

Lead Left Interview – Neil Cummings, G. Thomas Stromberg and Richard Levin (Part 2)

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This week we continue our conversation with Neil Cummings, G. Thomas Stromberg and Richard Levin, partners at Jenner Block, an international firm with offices in Chicago, London, Los Angeles, New York, and Washington D.C.

The Lead Left: Can last out lenders acquire first out debt?

Neil Cummings: Yes. Typically, last out lenders can purchase first out debt in two circumstances. The first involves buyout rights. When a trigger event is ongoing, last out lenders with a specified portion of the last out tranche typically can purchase first out obligations, usually at par and often plus certain prepayment premiums. In some deals, the buyout trigger is any event of default, but it is usually narrower. Common trigger events include acceleration or a payment or bankruptcy event of default or a breach of a maximum first out leverage ratio. Some last out lenders want to be able to exercise the buyout right whenever a payment waterfall trigger is in effect.

Some AALs include a yank-a-bank type trigger. This allows last out lenders with buyout rights to acquire the debt of first out lenders that don't vote in favor of an amendment to the loan documents that has been approved by the required last out lenders, but not the required first out lenders. First out lenders typically won't agree to be yanked from a deal in the case of amendments to sacred rights provisions, which can only be amended under the credit agreement by all lenders or all affected lenders.

TLL: What's the second instance?

G. Thomas Stromberg: Next there's the right of first offer or refusal. Last out lenders with buyout rights usually have a right of first offer or right of first refusal to purchase any loans or commitments proposed to be sold by a first out lender to a third party. In some deals, the loans or commitments must be offered to the other first out lenders first, before they are offered to last out lenders. In some deals, there is a reciprocal right of first offer or right of first refusal in favor of the first out lenders.

TLL: And who controls remedies?

TS: During a remedies trigger event, the first out lenders often have the initial right to exercise secured creditor remedies. But the required last out lenders can exercise secured creditor remedies if the required first out lenders fail to exercise those remedies within a specified period. Another common approach, which in the real world generally gets to the same result, is to allow either the required first out lenders or the required last out lenders to begin exercising remedies after a standstill period expires. Last out lenders are generally subject to a standstill period, often between 60 to 90 days. First out lenders are often, but not always, subject to a standstill period; if so, it is shorter than the last out lender standstill. As a result, if the last out lenders decide to exercise remedies, the first out lenders can take control over remedies if they act before the last out lender standstill expires.

The remedies triggers vary from deal to deal. Sometimes the trigger is any event of default. More frequently, the trigger events are the same as, or very similar to, the waterfall trigger events.

TLL: What rights do creditors have in a bankruptcy?

Richard Levin: Unsecured creditors may vote on – and in some circumstances propose – a plan of reorganization; challenge security interests on the bankrupt company’s assets; request the appointment of a trustee; and object to actions the trustee or debtor in possession proposes to take in the case or in the operation of the business. Secured creditors have all the rights of unsecured creditors and more, such as the rights to repayment priority from their collateral or its proceeds, to post-petition interest if their collateral is worth more than they’re owed, to credit bid for their collateral, and to adequate protection against decrease the value of their interest in the collateral during the case.

TLL: What rights do last out lenders waive in a bankruptcy?

RL: Under an AAL, last out lenders generally waive some secured creditor rights in favor of first out lenders, as long as certain conditions are met or protections provided to the last out lenders. The waivers typically restrict the last out lenders’ right to credit bid or to object to a debtor-in-possession financing secured by liens that are senior to or *pari passu* with the liens securing the last out debt, the use of cash collateral, and asset sales. Last out lenders almost never agree to waive any of their unsecured creditor rights.

TLL: We’ve written about this but would like your opinion: Is an AAL enforceable?

RL: A subordination agreement is generally enforceable under nonbankruptcy contract law, and the Bankruptcy Code provides that a subordination agreement is as enforceable in bankruptcy as it is outside. Bankruptcy courts generally treat an AAL as a subordination agreement and enforce it, except where it might violate fundamental bankruptcy policies, such as those giving creditors the right to vote on a reorganization plan. The case law is both sparse and mixed on this issue. And for some provisions that don’t affect the borrower or the bankruptcy case at all, a bankruptcy court will not enforce the agreement but will send the lenders to a state court to resolve any disputes among themselves.

As with all subordination agreements, vaguely worded AAL provisions waiving secured or unsecured creditor rights run the risk that a bankruptcy court will find them unenforceable, because bankruptcy courts are often reluctant to strip a creditor of these rights in the absence of clear contractual language.

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