

The Intersection of Bankruptcy and Intercreditor Agreements

By Andrew R. Cardonick and Rebecca D. Rosenthal



The purpose of an intercreditor agreement is to set forth the rights and positions with respect to a borrower's collateral, payment, and priority of payment, inter alia, between

various creditors. Given their relatively recent rise to prominence, there is a paucity of case law construing inter-creditor agreements. However, the few judicial opinions that are available provide useful insight and guidance to drafters and negotiators of intercreditor agreements.

Even though neither of the parties to an intercreditor agreement is a debtor in a bankruptcy proceeding, the bankruptcy court derives its authority to interpret the intercreditor agreement from section 510(a) of the Bankruptcy Code, which provides that a “subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable non-bankruptcy law.”¹ Accordingly, the courts have held intercreditor agreements are enforceable agreements under section 510(a) to the extent they are subordination agreements.² And, because intercreditor agreements are almost always contracts between two private parties, bankruptcy courts tend to enforce them in accordance with their express written terms.³

While the number of terms that can be placed in an intercreditor agreement is essentially infinite, there are many provisions that do arise frequently, and some that a number of courts have analyzed. The rest of this article focuses on these terms: standstill provisions, waivers in connection with section 363 sales, and provisions assigning the right to vote on a Chapter 11 plan.

Standstill Provisions

By agreeing to a standstill provision, a junior creditor is agreeing to forego enforcement action against the collateral until a specific time after the declaration of a default. The junior creditor will also be stayed from exercising its remedies until after the senior creditor has diligently pursued their remedies. Courts generally enforce these types of provisions. For example, in *Erickson Retirement Communities*,⁴ the senior secured lender’s agent argued that the subordinated entities “lack[ed] standing and/or have waived their right” to object to the appointment of an examiner due to the standstill provision and the earlier agreement to be “silent”.⁵ The court agreed with this argument and, applying general contract principles, stated that a reasonable person in the shoes of the subordinated party would have understood that they must not take action, but must “stand still” until the senior secured lenders were paid in full.⁶

Several courts have recently addressed whether standstill provisions in agreements among lenders in increasingly popular “unitranche” facilities are enforceable in bankruptcy. For example, in *In re American Roads LLC*,⁷ the court considered “a unique financing structure known as an ‘insured unitranche’” in which “all of the secured creditors’ claims are secured by the same lien, through the same trustee and collateral agent, on the terms set forth in prepetition financing contracts.”⁸ The unitranche facility provided for the issuance of bonds, which were insured by Syncora Guaranty, Inc. Under the financing documents, Syncora: (1) controlled the enforcement of rights and remedies after an event of default, (2) had exclusive authority to give direction to the trustee and the collateral agent and (3) was appointed as the sole holder and sole

representative for all purposes. Moreover, the financing documents provided that the bondholders: (1) could not institute or direct proceedings to enforce the terms of the financing documents without Syncora's consent and (2) were precluded from challenging or enforcing the lien without Syncora's consent.⁹

An ad hoc committee of bondholders sought to participate in the debtor's bankruptcy case and to enforce their rights under the financing documents. The bondholders argued that "no action" provisions in intercreditor agreements are narrowly construed and that such provisions must include specific language explicitly prohibiting the bondholders from participating in bankruptcy cases. The court disagreed and stated that "[n]o matter how the [b]ondholders characterize their actions and position to avoid falling within the 'no action' clauses ... they seek to enforce individual rights, remedies and actions, which is directly contrary to their bargained-for contractual agreements delegating and waiving such rights in favor of Syncora and the collateral agent."¹⁰ Furthermore, even though the court acknowledged that "courts have refused to enforce the terms of subordination agreements that are inconsistent with the provisions of the Bankruptcy Code, other than terms affecting the priority of distributions", it also stated that "[c]ourts, however, have upheld prepetition intercreditor agreements waiving a creditor's bankruptcy rights where the creditors are sophisticated parties fully aware of the implications of such a waiver."¹¹ In holding that the bondholders do not have standing to participate in the chapter 11 proceedings, the court stated that the parties were "clearly sophisticated" and that the situation at bar does:

not involve an ordinary multi-tranche financing where secured creditors with different liens on the same property have entered into a subordination agreement to order the priority of their respective property interests. Rather, there is only one lien securing the financing documents. As such, the [b]ondholders are part of an "insured unitranche," and any rights they may have to monetize or exert control over the collateral are undergirded only by contractual entitlements, not separate property interests.¹²

Section 363 Sales

Another common situation relates to sales of a debtor's assets pursuant to section 363 of the Bankruptcy Code. In *Boston Generating*, the court held that an intercreditor agreement did not contain sufficient language to contractually prevent the second lien lender from objecting to and frustrating a section 363 sale.¹³ The court stated that "[t]here is little dispute that the intercreditor agreement is not a model of clarity with respect to the narrow issues before the court" and, as no arguments were made or evidence adduced as to the intent of the parties to the intercreditor agreement, the court limited its analysis to interpreting the text of the above provisions.¹⁴ The court surmised that "[i]t should not and will not interpret [the intercreditor agreement] in a way that redrafts or re-negotiates the [s]ecured [p]arties' bargained-for rights."¹⁵ The court also drew a distinction between the lack of clarity in the intercreditor agreement and the language contained in the ABA's Model Intercreditor Agreement, which "contained an express waiver of the right to object to a sale pursuant to section 363 of the Bankruptcy Code."¹⁶

In analyzing whether the intercreditor agreement could be interpreted as a waiver of rights to object to a 363 sale, the court stated that “[i]f 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”¹⁷ and pointed out that New York law requires contractual waivers of rights to be explicit. In other words, the court would have enforced the waiver had it been explicitly provided for in the inter-creditor agreement but, in the absence of specific language, the court was unwilling to read any such waiver into the “stay silent” provisions, regardless of how broadly they were drafted.

When holding that it could not find any provision which could be read to reflect a waiver of the second lien holder’s right to object to a 363 sale motion, either as secured lender or as an unsecured creditor, the court stated that “[h]ere, the perfect storm of a poorly drafted agreement, the ill-defined scope of section 3.1(g)’s retained right to object as an unsecured creditor, and the fact that pursuant to [their own] stipulation, there is ‘no exercise of remedies’ leads me to conclude that the [s]econd [l]ien [a]gent and [s]econd [l]ien [l]enders have standing to object to the 363 sale.”¹⁸ However, the court also remarked that its decision was “a very close call” and, while not dispositive, additional facts that entered into its analysis included: (1) the fact that the issue was a section 363 sale of substantially all of the debtors’ assets outside a plan of reorganization which, if approved, would effectively deprive the second lien lenders of the opportunity to vote in an economically meaningful way on a plan of reorganization; and (2) recognition of its finding that at its earlier bid procedures hearing the court found that the second lien lenders are on the “cusp” of recovery and are not engaging in obstructionist behavior.¹⁹

Right to Vote on Chapter 11 Plan

Finally, while courts have also interpreted provisions in intercreditor agreements assigning the right to vote on a debtor’s Chapter 11 plan, these decisions are not uniform. As this topic has yet to be addressed by a circuit court, ambiguity is the only constant. For example, while one court has held that subrogation language contained in an intercreditor agreement authorized the first lien lender to vote the second lien lender’s claim²⁰, another court found that a provision in an intercreditor agreement stating that “[b]ank is irrevocably authorized ... to ... file claims, proofs of claim and take such other actions (including without limitation, voting the subordinated debt) as it may deem necessary or advisable” was clear, unambiguous and enforceable under applicable non-bankruptcy law and therefore would also be enforced in the context of confirming the debtor’s Chapter 11 plan.²¹

Relatedly, another court also has upheld the assignment of voting rights in an intercreditor agreement, even when the assignor vote was contrary to the assignee’s interest.²² The *Aerosol Packaging* court, relying on section 510(a) of the Bankruptcy Code and Bankruptcy Rules 3018 and 9010, reasoned that, since the intercreditor agreement was enforceable under applicable non-bankruptcy law, which explicitly permit agents and other representatives to take actions, including voting, on behalf of parties, the assignee could vote the claims of the junior creditor even if the junior creditor was opposed to how the assignee was casting the ballot.²³ *Aerosol*

Packaging analyzed the situation similar to a real estate lender acting as the agent for a borrower in executing a deed under the power of sale in Georgia to convey title to foreclosed property at a foreclosure sale and stated that in that situation, “the agent acts in its own interests, and not in those of the purported principal.”²⁴ The *Aerosol Packaging* court acknowledged that the junior creditor had a remedy to stop its claim from being voted contrary to its wishes and such remedy was to pay the senior creditor in full, in cash.²⁵

On the other hand, a third court has held that an intercreditor agreement’s assignment of voting rights was unenforceable. In *SW Boston Hotel Venture*,²⁶ the court adopted the reasoning of Judge Wedoff in *Bank of Amer. v. N. LaSalle Street Ltd. P’ship (In re 203 N. LaSalle Street P’ship)*.²⁷ In *203 N. LaSalle*, at issue was whether the subordinated creditor purported to agree to assign its voting rights in a future chapter 11 case to a senior secured creditor.²⁸ The court held that such a provision was contrary to 11 U.S.C. § 1126(a) and unenforceable because Congress did not intend to permit creditors to alter substantive provisions of bankruptcy law.²⁹

Conclusion

The relative newness of intercreditor agreements, and the lack of circuit court decisions interpreting them, leaves uncertainty with respect to many of the negotiated provisions of intercreditor agreements. For lenders with a large appetite for risk, there is ample opportunity for creativity. The above areas, while merely a sample, provide some guidance regarding the tolerance of courts to allow private, sophisticated parties to contract around the Bankruptcy Code and insight into the level of precision required in the drafting of intercreditor agreements. Given the evolving nature of the capital markets, as more lenders seek to lend on a second lien, or split lien basis, this area of the law should be monitored closely. **TSL**

1. 11 U.S.C. 510(a), See also *In re Ion Media Networks, Inc.*, 419 B.R. 585, 595 (Bankr. S.D.N.Y. 2009) (stating in dicta that the intercreditor agreement is an enforceable contract under section 510(a)).

2. *In re Boston Generating, LLC*, 440 B.R. 302, 318 (Bankr. S.D.N.Y. 2010).

3. *In re Lack’s Stores, Inc.*, 2012 WL 3043093 at *10 (Bankr. S.D. Tex 2012); *In re Plaza Resort at Palmas, Inc.*, 469 B.R. 398, 405 (B.A.P. 1st Cir. 2012) *aff’d*, 741 F.3d 269 (1st Cir. 2014).

4. *In re Erickson Retirement Communities, LLC*, 425 B.R. 309 (Bankr. N.D. Tex. 2010).

5. *Id.* at 314.

6. *Id.*

7. *In re American Roads LLC*, 496 B.R. 727 (Bankr. S.D.N.Y. 2013).

8. *Id.* at 727.
9. *Id.* at 730.
10. *Id.* at 731.
11. *Id.* at 732.
12. *Id.*
13. See generally *In re Boston Generating, LLC*, 440 B.R. 302 (Bankr. S.D.N.Y. 2010).
14. *Id.* at 318.
15. *Id.* at 318-319.
16. *Id.* at 319. See also *Business Lawyer*, American Bar Association's Report of the Model First Lien/Second Lien Inter-creditor Agreement Task Force, Model Intercreditor Agreement, (May 2010).
17. *Id.* at 319.
18. *Id.* at 320.
19. *Id.*
20. *In re Avondale Gateway Center Entitlement, LLC*, 2011 WL 1376997 (D. Ariz. 2011).
21. *In re Coastal Broad. Sys., Inc.*, 2012 WL 2803745 (Bankr. D.N.J. 2012).
22. *In re Blue Ridge Investors II, LP v. Wachovia Bank, N.A. (In re Aerosol Packaging, LLC)*, 362 B.R. 43 (Bankr. N.D. Ga. 2006).
23. *Id.* at 47.
24. *Id.*
25. *Id.*
26. *In re SW Boston Hotel Venture, LLC*, 460 B.R. 38, 52 (Bankr. D. Mass. 2011) vacated on other grounds, BAP 11-087, 2012 WL 4513869 (B.A.P. 1st Cir. Oct. 1, 2012).
27. *Bank of Amer. v. N. LaSalle Street Ltd. P'ship (In re 203 N. LaSalle Street P'ship)*, 246 B.R. 325, 331 (Bankr. N.D. Ill. 2000).

28. *Id.*

29. *Id.* at 332.

Andrew R. Cardonick is co-chair of the international law firm Greenberg Traurig's National Financial Institutions Practice and resides in the Chicago office. He focuses his practice primarily on the representation of sponsored and non-sponsored

commercial banks and other financial institutions, as well as select private equity funds, in and in connection with large and mid-sized asset-based, cash flow, subordinated, mezzanine, and unsecured syndicated, club, and single bank credit facilities, including restructurings, debtor-in-possession and bankruptcy exit financings throughout the country.

Rebecca D. Rosenthal, an associate also in the Chicago office, focuses her practice on business reorganization and financial restructuring matters, both in and out of court. She has experience advising corporations, individuals and assignees regarding Chapter 11 reorganizations, Chapter 7 liquidations and Illinois assignments for the benefit of creditors. More about the authors and the firm can be found at: <http://www.gtlaw.com/>