Understanding Agreements Among Lenders: How the Unitranche Differs From an Intercreditor Agreement

BY DANIELLE GARCIA AND ALYSSA KEON

Unitranche facilities are growing in popularity. They require less paperwork, so borrowers find them more economical and quicker to close. The unitranche is an agreement among lenders without the framework of the UCC or the Bankruptcy Code. Blank Rome’s Danielle Garcia and Alyssa Keon explain how unitranche facilities differ from intercreditor agreements and point out ways to create a more effective agreement among lenders.

When seeking a loan, borrowers require both good financial terms and an efficient closing process. Unitranche facilities help accomplish both goals by combining a senior/first lien credit facility with a junior/second lien credit facility to create one credit facility held by lenders who define their rights and priorities by entering into an agreement among lenders (AAL). Since unitranche facilities are contained in a single set of credit documents, they lower the borrower’s transaction costs and decrease the amount of time to close.

An AAL takes the place of the intercreditor agreement used in a traditional senior/junior or first lien/second lien debt structure. However, unlike intercreditor agreements, which have developed within the framework of adjusting legal rights of creditors under the Uniform Commercial Code and the U.S. Bankruptcy Code, an AAL is a contract between lenders holding a single secured claim. The AAL, among other things, establishes payment priority between the lenders (i.e. what the “first-out” obligations versus “last-out” obligations are), allocation of fees and interest and how actions under the credit documents will be taken.

Negotiating these provisions requires careful consideration of the realities of the underlying credit facility and a good understanding of how an AAL differs from an intercreditor agreement.

Collateral and Payment Priority

In a unitranche facility, an agent holds a single lien on the collateral on behalf of all the lenders. No lender has a “senior” or “junior” lien on the collateral or the ability to take actions individually on the collateral. Instead, they have differing rights to receive proceeds of collateral and payments and differing rights to direct the agent to exercise remedies. The most common structure for a unitranche facility is a “first-out” revolver and a “last-out” term loan.

The first-out obligations have priority over the last-out obligations with respect to all collateral payments and proceeds. A “split collateral” unitranche is an alternative structure in which the revolver obligations have priority only with respect to proceeds of the revolver collateral (typically the assets included in the borrowing base and related assets, such as cash) and the term loan has priority with respect to all other collateral proceeds. Sometimes a split collateral AAL will exclude from the term loan collateral certain “shared collateral” (such as equity interests) with all lenders sharing pro rata in proceeds of such collateral.

In split collateral AALs, the revolver lender needs to ensure that the AAL details how proceeds of revolver and term loan collateral disposed of in the same transaction will be shared, as well as how and when the non-revolver collateral can be disposed of, so that the revolver collateral can be liquidated with the applicable
term loan collateral, such as equipment and intellectual property. These provisions must be negotiated with a clear understanding of what an actual foreclosure on the revolver collateral in question will entail.

Payment Waterfall
In a typical intercreditor agreement, lenders with competing liens claim the proceeds of collateral, while an AAL covers all collateral proceeds and all payments received under the credit documents. If agreed upon “triggers” occur, payments under the credit agreement are applied per a waterfall that will, subject to certain exceptions, pay off the first-out obligations before the last-out obligations. The triggers are typically specified events of default, plus notice to the agent from the required first-out lenders (typically those holding a majority of the first-out loans).

The first-out lender should ensure that these triggers include notifying the agent if there is an over advance on the revolver or if the revolver is no longer available to the borrower. The first-out lender should also ensure that the waterfall applies to all amounts received in an insolvency (such as adequate protection payments), and that it applies automatically in an insolvency and after acceleration. If the revolver has the benefit of cash dominion in which all incoming funds to the borrower are automatically applied to the revolver balance, the first-out lender needs to understand how and when the waterfall will affect that application of payments.

Caps and Limits on Protective Advances
The waterfall will typically provide for payment in full of the first-out obligations up to an agreed upon cap. This cap will apply to the principal amount of the first-out obligations, as well as any bank products (i.e. hedges and cash management products and services) secured by the collateral under the terms of the credit agreement. The first-out lenders will want to negotiate a cap on bank products that allows the lenders to provide any bank product that the borrower may need.

However, the last-out lender will want those bank product obligations reserved against the revolver to minimize risk of the last-out obligations not being paid in full. Depending on the type of bank products a borrower needs, that can result in a material loss of availability to the borrower. As such, a first-out lender may want to negotiate for typical cash management obligations to be uncapped and for flexibility in the amount and timing of reserves for other bank products. Protective advances (made to preserve or protect the collateral or enhance the likelihood of repayment) are typically paid out in the waterfall ahead of most other obligations.

The AAL will cap either the amount of such advances or the amount of advances that have priority in the waterfall. In split collateral deals, the first-out lenders may also want the AAL to address whether protective advances, that are made mostly to protect or liquidate one pool of collateral over the other, should only have priority in the waterfall that applies to the collateral receiving the benefit of such advances.

Interest and Fees
In a unitranche facility with one rate of interest on all of the obligations, the AAL specifies how much each set of lenders is entitled to with respect to interest and certain fees. The AAL should be clear that the last-out lenders are only entitled to their additional interest and fees when they are actually paid by the borrower.

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(either at the borrower’s election or the agent’s), the first-out lenders should bargain for the ability to cease charging such amounts during a default or any events connected with a default.

Voting Rights
Most AAL’s will have rules that alter the voting provisions of the credit agreement, such that any right of the required lenders under the credit agreement is instead a right of required lenders as determined in the AAL. Class voting, in which the required first-out lenders and the required last-out lenders (typically those holding a majority) constitute required lenders for all purposes, is the preferred approach for first-out lenders.

In some AALs there is a drag along right in favor of the last-out lenders which gives the required last-out lenders all the rights of the required lenders so long as the borrower is performing at certain financial levels. The first-out lenders may agree to this when working with last-out lenders they have a relationship with, so the drag along should always be conditioned on the initial last-out lenders continuing to be in control of the required last-out lenders.

There will be items that the drag along does not apply to. One of the most important is the borrowing base and related rights to trigger cash dominion. The first-out lenders should ensure that any discretion they have, or their agent has, in managing the borrowing base and revolver is retained. Further, the first-out lenders should ensure that no changes may be made to the conditions under which they are required to make advances. A further protection that the first-out lenders should require is that the drag along does not prohibit the required first-out lenders from triggering the waterfall or creating an escape hatch.

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