

Presenting a live 90-minute webinar with interactive Q&A

Unitranche Financing for Middle Markets: Loan Facility Structure and Market Trends for Borrowers and Lenders

Structuring Agreements Among Lenders, Maximizing Recovery
for First-Out and Last-Out Lenders in Event of Default

THURSDAY, JUNE 12, 2014

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Jennifer B. Hildebrandt, Of Counsel, Corporate Department, **Paul Hastings**, Los Angeles

Jennifer St. John Yount, Partner, Corporate Department, **Paul Hastings**, Los Angeles

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 10.**

Tips for Optimal Quality

FOR LIVE EVENT ONLY

Sound Quality

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, you may listen via the phone: dial **1-866-570-7602** and enter your PIN when prompted. Otherwise, please send us a chat or e-mail sound@straffordpub.com immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press *0 for assistance.

Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

Continuing Education Credits

FOR LIVE EVENT ONLY

For CLE purposes, please let us know how many people are listening at your location by completing each of the following steps:

- In the chat box, type (1) your **company name** and (2) the **number of attendees at your location**
- Click the SEND button beside the box

If you have purchased Strafford CLE processing services, you must confirm your participation by completing and submitting an Official Record of Attendance (CLE Form).

You may obtain your CLE form by going to the program page and selecting the appropriate form in the PROGRAM MATERIALS box at the top right corner.

If you'd like to purchase CLE credit processing, it is available for a fee. For additional information about CLE credit processing, go to our website or call us at 1-800-926-7926 ext. 35.

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the ^ symbol next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides for today's program.
- Double click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.

**Unitranche Credit Facilities: Structural Issues
and Current Trends**

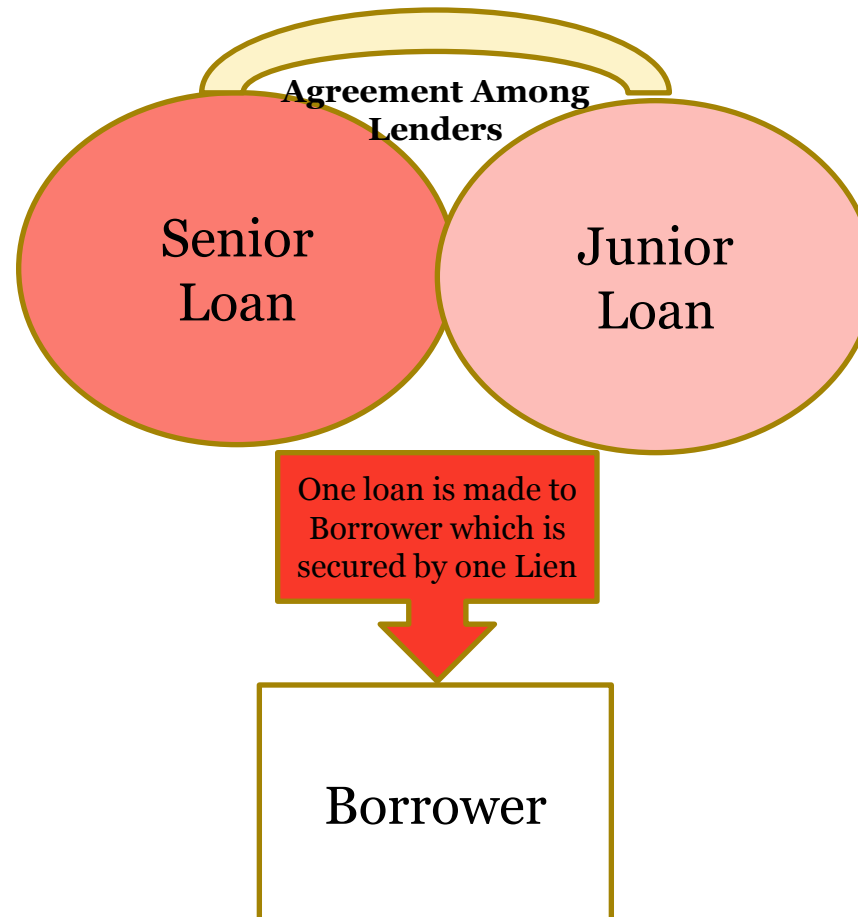
Jennifer B. Hildebrandt
Jennifer S. Yount
June 12, 2014

Single Credit Facility That Includes Both the “Senior” and the “Junior” Debt

- Simply put:
 - Unitranches combine what would otherwise be separate credit facilities into a single credit facility.
 - From the borrower's perspective a unitranche is structured as a single debt instrument, where all the debt is governed by such instrument.
- Unitranches are also known as “first out / last out credit facilities” and “A – B credit facilities”.

What Do We Mean by Unitranche?

General transaction structure:



What Do We Mean by Unitranche?

- Characteristics of Unitranches:
 - A single security interest (sometimes, two liens in one security agreement, although much less common).
 - An Agreement Among Lenders (the “AAL”) exists to which the lenders (but usually not the borrower) are party.
 - *Pari passu* debt (*i.e.*, from the borrower’s perspective, no portion of the debt is subordinated in right of payment to another portion of the debt).
 - A waterfall (usually in the AAL) regulates priority of payments and proceeds of collateral before and after specific triggering events.
 - Special interlender voting arrangements.
 - In the past, only 2 lenders; today a club or a syndicate is becoming more common.

What Do We NOT Mean by Unitranche?

■ Debt Subordination (aka Mezz)

- Junior lender cannot accept any payments (except interest absent a default under the senior facility) before senior lender is paid in full.
- Right to payment is subordinated coupled with a turnover provision (i.e., double dividend).
- Junior lender typically does not obtain a junior lien.

■ Lien Subordination (aka First Lien/Second Lien)

- Right to payment is not subordinated.
- Second lien lender's interest in collateral is second in priority.
- Second lien lender's exercise of remedies is subject to standstill period.

Comparison of Intercreditor Arrangements

	Senior - Mezz	2 Lien	Unitranche
Documentation	2 sets of documents/no lien for the mezz	2 sets of documents/2 liens	1 set of documents/1 lien
Debt Subordination	Yes - mezz facility is subordinated	No	FOLO waterfall upon triggering event
Lien Subordination	N/A	Yes – the 2nd lien is subordinated	FOLO waterfall upon triggering event
Remedies Standstill (“senior”)	None	None	FOLs from 0 – 30 days
Remedies Standstill (“junior”)	Sometimes claim / collection standstill for mezz lender	2nd lien for up to 180 days	LOLs from 60 – 90 days
Amendments and Waivers	Operate independently	Operate independently except for short list	A variety of voting constructs
Buyout Right	None	2nd lien has a buyout right	LOLs have a buyout right
Bankruptcy Provisions	Subordination agreement has few bankruptcy provisions	Intercreditor agreement has detailed bankruptcy provisions	AAL has select bankruptcy provisions
Pricing	Blended pricing is typically higher than 2 lien or unitranche	Blended pricing is typically less than mezz and close to, or slightly less than, unitranche	Pricing is typically less than mezz and close to, or slightly more than, 2 lien

- Began appearing early to mid 2000s as alternative to 2 lien and mezzanine financings.
- Like 2 lien financings and mezzanine financings, allow for higher leverage than traditional “senior only” financing.
- Addressed need in middle market (\$50MM-\$500MM range) for reduced complexity, delay and expense in connection with financing transactions (particularly in LBOs).

- Provide one stop solution for the entire transaction.
- Lower execution risk/speed of transaction.
- Perceived higher certainty of closing.
- Typically no market flex or syndication risk.
- AAL is perceived to be easier to negotiate (and thus, less costly) if there is a precedent between the first out lenders (“FO Lenders”) and last out lenders (“LO Lenders”).
- Generally blended interest rate; one amortization payment and one interest payment.
- Amortization of “blended rate” debt leads to lower cost of capital for borrower (compare typical alternative structure in which lower rate debt amortizes first).

- Eliminate the need for multiple sets of documents and the complexities they create.
 - Certain collateral may not be able to be pledged to more than one secured creditor.
- Single set of:
 - financial covenants
 - reporting requirements.
- Perception that unitranches are easier to administer post-closing with one agent (rather than two).

- **A single set of documents may provide either the first out or the last out with significant control over the entire debt.**
- Enable certain lenders to participate in the deal when they would not be able to if structured as “senior only” financing (*i.e.*, lower leverage point for the FO Lenders and higher pricing for the LO Lenders).

- AAL is more expensive to negotiate than an Intercreditor Agreement if there is not a precedent between the FO Lenders and LO Lenders.
 - There is really no market standard to reference.
- Additional debt in the capital structure can lead to complications.
 - Indentures (anti-layering provisions).
 - Mezz facilities (covenant setbacks).
- Numerous potential bankruptcy issues.

- Voting often requires consent of a majority of both the FO Lenders and a majority of the LO Lenders (higher possibility of a stalemate).
 - Lenders likely have conflicting interests in unitranches.
 - Select drag-along rights can mitigate the risk of a stalemate.
 - Exercise of remedies treated differently.

- **A single set of documents may provide either the first out or the last out with significant control over the entire debt.**
- Two sets of documents typically provide the “senior” and the “junior” with greater control over their destiny (particularly in 2 lien deals).
 - In unitranches, negotiations often center around when first out and/or last out can force the hand of the other and direct the exercise of remedies.
 - Query: Do LO Lenders really want to force the exercise of remedies?
 - Current market for cash flow deals has a 60 – 90 day standstill for the exercise of remedies by LO Lenders.
 - Current market for cash flow deals has a 30-day standstill for the exercise of remedies by FO Lenders.
 - For ABL deals, FO Lenders argue that there should be no standstill.

- Which party originated the deal?
- Which party has the larger piece?
- Which portion is harder to syndicate?
- What is the precedent?
 - How recent?
 - Same parties?
 - Same counsel?
- Experience level.
 - Lenders.
 - Lenders' counsel.

1. Required Lenders and Voting
2. Buy Out Right
3. Assignability and ROFO\ROFR
4. Exercise of Remedies
5. Waterfall
6. Interest Skims and Fee Splits
7. Protective Advances
8. Financial Advisors
9. Select Bankruptcy Provisions

- A typical voting regime in a credit agreement calls for
 - 50.1% affirmative vote of the claims of the lenders.
 - Sometimes, if 2 or more lenders, at least 2 lenders.
 - For certain issues, 66-2/3% of the claims of the lenders.
 - For certain major issues (rate, tenor, amount, and collateral), all lenders.
 - Variations on the general themes.

- A different voting regime typically applies in an AAL.
 - “Forced deadlock”: 50.1% of FO lenders plus 50.1% of LO Lenders.
 - Deadlock broken with respect to exercise of remedies upon an Event of Default.
 - List of drag-along rights?
- Borrower rarely sees AAL and is usually not a party.
 - Credit agreement should reference the fact that an AAL exists and that AAL contains a different voting agreement among lenders than in the credit agreement.

- The Buy Out Right is the principal means of resolving a difference in approach in a distressed situation.
- Often only available to LO Lender with a minimum hold.
- Triggering Event.
 - Payment default.
 - Acceleration.
 - Agent has commenced any Exercise of Remedies.
 - Bankruptcy (or injunction default).
 - Waterfall activation notice sent to Agent by FO Lenders.
 - If FO Lenders do not consent to an amendment requested by the LO Lenders.

- Purchase Price
 - Par plus accrued.
 - Prepayment premium if received within certain timeframe (30 to 180 days).
 - Difficult issues:
 - Bank products and derivatives, and
 - Rights under indemnity provisions.

- To whom?
 - Eligible transferee concept (if any) in the Credit Agreement must include FO Lenders and LO Lenders in order to give effect to buyout rights.
 - Include affiliates and related funds without consent.
- With whose consent?
 - Administrative agent consent on revolving loan except to an eligible transferee.
 - No borrower consent post-default.
 - No consent for portfolio sale or sale of business.

- Right of first offer to LO Lenders
 - Typically dependent upon a minimum hold.
 - FO Lenders may request that this right be mutual
 - Carve outs.
 - Pledges to financing sources.
 - Assignments to affiliates and related funds.
- Right of free assignability subject to right of first offer.
- Cross over voting restrictions

- Standstill Period
 - Resolves permanent stalemate of “agree to agree” construct.
 - At expiration of applicable standstill period, required class of lenders may instruct administrative agent to exercise remedies.
 - Typical periods:
 - FO Lenders: 30 days for cash flow; 0 days for ABL.
 - LO Lenders: 60 to 90 days.

- Exercise of Remedies.
 - What exactly is an “exercise of remedies”?
 - Sweeping of cash?
 - Ordinary course versus non-ordinary course.
 - Hiring a broker or investment banker?

Payment Waterfall



- Collateral proceeds and payments run through the waterfall.
 - It is the waterfall that implements the first-out, last-out prioritization.
- Triggering Events:
 - Payment default (includes acceleration).
 - Bankruptcy (or injunction against doing business).
 - Financial covenant default (possibly with “bandwidth”).
 - Administrative agent has commenced exercise of remedies.
 - Failure to deliver a Borrowing Base by the deadline (ABL deals only).

- Payments to FO Lenders that may come after the last out obligations:
 - Prepayment premiums.
 - Bank product and derivatives above the cap amount.
 - Certain contingent obligations.

- Skims:
 - LO Lenders will skim the FO Lender's Term Loan.
 - LO Lenders *may* skim the FO Lender's Revolver.
- FO Term Loan will be skimmed only if the interest payment is made in immediately available funds.
 - FO Lenders don't come "out of pocket" to pay the skim to the LO Lenders.
- Accordion can complicate interest skims.
- After a waterfall trigger event, LO Lender's interest skim continues, but the skim is "last out" in the waterfall.

- FO Lenders' (or administrative agent's) right to make protective advances.
 - May make protective advances in an aggregate principal amount not to exceed a cap.
 - Is the cap one that “refreshes” or “one and done”?
 - Protective advances within the cap are “first out” in waterfall.
 - Protective advances in excess of the cap are “last out” in waterfall.

- LO Lenders' right to make protective advances.
 - Not in every deal, but in select deals.
 - Amount is capped.
 - Similar issue relative to interpretation of the cap.
 - Protective advances up to the cap are early in the waterfall, but behind the first out obligations.
 - Protective advances made in excess of the cap are “last out” in the waterfall.

- LO Lenders may hire financial advisors even after Agent has commenced exercise of remedies to:
 - Value the Parent and its subsidiaries.
 - Appraise the Collateral.
 - Inspect the Collateral.

- Request by FO Lenders that :
 - these actions do not interfere with Agent's exercise of remedies.
 - no sales broker, marketing agent, I-bank, auctioneer, or similar party be retained to perform such valuation, appraisal, or inspection.
 - LO Lenders waive any right to interfere with the exercise of remedies by Agent.
 - appraisal be permitted only if Agent has not already engaged an appraiser.

- Bankruptcy provisions have become more common in AALs in the last few years.
 - DIP financing/cash collateral provisions
 - 363 sale provisions.
 - Relief from stay provisions.
 - Adequate protection provisions.
 - Plan of reorganization provisions.
 - Credit bid provisions.
- **Note: AALs have not been tested in bankruptcy!**

Select Bankruptcy Issues: Post-petition Interest

- *Ionosphere* decision
 - The Bankruptcy Code stops the accrual of interest as of the date of the petition.
 - Unless the creditor is fully secured, or
 - Unless the case involves 100% payment to all creditors.
 - *Ionosphere* involved three classes of equipment trust certificates, with the A certificates being first out, the B certificates being next, and the C certificates being last out.
 - The collateral had a value in excess of the amount of the A certificates, but not equal to the sum of the A and B certificates.

- *Ionosphere* decision
 - The Court held that NO post-petition interest was allowable because the debt that was secured exceeded the value of the collateral.
- Thus, in a unitranche, if the amount of the debt owed to the FO Lenders and plus the amount of the debt owed to the LO Lenders exceeds the value of the collateral, there is the possibility that the debtor will not have to pay any post-petition interest or attorneys fees.
 - Applies to each portion of the debt, even where these amounts would have been available to the FO Lenders if there were separate liens?

Select Bankruptcy Issues: Post-petition Interest

- The FO lenders typically get most of the impact back by virtue of the waterfall provisions.
 - *Rule of explicitness.*
 - Each dollar paid to the FO Lenders is a dollar that the LO Lenders cannot ever recoup.
 - Limitations are negotiated in some transactions relative to disallowed default interest.

Select Bankruptcy Issues: Classification of Claims

- Are the first out and last out placed in the same class or two classes?
 - The agreement by the lenders is not likely to compel the Bankruptcy Court to honor the arrangement.
- The Bankruptcy Code provides that only substantially similar claims may be placed in the same class.
 - It does not require that similar claims be placed in the same class.
 - Of course, if claims are dissimilar, they may be required to be separately classified.
 - Secured portion of debt classified separately from the unsecured deficiency.

Select Bankruptcy Issues: Classification of Claims

- If the unitranche is undersecured as a whole, the FO Lenders will expect the waterfall to govern whose claims are in the “secured” class(es) and whose claims are in the “deficiency” class
 - Is waterfall alone sufficient to cause this result?

- For a class of claims to approve a plan of reorganization requires a majority of the holders of the claims and 2/3rds in amount of the claims, **in each case that vote**, to vote in favor of the plan.
- Documents may require lenders to vote in an agreed fashion, but it is hard to determine what that is in advance.
 - For example, if the FO Lenders are fully covered and there is significant value for the LO Lenders and there is not a “melting icecube”, the FO Lenders should not be able to force a quick sale or reorganization that protects only their interests.
 - On the other hand, if the FO Lenders are impaired or barely covered and there is a concern that value will be lost, the LO Lenders don’t really have any interest to protect and merely have hold-up value.

- And, this may not be enforceable in a bankruptcy.
- Courts are split on whether voting rights may be assigned:
 - Some hold that assignment of voting rights is not enforceable pursuant to § § 510(a) & 1126(a) of the Bankruptcy Code: *In re SW Boston Hotel Ventures, LLC*, 460 B.R. 38 (Bankr. D. Mass. 2011), *vacated on other grounds*, 2012 Bankr. LEXIS 4662 (1st Cir. B.A.P. 2012); *Bank of Am. v. North LaSalle St. L.P. (In re 203 North LaSalle St. L.P.)*, 246 B.R. 325, 331 (Bankr. N.D. Ill. 2000) (provision in subordination agreement in which the subordinated creditor purported to agree to assign its voting rights in a future Chapter 11 case to a senior secured creditor was contrary to 11 U.S.C. Sec. 1126(a)); *Beatrice Foods Co. v. Hart Ski Mfg. Co. (In re Hart Ski Mfg. Co.)*, 5 B.R. 734 (Bankr. D. Minn. 1980) (Congress did not intend to permit creditors to alter substantive provisions of bankruptcy law).
 - But see *In re Aerosol Packaging LLC*, 362 B.R. 43, 47 (Bankr. N.D. Ga. 2006) (upholding the assignment of voting rights from a junior lienholder to a senior lienholder in a prepetition intercreditor agreement).

- To have a blocking position in a class, the first out and last out would each require at least 34% of the amount of the claims in the class.
- A cram down plan requires that there be one “impaired” class of claims that approves the plan.
- There may be advantages to the LO Lenders voting their deficiency claim in favor of a plan that is disfavored by the FO Lenders.

Select Bankruptcy Issues: Adequate Protection

- If the unitranche is treated as a single secured claim for adequate protection purposes, the traditional analysis should apply
- If the first out and last out are treated as separate claims, then the adequate protection analysis may change
- Can the last-out claim adequate protection because of the erosion of its position vis-à-vis the first out because of postpetition interest accrual on the first out?
- Can the debtor argue that the “subordination” creates an equity cushion in favor of the first out?
 - The subordinated secured claim may be seen as a form of third party collateral that is in effect additional security for the first out’s debt.

- More common to see syndicated unitranches, though most lenders still consider unitranches as being illiquid.
- Unitranches are being used with borrowers that have more complex capital structures.
- Some borrowers and sponsors are favoring two lien deals if they want an accordion that can be effectively utilized or if they want the ability to become a lender in the credit facility.
- Negotiation parameters are developing.
- Borrowers are pressing to be party to the AALs.
- Growing sophistication in the market is leading to more complex waterfalls, voting provisions, and bankruptcy provisions.
- “U.S. Style” unitranches have made their way into the U.K. and Europe broadly

Jennifer B. Hildebrandt is of counsel in the Corporate practice of Paul Hastings and is based in the firm's Los Angeles office. Ms. Hildebrandt represents banks, commercial finance companies, hedge funds, and other lenders in commercial and corporate finance matters, leveraged finance transactions (including acquisition financings, structured financings, and recapitalizations), asset-based finance transactions, multi-tranche and multi-lien transactions, and restructurings. In particular, Jennifer has extensive experience representing lenders in two lien deals, unitranche transactions, and bank / bond deals. In addition, Jennifer has experience in various business sectors including information technology, media, restaurants, casinos, manufacturing, and vehicle and airline transportation, and in cross-border transactions. Ms. Hildebrandt was ranked in Chambers USA (California Banking & Finance) in 2013 and 2014.



Counsel, Corporate Department
515 South Flower Street
Twenty-Fifth Floor
Los Angeles, CA 90071
T: 1(213) 683-6208
F: 1(213) 996-3208
jenniferhildebrandt@paulhastings.
com

Jennifer St. John Yount is chair of the Finance and Restructuring practice of Paul Hastings. Her practice primarily consists of representing finance companies, commercial banks, investment banks, and other lenders in acquisition financings and other leveraged finance transactions, asset-based lending transactions, cash flow transactions, restructurings, and debtor-in-possession and exit financings. Ms. Yount has extensive experience with multi-lien, multi-tranche, unitranche, and bank/bond transactions and has negotiated numerous intercreditor agreements, subordination agreements, and agreements among lenders. She has industry experience in a variety of business sectors and has extensive cross-border experience. Ms. Yount has been ranked in Chambers USA (California Banking & Finance) from 2007 through 2014.



Partner, Corporate Department
515 South Flower Street
Twenty-Fifth Floor
Los Angeles, CA 90071

Phone: 1(213) 683-6008
Fax: 1(213) 996-3008
Email:
jenniferyount@paulhastings.com

Appendix—Global Office Locations



NORTH AMERICA

- Atlanta
- Chicago
- Houston
- Los Angeles
- New York
- Orange County
- Palo Alto
- San Diego
- San Francisco
- Washington, DC

EUROPE

- Brussels
- Frankfurt
- London
- Milan
- Paris

ASIA

- Beijing
- Hong Kong
- Seoul
- Shanghai
- Tokyo

20 OFFICES ACROSS ASIA, EUROPE, AND THE U.S.

1 LEGAL TEAM TO INTEGRATE WITH THE STRATEGIC GOALS OF YOUR BUSINESS

ASIA

Beijing

19/F, Yintai Center Office Tower
2 Jianguomenwai Avenue
Chaoyang District
Beijing, 100022 PRC
t: +86.10.8567.5300
f: +86.10.8567.5400

Hong Kong

21-22/F Bank of China Tower
1 Garden Road
Hong Kong
t: +852.2867.1288
f: +852.2523.2119

Seoul

33/F West Tower
Mirae Asset Center1
26, Eulji-ro 5-gil, Jung-gu,
Seoul, 100-210, Korea
t: +82.2.6321.3800
f: +82.2.6321.3900

Shanghai

35/F, Park Place
1601 Nanjing West Road
Shanghai, 200040 PRC
t: +86.21.6103.2900
f: +86.21.6103.2990

Tokyo

Ark Hills Sengokuyama Mori Tower
40th Floor, 1-9-10 Roppongi
Minato-ku Tokyo 106-0032
Japan
t: +81.3.6229.6100
f: +81.3.6229.7100

EUROPE

Brussels

Avenue Louise 480
1050 Brussels
Belgium
t: +32.2.641.7460
f: +32.2.641.7461

Frankfurt

Siesmayerstrasse 21
D-60323 Frankfurt am Main
Germany
t: +49.69.907485.0
f: +49.69.907485.499

London

Ten Bishops Square,
Eighth Floor
London E1 6EG
United Kingdom
t: +44.20.3023.5100
f: +44.20.3023.5109

Milan

Via Rovello 1
20121 Milano
Italy
t: +39.02.30414.000
f: +39.02.30414.005

Paris

96, boulevard Haussmann
75008 Paris
France
t: +33.1.42.99.04.50
f: +33.1.45.63.91.49

UNITED STATES

Atlanta

1170 Peachtree Street, N.E.
Suite 100
Atlanta, GA 30309
t: +1.404.815.2400
f: +1.404.815.2424

Chicago

191 North Wacker Drive
Thirtieth Floor
Chicago, IL 60606
t: +1.312.499.6000
f: +1.312.499.6100

Houston

1000 Louisiana Street
Fifty-Fourth Floor
Houston, TX 77002
t: +1.713.860.7300
f: +1.713.353.3100

Los Angeles

515 South Flower Street
Twenty-Fifth Floor
Los Angeles, CA 90071
t: +1.213.683.6000
f: +1.213.627.0705

New York

75 East 55th Street
New York, NY 10022
t: +1.212.318.6000
f: +1.212.319.4090

Orange County

695 Town Center Drive
Seventeenth Floor
Costa Mesa, CA 92626
t: +1.714.668.6200
f: +1.714.979.1921

Palo Alto

1117 S. California Avenue
Palo Alto, CA 94304
t: +1.650.320.1800
f: +1.650.320.1900

San Diego

4747 Executive Drive
Twelfth Floor
San Diego, CA 92121
t: +1.858.458.3000
f: +1.858.458.3005

San Francisco

55 Second Street
Twenty-Fourth Floor
San Francisco, CA 94105
t: +1.415.856.7000
f: +1.415.856.7100

Washington, DC

875 15th Street, N.W.
Washington, DC 20005
t: +1.202.551.1700
f: +1.202.551.1705