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Today's Top Story

Unitranche deals: What you need to know about agreements among lenders

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The following post is an excerpt from a longer piece written by Neil Cummings, G. Thomas Stromberg and Richard Levin, partners at Jenner & Block LLP.

In a unitranche financing, lenders reengineer the terms of a single tranche of debt through a side agreement called an agreement among lenders, or AAL. The underlying tranche can be almost any type of secured debt, including senior or junior lien term loans or a revolver or both.

Basically, an AAL splits a single tranche of debt into first out ("FO") and last out ("LO") tranches, often with a goal of replicating economic and other terms of a first/second lien financing. The legal documentation typically consists of a single credit agreement, a single set of security documents and an AAL. An AAL typically covers the following ground.

Tranching

The tranches are created under the AAL by dividing the debt into FO debt and LO debt. FO debt generally includes any revolver provided under the credit agreement and often includes a specified portion of the term loan drawn at closing as well as any delayed draw or incremental loan commitments held by FO lenders. LO debt is the debt provided for under the credit agreement other than FO debt.

G. Thomas Stromberg

Payment waterfall

Unless a waterfall trigger event exists, the FO and LO obligations are usually paid pari passu. When a waterfall trigger event exists, all collateral proceeds and payments from the borrower are applied according to the AAL payment waterfall. During a waterfall trigger event, FO obligations (frequently subject to a cap) are usually paid in full first, before any amounts are applied to LO obligations. Customary AAL waterfall triggers include a payment, bankruptcy or financial covenant event of default, or notice of exercise of remedies by the FO lenders.

Reallocation of economics

In a unitranche deal, the credit agreement contains a single interest rate. Since the AAL spits the debt into pieces with different risk profiles, the AAL adjusts the yield payable to the FO and LO lenders through skim provisions that reallocate interest payments, and sometimes other amounts payable by the borrower, from the FO lenders to the LO lenders. The adjusted effective interest rate on each tranche is the same as in an analogous deal of the type the AAL seeks to replicate, typically a first/second lien financing.

Voting

An AAL usually specifies requisite lender consents to amend, modify or waive terms of the loan documents. The AAL provisions are in addition to the voting requirements in the credit agreement. They are intended to give FO and LO lenders a say in certain changes that are adverse to their interests by providing class voting rights. Voting provisions and the degree of protection afforded to lenders vary significantly from deal to deal and are often heavily negotiated.

Buyout rights

When a trigger event is ongoing, LO lenders with a specified portion of the LO tranche typically have the right to purchase FO obligations, typically 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 FO leverage ratio. Some LO lenders want to be able to exercise the buyout right whenever a payment waterfall trigger is in effect.

Richard Levin

Right of first offer or refusal

LO 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 FO lender to a third party. In some deals, the loans or commitments must be offered first to the other FO lenders before offering them to LO lenders. There may be a reciprocal right of first offer or right of first refusal in favor of FO lenders.

Exercise of remedies and remedy standstills

During a remedies trigger event, FO lenders often have the initial right to exercise secured creditor remedies, but required LO lenders can exercise secured creditor remedies if required FO 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 required FO lenders or required LO lenders to initiate the exercise of remedies after a standstill period expires. LO lenders are generally subject to a standstill period, often between 60 to 90 days. FO lenders are often, but not always, subject to a standstill period; if so, it is shorter than the LO lender standstill. As a result, if LO lenders decide

to exercise remedies, FO lenders can take control over remedies if they act before the LO lender standstill expires.

Sometimes the remedies trigger event is any event of default. Often the trigger events are the same as, or very similar to, the waterfall trigger events.

Bankruptcy-related issues and provisions

Secured and unsecured creditors have meaningful rights in a bankruptcy. Unsecured creditors may vote on a plan and object to actions taken or not taken in the case. Secured creditors have all the rights of unsecured creditors and more, such as the right to credit bid and to object to a debtor-in-possession financing secured by liens that are senior to or pari passu with that creditor's liens, the use of cash collateral and asset sales.

Under an AAL, LO lenders generally waive specified secured creditor rights in favor of FO lenders as long as certain conditions are met or protections provided to the LO lenders. LO lenders rarely grant broad waivers of their secured creditor rights and almost never agree to waive their unsecured creditor rights.

Under the Bankruptcy Code, a subordination agreement is as enforceable in a bankruptcy as it is outside of it. Bankruptcy courts will generally treat an AAL as a subordination agreement and enforce it. But certain provisions might violate fundamental bankruptcy policies, such as those relating to classification and voting.

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