NEGOTIATING & DOCUMENTING THE

MULTI-LENDER CREDIT

NEGOTIATING AND DOCUMENTING THE MULTI-LENDER CREDIT

LOS ANGELES
June 5-6, 1989

NEW YORK
June 12-13, 1989

SANTA MONICA, CA — Infocast, Inc. is pleased to announce two conferences on "Negotiating and Documenting the Multi-Lender Credit." The use of shared lending has become an ever-increasing trend in today's banking environment, with the participation agreement strictly controlling the allocation of risks and rewards. All lenders taking part in negotiating these agreements should be able to recognize possible downside risks and know how to obtain the necessary documentary protection for their institution's interests. The purpose of this course is to provide lenders with a thorough introduction to negotiation issues and the techniques necessary to minimize avoidable risks and get the best deal for their employer.

Our panel of experts will examine the conflicting interests of the lending parties and their basic negotiating postures. A complete participation agreement will be examined, explained and negotiated point by point. Likewise an inter-creditor agreement on the distribution of collateral will be developed in our session. The second day of the program will examine in detail the possible risks involved in these deals; the consequences of insolvency in either the lead or participant lender; the special problems that can arise when real estate loans go sour; the possible conflicts between lenders arising from the bankruptcy of the borrower; the impact lender liability lawsuits can have on parties that may not be directly involved with troubled borrowers; and the special techniques required in managing multi-lender workout situations.

This course will be of value to all lending personnel looking for an introduction or review of this vital area; to loan documentation specialists; to in-house counsel; and to outside counsel for lending institutions. Please examine our course outline and sign up today.

FACULTY

LOS ANGELES: Thomas W. Baxter, Esq., O'Melveny & Myers • **Alan G. Benjamin, Esq.,** Morrison & Foerster • **David L. Ficksman, Esq.,** Loeb and Loeb • **Warren Loui, Esq.,** O'Melveny & Myers • **Richard Lowen, Esq.,** Buchalter, Nemer, Fields & Younger • **Randy P. Orlik, Esq.,** Brobeck, Phleger & Harrison • **Lawrence Peitzman, Esq.,** Morrison & Foerster • **Gerard J. Walsh, Esq.,** Brobeck, Phleger & Harrison • **Thomsen Young, Esq.,** Dennis, Shafer, Young & Wish

NEW YORK: Lawrence David Swift, Esq., Parker, Chapin, Flattau & Klimpl, *Chairman* • **Barry J. Dichter, Esq.,** Cadwalader, Wickersham & Taft • **Bruce A. Claugus, Esq.,** Reid & Priest • **Claudia J. Dumas, Esq.,** Shearman & Sterling • **Allan L. Groper, Esq.,** White & Case • **Harry G. Heching, Esq.,** Reid & Priest • **Eric Lindauer, Esq.,** Sullivan & Cromwell • **Edward A. Manuel, Esq.,** Reid & Priest • **Stephen Sawyier, Esq.,** McDermott, Will & Emery • **Merrill B. Stone, Esq.,** Kelley, Drye & Warren • **Sava Thomas, Esq.,** Security Pacific Merchant Banking Group • **Stephen D. Wayne, Esq.,** Marks, Murase & White

A thorough introduction to the legal and business issues involved in negotiating multi-lender credit agreements and inter-creditor agreements for liquidating collateral

PROGRAM OUTLINE

NEGOTIATION ISSUES FOR THE LEAD LENDER

Structuring the credit facility to promote participation sales

Managing the relationship with the borrower

Risk of participant default

Potential liability of lead lender

NEGOTIATION ISSUES FOR THE PARTICIPATING LENDER

Credit Evaluation

Documentation risk

Administration and enforcement risk

Structural risk: is the participation a loan to the lead bank or a purchase of the borrower's note?

Performance and insolvency risk

Absence of direct participant/borrower relationship

Lead bank's conflict of interest

NEGOTIATION SESSION #1 — DOCUMENTING THE PARTICIPATION

Mechanics of sale

Mechanics of disbursement of advances

Collections and remittances

Sharing of setoffs and collateral

Loan administration; standard of care

Participant representations and warranties

Lead bank compensation for loan administration

Modifications and waivers of loan documentation

Interest rate hedging products

How decisions will be made between lead and participants on loan enforcement

NEGOTIATION SESSION #2 — DOCUMENTING THE INTER-CREDITOR AGREEMENT

Description of collateral

Priority provisions

Procedures for liquidating collateral

Termination provisions

Contingent obligation — receivable purchase facilities

SPECIAL ISSUES TO BE AWARE OF IN THE NEGOTIATED REAL ESTATE CREDIT:

Loan administration and reporting issues in construction loans

Title insurance issues

Authority delegated to lead lender in construction loans

Foreclosure issues

Ownership and operation of property after foreclosure

Conflicts between lead and participants

Regulatory issues affecting real estate participations

INSOLVENCY OF LEAD OR PARTICIPANT

Lead insolvency

Participant insolvency — issues to address in documentation

BANKRUPTCY OF THE BORROWER

Rights against creditors of the borrower

Indemnification of lead for actions taken against borrower

Setoff by lead or participant

Conflicts between lead and participants

Lead's actual fraud; possession of documents

LENDER LIABILITY

Implied covenants of good faith and fair dealing

Relationships of the parties: impact on liability

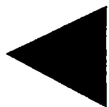
Pitfalls in the workout area

WORKING OUT THE MULTI-LENDER CREDIT — CASE STUDY

REGISTRATION INFORMATION

Tuition:

$595.00



The full fee is payable in advance and includes the cost of the program, complete program documentation, luncheon on the first day and refreshments.

Program Schedule: Registration begins at 8:30 a.m.; the conference begins at 9:00 a.m. and ends at 4:00 p.m.

Accommodations: Hotel accommodations are the responsibility of the attendee and can be made directly with the hotel by calling the telephone number listed.

Cancellation Policy: If your written cancellation is received 10 working days before the meeting, a full refund of your tuition will be made. Written cancellation received less than 10 working days before the meeting will create a credit of your tuition. Substitutions are recommended if you cannot attend. Please notify our office if you plan to send a substitute.

FOR IMMEDIATE REGISTRATION CALL (213) 452-7214

REGISTRATION FORM

Enclosed is a check payable to "Infocast, Inc." to register the following individual in

NEGOTIATING AND DOCUMENTING THE MULTI—LENDER CREDIT

Please check session:

☐ **LOS ANGELES**
June 5-6, 1989
Westin Bonaventure Hotel
(213) 624-1000

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June 12-13, 1989
Southgate Hotel
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I am confirming a telephone registration made on ______________ *date*

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NEGOTIATING AND DOCUMENTING THE MULTI-LENDER CREDIT

New York
June 12-13, 1989

Speaker List

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NEGOTIATING AND DOCUMENTING THE MULTI-LENDER CREDIT

New York
June 12-13, 1989

Program Schedule

June 12:

9:00 - 10:00 NEGOTIATION ISSUES FOR THE LEAD LENDER
Erik Lindauer, Sullivan & Cromwell

10:00 - 10:15 BREAK

10:15 - 11:15 NEGOTIATION ISSUES FOR THE PARTICIPATING LENDER
Stephen D. Wayne, Marks, Murase & White

11:15 - 12:00 PANEL DISCUSSION:
NEGOTIATING & DOCUMENTING THE PARTICIPATION - Part I
Sava Thomas, Security Pacific Merchant Banking Group
Stephen Sawyier, McDermott, Will & Emery

12:00 - 1.30 LUNCHEON for Speakers & Attendees

1:30 - 2:45 PANEL DISCUSSION:
NEGOTIATING & DOCUMENTING THE PARTICIPATION - Part II
Sava Thomas, Security Pacific Merchant Banking Group
Stephen Sawyier, McDermott, Will & Emery

2:45 - 2:50 DAY ONE COURSE EVALUATIONS

2:50 - 3:00 BREAK

3:00 - 4:30 PANEL DISCUSSION:
NEGOTIATING & DOCUMENTING THE INTER-CREDITOR AGREEMEN
Bruce A. Claugus, Reid & Priest
Harry Heching, Reid & Priest
Edward Manuel, Reid & Priest

<u>June 13</u>:

9:00 - 10:00	SPECIAL ISSUES IN THE NEGOTIATED REAL ESTATE CREDIT Mitchell Gilbert, Windels, Marx, Davies & Ives
10:00 - 10:15	BREAK
10:15 - 11:00	INSOLVENCY OF LEAD OR PARTICIPANT Barry Dichter, Cadwalader, Wickersham & Taft
11:00 - 12:00	BANKRUPTCY OF THE BORROWER Alexander Sheers, Shearman & Sterling
12:00 - 1:30	LUNCH (No Luncheon This Day)
1:30 - 2:30	LENDER LIABILITY Merrill B. Stone, Kelley, Drye & Warren
2:30 - 2:45	DAY TWO COURSE EVALUATIONS
2:45 - 3:00	REFRESHMENT BREAK
3:00 - 4:00	WORKING OUT THE MULTI-BANK CREDIT Allan L. Gropper, White & Case
4:00	ADJOURN

NEGOTIATING AND DOCUMENTING THE INTERCREDITOR AGREEMENT

Bruce A. Claugus, Esq.
Harry J. Heching, Esq.
Edward A. Manuel, Esq.

Reid & Priest
New York, New York

Negotiating and Documenting the Multi-Lender Credit Conference

New York, New York
June 12-13, 1989

NEGOTIATING AND DOCUMENTING THE INTERCREDITOR AGREEMENT

I. Introduction

A. Whenever one or more creditors lend to a single borrower, there are conflicting interests, current or potential. These conflicts are exacerbated when loans are made pursuant to more than one facility. When the lenders seek to deal with some or all of these potential conflicts, a contract among the creditors is required. This contract is frequently, but not necessarily, called an intercreditor agreement. For purposes of this presentation, we will define an intercreditor agreement as any agreement which in one way or another specifies the rights of lenders to the same borrower as between or among themselves. The concept is generic to participation agreements, subordination agreements, collateral pooling agreements and other such agreements regulating the interaction of creditors common to a single borrower. Since participation agreements have already been discussed in the course of this conference, we will deal with the remaining types, with emphasis on the most common type, the subordination agreement.

B. Usually an intercreditor agreement is signed by all affected creditors. However, an agreement subordinating a creditor in right of payment may be between a borrower and a single creditor for the benefit of other creditors. Also an agreement subordinating a lien may be signed only by the creditor which is subordinating its lien.

II. <u>Purpose of Intercreditor Agreements</u>

The purpose of an intercreditor agreement is to regulate and minimize conflict between lenders, distributing risk and bargaining power of the lenders in respect of the borrower. Several areas of conflict are important and typical.

A. <u>Lien Priority and the Sharing of Collateral</u>. If more than one of the creditors holds collateral securing the satisfaction of obligations to it, and, similarly, the same collateral also secures other creditors, a re-ordering of the priorities or an agreement as to a sharing of collateral may be necessary or desirable. Without such an agreement, the statutory framework enacted in the controlling jurisdiction will specify the priorities which exist. By means of and intercreditor agreement, the creditors prescribe their own hierarchy of priorities.

B. <u>Debt Priority and the Sharing of Cash Flow</u>. Whether or not there is collateral, the business

deal may involve an agreement as to priority in right of payment of the debts to the respective creditors. The agreement may (a) cover principal, interest or both, as to some or all of the debt; (b) be (but usually is not) independent of lien priorities and remedies; (c) be immediately or deferred in effect for some or all purposes; and (d) be triggered only in certain events, such as loan default or bankruptcy.

C. Loan Administration and the Exercise of Remedies. The most serious conflicts arise over the best method of dealing with a borrower in trouble and the associated restructuring or exercise of remedies, e.g., a loan extension, an additional loan, an acceleration, a lawsuit, a bankruptcy filing, etc. Generally speaking, no one lender can act without affecting the others. An acceleration by one lender may force the hand of the others to the detriment of all. An intercreditor agreement is utilized to regulate the actions one or more lenders will be permitted to take without the approval of an agreed number of his co-lenders. Such agreement may only require notice and consultation, but normally provides for voting and unified action in connection with changes to documentation needed as a part of a restructuring or the exercise of or forbearance to exercise

remedies, including realization on collateral, sharing of the costs of foreclosure, or for restraints on acceleration or other enforcement actions.

D. Statutory Provisions. As indicated, in developing an intercreditor agreement, the creditors seek to reorder priorities that would otherwise be controlled by statute or common law. A threshold question arises as to whether this reordering is lawful. Actually, intercreditor agreements are recognized by key statutes affecting lenders.

1. Bankruptcy Code. Under Section 510(a) of the Bankruptcy Code (11 USC 510(a)) intercreditor agreements are enforceable in federal bankruptcy proceedings to the same extent as under applicable state law.

2. Uniform Commercial Code.

   (a) Section 9-316 of the Uniform Commercial Code ("UCC"), and the accompanying Official Uniform Comment, make it clear that a person entitled to priority of lien may agree to subordinate his rights. The language of Section 9-316 and its placement in Article 9, however, make it clear that it deals only with subordination of liens.

(b) Section 1-209 of the UCC authorizes subordination of debt. This section also states that a subordination agreement does not create a security interest as against either the debtor or the subordinating creditor. However, Section 1-209 does not contemplate an assignment of junior debt to the holders of senior debt (discussed below) which assignment may arguably be a "security interest" requiring a UCC filing on behalf of the senior creditors. Section 1-209 has been adopted in only 18 states, but it is, by its terms, intended to be declarative of existing state law.

III. Intercreditor Agreements Subordinating Rights to Payment

A. General

1. Intercreditor agreements subordinating rights to payment provide that the creditor agrees that some part or all of its debt shall be subordinate in right of payment to the payment of other debt of its debtor. The debt which is subordinated and that relative to which it is subordinated must be precisely defined.

B. Subordination of Payment: Definitions

1. Senior Debt. The debt entitled to the benefit of the subordination may be identified in various ways.

   (a) Senior debt may be defined in quantitative terms such as all indebtedness up to a maximum amount. Considerable care should be exercised, however, since a stated limit on the amount of the senior debt may give rise to the inference that the "senior" creditor has agreed to limit the amount of the senior debt for the benefit of the junior creditor, with the possible result of invalidating the entire subordination agreement if the limit is exceeded.

   (b) Senior debt may also be categorized qualitatively as, for example, "indebtedness for borrowed money", or there may be a broader definition which might encompass certain purchase/repurchase obligations as in the case of a "purchase" of receivables or the obligations of the borrower under a sale and leaseback transaction.

   (c) Senior debt may also be defined as indebtedness incurred under a particular

facility such as a specific credit agreement.

(d) As another word of caution, when defining senior debt by reference to a specific agreement, the law of suretyships and guarantees may apply and the intercreditor agreement may be construed as in the nature of a guarantee and may be rendered ineffective by a modification or change in the obligation, i.e., the senior debt which is, in effect, "guaranteed" by the subordination of subordinated debt.

2. Junior Debt. The debt subordinated by the agreement and its relation to the other debt must also be carefully defined and the limitations on its repayment or collection specified.

(a) In general terms, junior debt can be defined just as senior debt is defined, i.e., by reference to amount, qualitatively and by reference to specific facilities.

(b) The relation of junior debt to other debt may be defined by describing the junior debt as being subordinated in right of payment to all other indebt-

edness. Normally, limited payments to the junior creditor are permitted, such as for interest and regularly scheduled amortization, until there is a triggering event such as a default in the senior debt, bankruptcy or other occurrence

(c) Debt may be junior only relative to a particular other creditor or a particular other indebtedness.

(d) A word to the wise for those who treat subordinated debt as equity for the purpose of credit analysis: Notwithstanding the fact that debt is subordinated or the degree to which it is subordinated, it is still debt of the borrower. It must be deducted from the assets of the borrower to determine solvency and it still must be dealt with as a separate class of debt in any bankruptcy. As debt, it is much more difficult to deal with than equity and in many situations the junior debt becomes the stumbling block to a successful reorganization, despite and, indeed, because of the fact, it is junior.

C. Particular Provisions for Intercreditor Agreements Subordinating Rights to Payment

1. Subrogation. In simple terms, subrogation occurs when one creditor steps into the shoes of another because it has satisfied the obligations of a debtor to the creditor which has been satisfied. Having satisfied the obligations of the debtor, it steps into the rights and remedies of the satisfied creditor relative to the obligations satisfied. Subrogation rights will arise as a matter of law whenever one creditor, in effect, pays the debt owing to another creditor. Consequently, subrogation rights should be expressed and should be specifically limited to the extent of the amounts paid or applied from monies that are diverted from the junior creditors to the senior creditors. Most agreements subrogating rights to payment provide for subrogation only after the senior debt is paid in full.

   (a) Subrogation Example: $100,000 Senior Debt; $100,000 Junior Debt. If there is a $50,000 payment to both the senior and junior creditors and the senior creditor receives the junior creditor's share, the senior creditor will have received

the full $100,000 due. The junior creditor will still be owed $100,000, but he will have received payment from the debtor of $50,000, so there is only $50,000, of junior debt outstanding. Similarly, $50,000 of the senior debt in fact remains outstanding even though the senior creditor is paid in full. In such a situation, the junior creditor would be subrogated to the senior debtor's right so that he could (if there are sufficient assets) exercise the rights of the senior creditor relative to the senior debt as yet unpaid to collect at least $50,000.

2. Clawback. Often a subordination agreement will include a provision for the benefit of the senior creditor which provides that, in the event payments received by the senior creditor on its debt are recaptured by a trustee in a bankruptcy proceeding against the borrower, the senior creditor may then have a claim against the junior creditor for any payment received by the junior creditor after payment was made ~~by~~ to the senior creditor and before such payment was recaptured by the bankruptcy trustee.

3. Termination. Some intercreditor or subordination agreements may contain provisions terminating the agreement after a stated dated or period of time or upon the occurrence of specified events. This is obviously highly undesirable for the senior creditor unless such termination is designed to occur only after the senior creditor has or expects to have no commitment or loan outstanding.

4. Assignment of Junior Debt. A provision frequently found in agreements subordinating rights to payment expressly assigns and transfers the subordinated debt to the senior creditor. The senior creditors is thus given the right, upon a triggering event, to exercise its right to collect the junior debt and apply it in payment of the senior debt. Theoretically, this transfer removes from the hands of the junior creditors the ability to commence any enforcement procedures. Remember, however, our word to the wise during our discussion of junior debt and its relation to other debt.

   (a) The greater degree of control on the part of the senior creditor inherent in this situation makes the senior creditor more vulnerable to an "equitable subor-

dination" claim if the senior creditor acts in such a way as to appear to take undue advantage of the junior creditor. This equitable subordination will negate the benefit of the subordination agreement.

(b) The senior creditor should require that the assignment be immediate instead of an assignment in the future. The assignment should take effect immediately, with a consent by the senior creditor for the junior creditor to continue collecting permitted payments on subordinate debt until a specific triggering event. The bankruptcy of the junior creditor will cause problems for the senior creditor, particularly if the assignment was not immediate and the contract to give an assignment could be disavowed as executory. The transfer could also be seen as a transfer for security, and Article 9 of UCC could control the transfer requiring perfection, etc.

(c) The assignment should involve the right to vote in any bankruptcy.

(d) The junior creditor must be careful that it does not assume any liability for the assigned debt through endorsement of the instrument evidencing the debt.

IV. Intercreditor Agreements Subordinating Liens

A. General. An intercreditor agreement subordinating a lien realigns the priorities of the liens. These agreements may be specific to particular collateral or a particular creditor or may be a general subordination for the benefit of all of the creditors (such as in a real estate space lease providing that the rights of the tenant are subordinate to the rights of the holder of any mortgage on the property). A lien subordination agreement releases or subordinates a lien in favor of another lien and need not be filed or recorded, since it does not itself create any lien or security interest. The agreement simply specifies the order in which the creditors can pursue specified collateral.

B. Particular Provisions for Intercreditor Agreements Subordinating Liens

1. Anti-Marshalling. From the standpoint of the senior creditor, the agreement should contain a waiver by the junior creditor of its rights under the equitable doctrine of marshalling. Under this doctrine, the junior creditor has

the right to require the senior creditor to assemble all collateral and first seek satisfaction of the debt from other collateral of the borrower held by the senior creditor before foreclosing on the collateral jointly held with the junior creditor. This doctrine preserves the maximum value of the joint collateral for the benefit of the junior creditor. Without such a waiver, senior creditors may be unable to proceed against the most saleable collateral in satisfaction of the debt.

2. <u>Foreclosure Procedures</u>. In a foreclosure against the collateral, the senior creditor must respect the rights of the junior creditor, as well as the borrower, or it may be held liable for any failure to act reasonably. The subordination agreement should specifically waive, release or otherwise provide for the various aspects of this problem. In the absence of an agreement specifying agreed procedures, the junior creditor is entitled to specified notice of any sale and the senior creditor must act in a commercially reasonable manner in connection with any such sale. It is better to specify the procedures which can be followed

rather than take a chance on a court decision.

V. Provisions Common to Intercreditor Agreements Subordinating Rights to Payments and Liens.

A. Standstill. The subordination agreement should contain provisions regarding forbearance by the junior creditor in the exercise of its enforcement rights against the debtor until the senior debt has been paid or until the senior creditor is prepared to take action together with the junior creditor. In some cases, the junior creditor may obtain an agreement that some action be taken by the senior creditor within a specified period of time if the junior creditor is to continue its forbearance.

B. Turnover. All subordination agreements, whether lien or debt, should require that all property or payments received by the junior creditor in contravention of the agreement be held in trust and turned over or relinquished to the senior creditor.

VI. Pooled Collateral

A. Syndicated and Structured Loans. The more lenders that are involved and the more diverse the purpose and terms of the loans outstanding, the greater the need for some form of intercreditor agreement.

1. Fully integrated so-called "syndicated" loans and structured transactions commonly involve multiple lenders jointly making a loan and multiple facilities, each for a different purpose and for a different term.

2. In syndicated loans, each lender disburses its _pro rata_ share of each advance and repayments are simultaneously made on a _pro rata_ basis to each lender. In structured financings, different amounts may be loaned and different procedures may be used pursuant to different facilities, however, to achieve a specific economic result, the disbursements are usually closely related.

B. _Operational Characteristics_. A collateral pooling agreement permits the use of multiple credit sources and facilities without the lock-step of _pro rata_ lending with common interest rates, maturities, sharing of collateral and other terms and conditions.

1. A collateral pool for the benefit of all the creditors is established to provide for the orderly liquidation of collateral and a prescribed sharing of such collateral among the creditors.

2. Such an agreement may contain a provision for voting and the joint enforcement of the

rights of creditors. Creditors representing an agreed portion of the debt may control acceleration of indebtedness and waivers of events of default.

3. The agreement may also provide that the disposition of or other realization upon the collateral shall be directed by creditors holding an agreed portion of the debt outstanding.

4. For administrative simplicity, the rights of the creditors in and to the collateral upon an event of default or otherwise may be delegated to a single creditor, agent or trustee acting on behalf of all creditors.

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