd lien has a buyout right in club deals.	Yes. Typically, the term loan lenders have a buyout right in club deals.	Sometimes the mezzanine lenders will have a buyout right.	Yes. Last out lenders have a buyout right. Sometimes first out lenders have a buyout right.
9.	Bankruptcy Provisions	Yes	Yes	Sometimes. If so, very limited if the mezzanine facility is unsecured.	Generally yes, though some agreements have very limited bankruptcy provisions.

# **Key Points of Negotiation**

# Scope of Priority Obligations

- It is critical for both parties that the intercreditor arrangements clearly define which “obligations” are entitled to lien priority/payment priority.
  - First lien lenders need certainty around which of their obligations are entitled to lien priority
  - Second lien lenders need to quantify (and limit) the obligations that have lien priority ahead of the second lien obligations
- Common Categories:
  - Principal, interest, fees, expenses, indemnities, reimbursement obligations for letters of credit
  - Be explicit about including interest, fees, an expenses that accrue after the commencement of a bankruptcy proceeding (regardless whether allowed in such proceeding)
  - Post-petition interest – can be subject to negotiation
  - Bank Products/Hedging

# Debt Caps

- Junior lien or subordinated lenders will usually negotiate a cap on the amount of senior indebtedness that will have lien priority and/or payment priority ahead of them.
- The debt generally applies only the principal amount of the senior indebtedness.
  - However, there may be a cap applicable to bank products and hedging obligations if they are included among senior obligations
- The cap is reduced by the amount of permanent reductions in the First Lien Obligations (i.e. repayment of term loans)

# Debt Cap Formulations

First Lien/Second Lien	Split Collateral	Subordinated Debt	Bifurcated Unitranche
<p>Typically, the first lien may only have “seniority” relative to a limited debt amount. The amount of the debt cap is subject to negotiation. Considerations include:</p> <ul style="list-style-type: none"> <li>principal amount of first lien term loan made on closing date</li> <li>the lesser of (i) revolver commitment; and (ii) borrowing base in most recent borrowing base certificate received by Agent</li> <li>a cushion (typically 10% to 20%)</li> <li>accordion</li> <li>inadvertent overadvances</li> <li>bank product and hedge obligations <ul style="list-style-type: none"> <li><u>Included in the cushion in some deals; in addition to the cushion in others.</u></li> </ul> </li> <li>The first lien DIP <ul style="list-style-type: none"> <li><u>Second lien lenders should consider whether this is drafted as an additional cushion above the 10% - 20% cushion referenced above.</u></li> </ul> </li> </ul> <p><u>Deductions:</u></p> <ul style="list-style-type: none"> <li>aggregate amount principal payments of loans (other than refinancings) (and to the extent revolver loans, accompanied by commitment reductions)</li> </ul> <p>Sometimes the second lien facility is also subject to a debt cap.</p> <p>Considerations: indemnities and disallowed default interest.</p>	<p>There are 3 ways of addressing the debt cap in split collateral deals:</p> <ol style="list-style-type: none"> <li>No debt cap on the ABL facility. No debt cap on the term loan/bond facility.</li> <li>Debt cap imposed on the ABL facility. No debt cap on the term loan/bond facility.</li> <li>Debt cap imposed on the ABL facility. Debt cap imposed on the term loan/bond facility</li> </ol> <p>Most commonly there is a debt cap on the ABL facility and no debt cap on the term loan/bond facility.</p>	<p>The senior debt is typically subject to a debt cap.</p> <p>Similar optionality as the First Lien/Second Lien or Split Collateral structures.</p>	<p>The “first out” tranche is usually subject to a debt cap.</p> <p>The “last out” tranche is usually subject to a debt cap.</p> <p>The debt caps vary from deal to deal. There is no real market reference.</p> <p>In some deals, the caps arise by virtue of the voting arrangements in the credit agreement or the AAL.</p>



# Remedies Standstill

The senior lenders expect priority rights to exercise remedies against the common collateral/obligors ahead of the junior lenders. This is referred to as a “remedies standstill”

The remedies standstill prevents the junior creditor from taking enforcement actions against the common collateral (or, in the case of a debt subordination, common obligors) for a specified period of time.

- Designed to give the senior lender time to work through the situation to determine whether a restructuring can be achieved and to evaluate the course of action relative to the exercise of remedies
- The standstill in a lien subordination primarily restricts the exercise of secured creditor remedies
- The standstill in a payment subordination restricts unsecured creditor remedies as well.

Key Points of negotiation:

- Scope of Prohibited Actions
- Trigger Events
- Duration of Standstill

# Remedies Standstill

First Lien/Second Lien	Split Collateral	Subordinated Debt	Bifurcated Unitranche
<p>First Lien Agent has right to immediately exercise remedies with respect to any or all of the collateral. There is typically not a standstill on the First Lien Agent's right to exercise remedies.</p> <p>The Second Lien Agent is typically subject to a standstill period of 120 to 180 days.</p> <p>Key point of negotiation: What triggers the standstill period? Acceleration? Any Event of Default?</p> <p>Second lien lenders negotiate to preserve many unsecured creditor rights.</p>	<p>The ABL Agent has the right to immediately exercise remedies with respect to the ABL priority collateral. There is typically not a standstill on the ABL Agent's right to exercise remedies with respect to such ABL priority collateral.</p> <p>The Term Loan Agent has the right to immediately exercise remedies with respect to the term loan priority Collateral. There is typically not a standstill on the Term Loan Agent with respect to such term loan priority Collateral.</p> <p>Sometimes the standstill is permanent and sometimes it is limited to a certain number of days.</p> <p>After the term loan agent takes control of its priority lien collateral, it provides the ABL agent access to the loan parties' facilities and a license to use intellectual property rights; access and use provisions are often highly negotiated. Access and use periods range from 90 – 180 days and are rent and royalty free.</p>	<p>Senior Agent has right to immediately exercise remedies with respect to any or all of the collateral. There is typically not a standstill on the Senior Agent's right to exercise remedies.</p> <p>There is a standstill on the <i>subordinated</i> creditors right to exercise unsecured creditor remedies. The negotiation is around the duration of the standstill and the trigger events. Sometimes the standstill is permanent and sometimes it is limited to a certain number of days. Typically, the standstill period would terminate upon the acceleration of the senior secured debt (including upon a filing of an insolvency proceeding or upon the exercise of remedies by the Senior Agent).</p> <p>If the mezzanine debt is secured, secured creditor remedies are subject to a standstill (often permanent).</p>	<p>The Agent has the right to exercise remedies at the direction of the first out lenders.</p> <p>Sometimes a standstill will apply for the first out lenders and/or the last out lenders.</p> <p>Sometimes the standstill for one of the tranches (<i>e.g.</i>, the first out lenders) is indefinite until a triggering event has occurred.</p>

# Permitted Actions

- Lien Subordination: Junior lenders retain the ability to exercise certain rights and remedies even during a standstill period, such as:
  - Take action to preserve and perfect lien
  - Acceleration of the second lien obligations
  - File proof of claim in bankruptcy
  - Vote on a plan of reorganization
  - Rights as unsecured creditor (subject to any restrictions in the intercreditor agreement)
- Payment Subordination: Receipt of permitted payments, if any permitted. Otherwise, extremely limited during the standstill.

# Release of Liens

- In order to fully realize on their priority position, the senior lienholder will require the ability to drag junior lienholders along on the release of liens on collateral being sold. Absent this, the junior lien creditor could impede the ability of the senior lienholder to realize on its priority collateral.
- The scope of the ability of the senior lienholder to cause the automatic release of the junior lienholder's lien on collateral varies and is the subject of significant negotiation in many intercreditor transactions.
- Some agreements provide that the liens of the junior creditor are automatically released when the the liens of the senior creditor are released. This is most common in "silent" second lien arrangements.
- Privately negotiated junior lien positions typically negotiate greater protection of the junior lienholder's interest in the collateral around the lien release point.
- Some parameters that may be the subject of negotiation include:
  - Limiting release of liens to assets sold by the first lien lender in the exercise of its enforcement rights.
  - Limiting release of liens to assets sold by the borrower where the sale is permitted by the first lien loan agreement and second lien loan agreement.
  - Requiring proceeds to permanently reduce the senior obligations
  - Requiring prior notice be given to junior creditor before such dispositions
  - Requiring the terms of the disposition to be commercially reasonable
  - Requiring consent of junior creditor if the sale is to an insider (i.e. no automatic release for sales to sponsor)

# Release of Liens

First Lien/Second Lien	Split Collateral	Subordinated Indebtedness	Unitranche
<p>First lien can compel the second lien to release its lien in connection with:</p> <ol style="list-style-type: none"> <li>1. Exercise of remedies conducted in a commercially reasonable manner.</li> <li>2. Dispositions permitted under the credit facilities (sometimes absent an event of default under the facility secured by the non-priority lien).</li> <li>3. Default dispositions (sale of the Collateral with the consent of the first lien after an event of default to the extent undertaken in good faith to consummate the disposition of such Collateral and repayment of the Collateral) (sometimes).</li> </ol> <p>Issues for second lien lenders to consider:</p> <ul style="list-style-type: none"> <li>• Application of proceeds to permanently repay First Lien Debt (and reduce permitted priority obligations)</li> <li>• Receipt of information regarding disposition</li> <li>• Right to participate in any bidding</li> <li>• Lien releases in connection with default dispositions to affiliates should not be permitted</li> <li>• Proceeds of disposition should permanently reduce the first lien debt</li> </ul>	<p>Neither ABL nor term loan can be compelled to release its lien on its priority collateral.</p> <p>Otherwise the lien release provisions in split collateral Intercreditor Agreements operate substantially the same as 2 lien Intercreditor Agreements.</p> <p>ABL and term loan should consider whether lien release provisions should be applicable if there is a dispute regarding allocation of proceeds of mixed collateral sales. Some split collateral Intercreditor Agreements have provisions which address the allocation of proceeds from mixed collateral sales. This can help avoid disputes, but lenders should be very careful that their priority collateral is not being undervalued in the methodology.</p>	<p>Typically not applicable given that subordinated indebtedness is usually unsecured.</p>	<p>Rights granted in connection with the exercise of remedies or other voting arrangements typically carry through.</p>

# Use of Cash Collateral / DIP Financing

- Senior lenders negotiate for waivers pursuant to which junior lender agrees not to object to efforts by senior lender to provide DIP financing or to permit the use of cash collateral.
- Common restrictions include:
  - (1) retention of liens by subordinate lenders,
  - (2) cap on amount of financing,
  - (3) priority of liens granted to secure DIP Financing,
  - (4) absence of provisions dictating terms of plan and/or sale,
  - (5) reasonableness of commercial terms of financing proposal,
  - (6) ability to “roll up” prepetition debt, and
  - (7) limitations on carve-outs for professional fees and other case expenses.
- Subordinate creditors often negotiate for an exception from the waiver that permits them to raise any objection that could be raised by an unsecured (as opposed to secured) creditor.

# Use of Cash Collateral / DIP Financing

1 <sup>st</sup> Lien / 2 <sup>nd</sup> Lien	Split Collateral	Subordinated Debt	Bifurcated Unitranche
<p>Generally ICA prohibits 2<sup>nd</sup> lien lender from objecting to DIP financing or use of cash collateral if:</p> <ol style="list-style-type: none"> <li>(1) Proposed financing does not exceed Debt Cap.</li> <li>(2) Second lien lender provided with replacement liens and junior priority liens to the same extent 1<sup>st</sup> liens received same.</li> <li>(3) Prior notice to 2<sup>nd</sup> liens.</li> <li>(4) DIP Financing does not dictate specific plan terms or liquidation (but milestones are allowed).</li> </ol> <p>2<sup>nd</sup> lien lenders negotiate for:</p> <ol style="list-style-type: none"> <li>(1) Requirement that DIP Financing is on commercially reasonable terms</li> <li>(2) Ability to provide DIP Financing if 1<sup>st</sup> lien lenders do not provide (priming lien rarely allowed).</li> <li>(3) Limit on carve outs from collateral.</li> </ol>	<ul style="list-style-type: none"> <li>• Rights of each group of lenders may be mirror rights but more likely that working capital lenders receive first right to provide conforming DIP.</li> <li>• No priming of collateral that is lender's primary collateral.</li> </ul>	<ul style="list-style-type: none"> <li>• No consent rights for subordinated debt.</li> </ul>	<p>Generally same as 1<sup>st</sup> lien / 2<sup>nd</sup> lien.</p>

# Disposition of Collateral in Bankruptcy

- Secured lenders have right to object to sale of their collateral free and clear of their liens unless conditions set forth in 11 U.S.C. § 363(f) are satisfied.
  - Release under U.S.C. § 363(f) generally premised on either (1) payment in full of all liens or (2) consent of all lienholders.
  - As a result, non-consenting junior lenders may block sale supported by the senior lender.
- Senior lenders negotiate to eliminate /reduce ability of junior lender to block sale.



# Disposition of Collateral in Bankruptcy

1 <sup>st</sup> Lien / 2 <sup>nd</sup> Lien	Split Collateral	Subordinated Debt	Bifurcated Unitranche
<p>Junior lenders generally agree to waive their right to object to sale of their collateral provided that:</p> <ul style="list-style-type: none"> <li>(1) Their liens attach to proceeds of sale; and</li> <li>(2) Proceeds used to repay obligations owed to senior lender.</li> </ul> <p>Junior lenders negotiate for:</p> <ul style="list-style-type: none"> <li>(1) Right to object to bid procedures.</li> <li>(2) Right to object as unsecured creditor (other than under 11 U.S.C. §363(f)).</li> <li>(3) Limitations on use of sale proceeds for purposes other than repayment of senior obligations.</li> </ul>	<ul style="list-style-type: none"> <li>• Consent of holder of primary collateral is required for sale of such collateral.</li> <li>• Consent rights with respect to non-primary collateral mirror rights of junior lien holder in 1<sup>st</sup> lien / 2<sup>nd</sup> lien structure with respect to junior interest.</li> </ul>	<p>No consent right for subordinated debt on sale of collateral.</p>	<p>Same as 1<sup>st</sup> lien / 2<sup>nd</sup> lien.</p>

# Voting Arrangements (for Unitranche)

- In a 1<sup>st</sup> lien / 2<sup>nd</sup> lien structure, the claims of 1<sup>st</sup> lien lenders and the claims of 2<sup>nd</sup> lien lenders are separately classified under a plan of reorganization.
- As such, the 1<sup>st</sup> lien lenders control the vote of the claims of 1<sup>st</sup> lien lenders and the 2<sup>nd</sup> lien lenders control the vote of the claims of 2<sup>nd</sup> lien lenders.
- Under Section 1126(c) of the Bankruptcy Code,

“(c) A class of claims has accepted a plan if such plan has been accepted by creditors, other than any entity designated under subsection (e) of this section, that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors, other than any entity designated under subsection (e) of this section, that have accepted or rejected such plan.” 11 U.S.C. §1126(C).”
- If the senior lenders and the junior lenders are not separately classified there is a risk that one tranche of lenders may hold a blocking position or a control position with respect to voting on a proposed plan.
- Where one tranche of lenders has a control position (more than 1/2 in number and at least 2/3 in amount of claims) and votes in favor of a plan, this would result in the plan proponent being relieved of its obligation (1) to demonstrate that the plan is in the best interest of creditors under 11 U.S.C. §1129(a)(7), and (2) that the plan is fair and equitable under 11 U.S.C. §1129(b).

# Voting Arrangements (for Unitranche)

(continued)

- In Unitranche structure, because there is one lien and on agent, First Out and Last Out lenders are likely to be classified in a single class for voting purposes under a plan.
- In AAL negotiations, each of Last Out and First Out lenders negotiate to preserve “cram down” rights in Unitranche structure.
- What does not work:
  - Voting rights seen as sacred by a number of courts.
  - Assignment of voting rights disfavored.
- What may work:
  - In Unitranche structure parties generally agree that if not separately classified then each lender agrees not to vote in favor of plan unless 2/3 in amount of First Out lenders and 2/3 in amount of Last Out lenders support plan.
  - Preserves cram down rights.

# Amendments to Underlying Loan Documents

Limitations on amendments to the respective loan documents may be included in the intercreditor agreement/subordination agreement and/or the underlying loan documents. This is a part of the intercreditor arrangements where the Borrower may also get involved.

## **Common Restrictions on Amendments to Senior Documents:**

- Increasing interest rates, fees, or other yield beyond certain permitted thresholds
- Extension of the first lien maturity date beyond the stated maturity of the second lien debt
- Changes to mandatory prepayment provisions to make them more onerous
- Changing covenant to make more restrictive provisions restricting payment of the second lien debt
- Restrictions on the ability to subordinate the first lien indebtedness
- In an ABL, restrictions around changes to the Borrowing Base and/or advance rates

# Amendments to Underlying Loan Documents (continued)

## **Common Restrictions on Amendments to Second Lien Documents:**

- Increasing interest rates or fees beyond certain permitted thresholds
- Shorting maturity or changing to earlier the dates on which principal payments are required
- Changing mandatory prepayment provisions to make them more onerous
- Changing covenants to make them more restrictive

## **Complex Considerations:**

- Limiting pricing on uncommitted incremental facilities
- Governing impact of MFN

# Restrictions on Amendments

First Lien/Second Lien	Split Collateral	Subordinated Debt	Unitranche
Operate independently (short list of exceptions).	Operate independently (short list of exceptions)	Operate independently (short list of exceptions)	A variety of voting constructs.
See prior slides	See prior slides	See prior slides	<p>The voting arrangements in unitranche structures are flexible and may be structured to fit the specifics of a deal. Parties may utilize a number of different features, including “forced deadlocks”, “drag alongs”, “tag alongs”, buy-outs, right of first offers/refusals, and standstills to fit the diverse needs of each deal.</p> <p>In addition, a number of deals the voting mechanics in the Credit Agreement are operative until a triggering event occurs and then the consent of the majority of the first out and a majority of the last out would be required.</p>

# Reorganization Securities

- The plan of reorganization may provide for the distribution of debt or equity securities to the subordinate lender on account of their claims.
- The Intercreditor Agreement generally addresses whether securities (referred to reorganization securities) may be retained by the subordinate lender or must be turned over to the senior lender. This clause in the intercreditor agreement is known as the “X Clause.”
- Senior lenders negotiate for turnover of such securities to the extent that they represent distributions on account of secured claims.
- Subordinate lenders negotiate to retain such security.

# Reorganization Securities

1 <sup>st</sup> Lien / 2 <sup>nd</sup> Lien	Split Collateral	Subordinated Debt	Bifurcated Unitranche
ICA generally provides for property received on account of secured claim to be turned over to 1 <sup>st</sup> lien lender.	Each lender keeps securities distributed on account of primary collateral.	ICA generally provides that subordinated debt holder may retain securities only if securities given to senior noteholder have higher priority to future distributions and dividends.	Same as 1 <sup>st</sup> lien / 2 <sup>nd</sup> lien.
2 <sup>nd</sup> lien lenders negotiate to --	Treatment of reorganization securities distributed on account of non-primary collateral mirrors 1 <sup>st</sup> lien / 2 <sup>nd</sup> lien treatment.	Senior creditor views this as a role of convenience allowing the junior creditor to retain junior securities rather than turning them over to senior lender, having senior lender liquidate and return excess to junior lender.	Some First Out lenders seek greater turnover rights in Unitranche Structure due to payment subordinator features.
(1) Keep equity securities			
(2) Keep regularly scheduled interest payments on debt securities			
(3) Keep debt securities as long as subject to ICA terms		Junior creditor will negotiate for more than “round tripping” rights.	



# **Enforceability Considerations**

# Enforceability in Bankruptcy

- Section 510(a) of the Bankruptcy Code:
  - "A subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law."
- Intercreditor agreements are generally considered to be subordination agreements for purposes of section 510(a). *In re Bank of New England Corp.*, 364 F.3d 355 (1st Cir. 2004).
- State law governs interpretation and enforceability of subordination agreements.
  - *In re Envirodyne Industries, Inc.*, 161 B.R. 440 (Bankr. N.D. Ill. 1993), *aff'd*, 29 F.3d 301 (7th Cir. 1994) (state law governs, and "the interpretation of the subordination clause is not affected by the bankruptcy proceedings").
  - *In re 203 North LaSalle Street Partnership*, 246 B.R. 325 (Bankr. N.D. Ill. 2000) (subordination agreements enforceable to the extent provided under non-bankruptcy law so long as enforcement does not violate a principle of bankruptcy law).

# Enforceability in Bankruptcy (cont'd)

- While subordination agreements are generally enforceable in bankruptcy, the case law is split on the enforceability of various junior lienholder waivers and consents commonly found in subordination and intercreditor agreements and courts generally tend to closely scrutinize and narrowly interpret the contractual language. Common junior lienholder waivers and restrictions include:
  - *In re 203 N. LaSalle St. P'ship*, 246 B.R. 325 (Bankr. N.D. Ill. 2000) (prohibiting senior lienholder from voting claim of junior lienholder).
  - *In re Aerosol Packaging, LLC*, 362 B.R. 43 (Bankr. N.D. Ga. 2006) (enforcing provision in intercreditor agreement permitting senior lienholder to vote claims on junior lienholder).
  - *In re Ion Media Networks, Inc.*, 419 B.R. 585 (Bankr. S.D.N.Y. 2009) (barring junior lienholder from objecting to confirmation of plan based on intercreditor agreement).

# Enforceability in Bankruptcy (cont'd)

- Waiver of the junior lienholder's right to challenge the senior lienholder's liens or claim in bankruptcy.
  - *In re Ion Media Networks, Inc.*, 419 B.R. 585 (Bankr. S.D.N.Y. 2009) (intercreditor agreement expressly prohibits junior lienholder from arguing senior lienholder's claim is unsecured).
- Consent by the junior lienholder to the use of cash collateral if consented to by senior lienholder.
  - *Aurelius Capital Master, Ltd. v. TOUSA Inc.*, 2009 WL 6453077 (S.D. Fla. Feb. 6, 2009) (holding that junior lienholder "bargained away its right to object" to cash collateral order).
- Consent by the junior lienholder to any section 363 sale and bidding procedures if consented to by senior lienholder.
  - *In re Boston Generating, LLC*, 440 B.R. 302 (Bankr. S.D.N.Y. 2010) ("If a secured lender seeks to waive its rights to object to a 363 sale, it must be clear beyond peradventure that it has done so.").

# Enforceability in Bankruptcy (cont'd)

- Provisions prohibiting junior lenders from moving for the appointment of a trustee or examiner.
  - *In re Erickson Ret. Communities, LLC*, 425 B.R. 309 (Bankr. N.D. Tex. 2010) (junior lienholder prohibited from seeking appointment of examiner under "standstill" provision of intercreditor agreement).
- Consent by the junior lienholder to any DIP financing approved by senior lienholder; waiver of the junior lienholder's right to object to the senior lienholder's request for adequate protection and relief from the automatic stay.
  - *In re MPM Silicones, LLC*, 518 B.R. 740 (Bankr. S.D.N.Y. 2014) (addressing numerous issues and closely scrutinizing terms of intercreditor agreement).
- Provisions regarding the application of proceeds and distributions.
  - *In re Energy Future Holdings*, 546 B.R. 566 (Bankr. D. Del. 2016) (rejecting request to require application of adequate protection payments and plan distributions based on intercreditor agreement where contractual conditions had not been met).
  - *In re Energy Future Holdings*, 548 B.R. 79 (Bankr. D. Del. 2016) (similar).

# Enforceability in Bankruptcy (cont'd)

- Notwithstanding the enforceability of subordination and intercreditor agreements in bankruptcy, section 1129(b)(1) of the Bankruptcy Code provides that a cramdown plan may be confirmed "notwithstanding section 510(a)."
  - *In re TCI 2 Holdings, LLC*, 428 B.R. 117 (Bankr. D. N.J. 2010) ("The only logical reading of the term 'notwithstanding' in section 1129(b)(1) seems to be: 'Even though section 510(a) requires the enforceability of subordination agreement in a bankruptcy case to the same extent that the agreement is enforceable under nonbankruptcy law, if a nonconsensual plan meets all of the § 1129(a) and (b) requirements, the court 'shall confirm the plan.'").
  - *In re Consul Restaurant Corp.*, 146 B.R. 979 (Bankr. D. Minn. 1992) (reaching opposite conclusion on the basis that, notwithstanding the language in section 1129(b)(1), "it is generally understood that such rights are enforceable under the discrimination and fair and equitable concepts of the statute").