



Continuing Education

SELECTED ISSUES IN THE WORKOUT OF SYNDICATED LENDING FACILITIES

MODERATOR: Scott A. Lessne, Esq.

FleetBoston Financial Corporation

PANELISTS:

Julie Bouhuys, Wachovia Securities, Inc.

Peter C. Cheston, Alvarez & Marsal, Inc.

Brian Trust, Esq., Mayer, Brown, Rowe & Maw

MATERIALS

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The most recent economic down cycle has brought with it a variety of challenges to the lender community. One of those challenges relates to loan facilities extended to national and multinational corporate borrowers in a lending syndicate structure. While the so called "syndicated loan" structure has been around for quite some time, the most recent economic recession has brought forth numerous issues in connection with the workout of loan facilities booked with this type of lending structure. Issues relating to lender group dynamics resulting from a diverse lender group composition, voting rights in multi-tranche facilities, indemnification of financial advisory professionals, and the effects of a potential bankruptcy filing have heightened the challenges faced by lender groups in the current economic environment.

The members of this panel all have had significant experience in the legal and business aspects of managing syndicated loan facilities prior to and during the course of the workout or bankruptcy of the borrower.

This panel will address these and other issues from the point of view of the legal professionals to the transaction, the financial advisory professionals as well as the business professionals based on their many years of active involvement in syndicated loan workout:

All materials are in PDF format (requires Adobe Acrobat Reader, which may be downloaded at no charge from <http://www.adobe.com>)

Scott Lessne is the moderator of the panel and a Vice President of ACFA. He is the senior in-house workout counsel for FleetBoston Financial Corporation where he has responsibility for all legal aspects relating to workouts for the corporation. He is a graduate of Trinity College, Connecticut and Western New England College School of Law where he was the Research Editor of the Law Review. In addition to his extensive interaction with outside counsel with respect to syndicated credits, he directly represents the bank and supervises other bank house workout attorneys in connection with syndicated credits where the corporation is a member of the syndicate. In addition, Scott frequently lectures on a variety of workout and commercial finance topics. He is currently an adjunct faculty member at Suffolk University Law School where he teaches a course on secured transactions.

Julie Bouhuys is a Managing Director at Wachovia Securities where she heads the bank's Special Situations Group. Her current responsibilities include management of the bank's Restructuring and Workout Group for large middle market and large corporate borrowers, the Restructuring Finance Group, which provides DIP and Exit Financings, and the bank's proprietary distressed loan trading activities. Having formed First Union's Special Situations Group in 1997, she has supervised many syndicated loan workouts from the position of Agent, Committee member, and syndicate participant, both in an out of bankruptcy proceedings, and has been an active buyer and manager of distressed securities. Ms. Bouhuys interacts extensively with attorneys specializing in bankruptcy and creditor's rights as well as professional workout advisors, accountants and consultants in the normal course of her responsibilities. Prior to 1997, Ms. Bouhuys was a Senior Credit Officer for the Leveraged Finance Group at First Union National Bank. Between 1983 and 1995 she was with Manufacturers Hanover/Chemical Bank, where she was a corporate banker specializing in high risk credits, and a member of the Special Loan Group managing workouts, restructurings and DIP financings. Overall she has over 18 years of banking and workout experience in the syndicated loan market.

Peter Cheston is a Managing Director of Alvarez & Marsal, Inc. where he heads the firm's Credit Advisory Services Group. At his current assignment at Alvarez & Marsal, he has had engagements in a variety of industries and also served as Chief Operating Officer of several financially distressed companies. He also regularly serves as

advisor to creditor groups where he has extensive experience in evaluating both the credibility of business plans and management's ability to execute business plans. He has participated in numerous successful debt restructurings with emphasis on developing out of court solutions. Prior to joining Alvarez & Marsal, he was in the Special Loan Department of the Chase Manhattan Bank where his responsibilities included the negotiation of debt restructurings and the review of business plans for financially troubled companies.

Brian Trust is a partner in the New York office of Mayer, Brown, Rowe & Maw where he specializes in representing creditors connection with multibank workouts and bankruptcies. His practice includes representing creditors in complex Chapter 11 reorganizations, out of court restructurings and recapitalizations, mergers and acquisitions of financially distressed companies. In addition, he has had extensive experience in bankruptcy matters pertaining to the real estate and airline industries. Brian went to Brooklyn College, received an MA from New York University and his law degree from New York Law School, cum laude where he was Articles Editor of the Law Review. In addition to frequently lecturing he is an Assistant Editor of the Norton Bankruptcy Law and Practice series and has co-authored articles on "Application of Fraudulent Conveyance Laws to Leveraged Buy Outs" and "Section 1110: Aircraft Equipment and Vessel Financing Arrangements".

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BRIAN TRUST, ESQ., MAYER, BROWN, ROWE & MAW

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I. Introduction

The commercial lending market is in the midst of a bad debt crisis. In fact, banks were forced to charge off an aggregate of \$7.9 billion in bad loans during the second quarter of 2001, a 50% increase from the prior year. Commercial and industrial loan portfolios at larger banks have suffered the most, with a 77% increase in bad loans from one year ago. Despite these charge-offs, non-current loans on the books have increased by \$12.2 billion between June 2000 and June 2001, resulting in the highest level of non-current loans in the commercial and industrial sector since 1993. The numbers have only gotten worse since the September 11th attacks and the continuing economic slowdown, with more and more companies facing difficulties in meeting their loan obligations.

Given the current restriction on access to capital markets, lenders are left with the following difficult choices: (a) to restructure the loans in a workout or (b) take their chances with potential bankruptcy or liquidation, facing the prospect of additional charge-offs. Accordingly, today there is a significant rise in the number of loan workouts of syndicated credit facilities. This seminar discusses several key issues which arise in connection with the workout of syndicated loan facilities:

- Current Issues With Respect to the Retention by the Agent Bank of Financial Advisory Professionals
- Composition of Bank Group
- Certain Intercreditor Issues
- Certain Bankruptcy Issues
- Certain Confidentiality Issues

II. Current Issues With Respect to the Retention by the Agent Bank of Financial Advisory Professionals

- A. Power of Agent Bank to Retain Professionals. The Agent Bank generally has the power to retain professionals under the provisions of a typical Credit Agreement, including, without limitation, counsel and financial advisors. A standard provision in a Credit Agreement may read as follows:

“The Agent may execute any of its duties under this Agreement and the other Loan Documents by or through agents or attorneys-in-fact and shall be entitled to advice of counsel and financial advisors concerning all matters pertaining to such duties.”

- B. When may the Agent Bank Retain a Financial Advisor? The terms of the Credit Agreement govern when an Agent Bank may retain a financial advisor. The following are examples, taken from certain credit agreements, of the circumstances under which the Agent Bank may retain a financial advisor: (i) upon the occurrence and during the continuance of a default or event of default under the credit agreement, (ii) at any time, or from time to time, in the Agent Bank’s sole discretion or (iii) upon the prior written consent of the borrower, which consent will not be unreasonably withheld. It is typical in today’s syndicated loan market in a default situation for the lenders, as a condition precedent to amending the credit agreement or waiving a default thereunder, to require

the borrower to (a) acknowledge the Agent Bank's right to retain a financial advisor and (b) to confirm its obligation to reimburse the Agent Bank for all of the fees and expenses of the Agent Bank's financial advisor.

- C. Scope of Engagement. The Agent Bank should carefully assess the financial advisor's scope of engagement. There exist differing schools of thought as to whether, in the context of a workout, a narrow or broad scope of engagement is the better approach to retaining a financial advisor. On the one hand, a narrow scope of engagement may serve to better manage the Agent Bank's and the borrower's expectations with respect to the financial advisor's role in a workout situation. However, a narrow scope of engagement may cause unanticipated problems if the financial advisor is asked to engage in a project that would otherwise be considered outside its scope of engagement. On the other hand, a broad scope of engagement may serve to provide the financial advisor with discretion to act in a greater variety of situations, but may also sow discontent if the financial advisor engages in projects that the Agent Bank and/or borrower consider to be unnecessary or otherwise duplicative or wasteful. The following is illustrative of a broad scope of engagement in a financial advisor's engagement letter:

- (1) Assist the borrower in finalizing its business plan and cash flow projections.
- (2) Identify opportunities for profit enhancement, including cost reductions, improved working capital utilization and cash generation opportunities, including execution of plans to achieve such opportunities.
- (3) Assist the borrower with the preparation and dissemination of financial analysis and information, including reports to the lenders. Additionally [financial advisor] will act as liaison between the borrower and the lenders with respect to such information.
- (4) Assist the borrower in developing and implementing a financial restructuring plan in conjunction with the borrower's investment bankers.
- (5) Perform other tasks as requested by you from time to time.

- D. Retention of Financial Advisor by Counsel to Agent Bank; Attorney-Client Privilege. To the extent the Agent Bank and the Lenders find it advisable to retain a financial advisor, counsel to the Agent Bank generally retains the financial advisor to be able to assert that the attorney-client privilege and work-product doctrine applies with respect to such financial advisor. The theory is that all of the work prepared by the financial advisor, and all communications and information exchanged between the financial advisor and the Agent Bank's counsel, is in relation to and in furtherance of, counsel's legal services to the Agent Bank. It is worth noting that there is no assurance that this is a "fool proof" approach to creating a privilege. We can certainly anticipate arguments that no privilege exists in respect of a financial advisor because the financial advisor's retention by counsel is merely form over substance and the Agent Bank is the real party in interest. Nevertheless, it is the practice in the syndicated lending market to have counsel to the Agent retain the financial advisor. A typical provision found in a financial advisor's engagement letter acknowledging the privilege may read as follows:

"We understand that our work will be done at the direction of _____ [name of law firm] to assist _____ [name of law firm] in rendering legal advice, and that work performed by us as part of this engagement, including, without limitation, any reports we

may prepare, is privileged and confidential and is deemed to constitute an attorney work product which we will not as close to any other third-party (other than _____ [name of law firm], the Agent, the Lenders, and their respective attorneys and advisors) except in accordance with the terms hereof. The Company hereby agrees that the reports and any oral advice we may give are solely for the benefit of _____ [name of law firm] as counsel to the Agent and that no other party (other than the Agent, the Lenders and their respective attorneys said advisors) are entitled to receive or rely on such reports or advice.

We recognize and acknowledge that certain information and documentation which we may receive in connection with our engagement its proprietary and confidential, including, without limitation, nonpublic financial and business information documents hereafter furnished to us by the Company, _____ [name of law firm], the Agent or the Lenders. By signing this Agreement, we confirm and agree that, without the prior written consent of _____ [name of law firm] and the Company, we will not disclose, distribute, publish or release to any third party (_____ [name of law firm], the Agent, the Lenders and their respective attorneys and advisors are not considered third parties) any information or documents now or hereafter received or obtained by us in this engagement, except as required by law, subpoena, or other process and as to which we will provide the Company, _____ [name of law firm], and the Agent prior notice. All obligations as to non- disclosure shall cease as to any part of such information to the extent that such information is or becomes public other than as a result of acts by us.”

It is also important, for purposes of preserving the privilege, that there exists either (i) a an appropriate confidentiality provision in the Credit Agreement binding all of the lenders thereto or (ii) a separate confidentiality agreement executed by all of the lenders. To the extent that the Agent Bank or counsel to the Agent Bank distributes information to the lender group without there being an appropriate confidentiality agreement in place, counsel to the Agent Bank, in light of the fact that the Agent Bank is technically such counsel’s client, risks losing any privilege to which it may otherwise be entitled.

- E. Who Pays Fees and Expenses of Agent Bank’s Financial Advisor? Under a typical Credit Agreement, the Borrower is required to reimburse all of the fees and expenses of the Agent Bank’s professionals, including, without limitation, the Agent Bank’s financial advisor. Accordingly, notwithstanding the fact that counsel to the Agent Bank generally retains the financial advisor, the Borrower is nonetheless required to reimburse the Agent Bank for the financial advisor’s fees and expenses. A typical provision in a Credit Agreement may read as follows:

“The Borrower agrees:

(a) to pay or reimburse the Agent for all its out-of-pocket costs and expenses incurred in connection with the development, preparation and execution of, and any amendment, supplement or modification to, this Agreement and the Notes and the other Loan Documents and any other documents prepared in connection herewith or therewith, and the consummation and administration of the transactions contemplated hereby and thereby, including, without limitation, the fees and disbursements of counsel to the Agent[.]”

While not necessary or advisable, a financial advisor may, under certain circumstances, request that the Borrower acknowledge its reimbursement obligation in the engagement letter.

- F. Issues Pertaining to Indemnification of Financial Advisor. It is not uncommon for a financial advisor to request that the Agent Bank and the Lenders indemnify and hold harmless the financial advisor. While under certain circumstances the financial advisor may succeed in obtaining such indemnity, there is a trend in the syndicated loan market place for financial advisors to receive no such indemnity from the Agent Bank and the Lenders. In this instance, the financial advisor obtains, as part of its general overhead, liability insurance and typically shows evidence of such liability insurance to the Agent Bank. A further potential middle-of-the-road solution to the indemnification issue that often arises in connection with negotiating the engagement letter is for the Borrower to confirm in writing that it will indemnify the financial advisor as part of its indemnity running in favor of the Agent Bank and the Lenders pursuant to the Credit Agreement. A typical indemnification provision in a Credit Agreement which creates the foregoing indemnification by the Borrower of the financial advisor may read as follows:

“The Borrower agrees:

to pay, indemnify, and hold each Lender and the Agent harmless from and against any and all other liabilities, obligations, losses, damages, penalties, actions (whether sounding in contract, in tort or on any other ground), judgments, suits, costs, expenses or disbursements of any kind or nature whatsoever with respect to the execution, delivery, enforcement, performance and administration of, or in any other way arising out of or relating to, this Agreement, the Notes, the other Loan Documents or any other documents contemplated by or referred to herein or therein or any action taken or omitted to be taken by any Lender or the Agent with respect to any of the foregoing (all of the foregoing, collectively, the “*Indemnified Liabilities*”), provided, that the Borrower shall have no obligation hereunder to the Agent or any Lender with respect to Indemnified Liabilities arising from:

- (1) the gross negligence or willful misconduct of the Agent or any such Lender, or
- (2) legal proceedings commenced against the Agent or any such Lender by any holder of any securities of the Agent or such Lender or any creditor of the Agent or such Lender arising out of and based solely upon rights afforded any such holder of securities or such creditor in its capacity.

The agreements in this subsection shall survive repayment of the Notes and all other amounts payable hereunder.”

It is worth noting that much of the current thinking regarding the indemnification of financial advisory professionals arises out of some recent Bankruptcy Court decisions which are analogous to the indemnification issue discussed herein. Following a spate of lawsuits against consulting firms by their clients and third parties (most notably the lawsuit against Ernst & Young, in connection with the bankruptcy of Merry-Go-Round Enterprises, which was settled for \$185 million), financial consultants attempted to strengthen their contractual protections from liability by including in their engagement

letters broad indemnification and limitation of damages provisions. As a result, in the context of the retention of professionals in bankruptcy cases, bankruptcy courts have had to address whether financial advisors should be entitled to such indemnification. In the *Daily International* bankruptcy case, Ernst & Young sought to execute an engagement letter which contained extensive indemnification, exculpation, waiver and limitation of damage provisions. In response, Bankruptcy Judge Peter Walsh (District of Delaware) wrote an unpublished letter whereby he acknowledged Ernst & Young's settlement in *Merry-Go-Round*, then stated that "Ernst & Young's efforts to avoid similar liability exposure in the future is understandable; however, I find its apparent efforts in that regard in the instant case as overreaching and not consonant with the public policy design embodied in the Bankruptcy Code." Accordingly, in light of the foregoing, while there is a clear distinction between the legal responsibilities of a consultant who is engaged by a fiduciary of a bankruptcy estate and a consultant who is engaged by a creditor on its own behalf, many of the financial advisory firms have voluntarily succumbed to market pressure and have deleted indemnification provisions with respect to third party suits when being retained in the bankruptcy context.

- G. Exculpation; Limitation on Damages. There is a significant issue in the marketplace as to the appropriate standard of care for a financial advisor in discharging its duties. While many financial advisors typically seek a "gross negligence" or "willful misconduct" standard, there is a view at several major financial institutions that financial advisors should be held to some lower standard such as simple negligence, breach of contract or the like. In many cases, the final determinant of this issue is the relative bargaining power of the parties in light of market demand for the financial advisor's services.

A further related issue is whether there should be a contractual limitation on damages to the extent a financial advisor is found to have breached its standard of care. Virtually all financial advisors take the position that to the extent they are liable to the Agent Bank and the Lenders, such damages should be limited to the amount of fees actually paid to the financial advisor, even if there is found to exist gross negligence or willful misconduct. Nonetheless, there are certain financial institutions who find such a limitation unacceptable. Rather, those financial institutions insist that, in the case of liability, the financial advisor's liability be limited to actual damages but not consequential, incidental, indirect or punitive damages under a simple negligence or breach of contract standard. Like the issues discussed above, this issue is very often resolved based on the relative bargaining positions of the parties, including supply and demand in the marketplace for financial advisors. A sample provision limiting liability to actual damages (but with no cap) may read as follows:

"As to the services that _____ [name of law firm] has requested and _____ [name of financial advisor] has agreed to provide as set forth in this Agreement, the total aggregate liability of _____ [name of financial advisor] under this Agreement to _____ [name of law firm], the Agent, the Company and their successors and assigns, whether such liability is based on breach of contract, tort, strict liability, breach of warranties, failure of essential purpose or otherwise, shall be limited to the actual damages incurred by _____ [name of law firm], the Agent, the Company or their successors or assigns. In no event will _____ [name of financial advisor] or any of its affiliates be liable to _____ [name of law firm], the Agent, the Company or their successors or assigns for consequential, incidental, indirect, punitive, or special damages, including loss of profits, data, business, or goodwill (collectively, "*Excluded Damages*"), regardless of whether Excluded Damages

or liability is based upon breach of contract, tort, failure of essential purpose or any other basis, even if advised of the likelihood of such damages.”

III. Composition of Bank Group

A. Agent Bank

- (i) *Power and Duty.* The Agent Bank generally has the power to act in a broad range of situations, but has no duty do act, other than in specified instances (*e.g.*, when requested by the required banks to act).
- (ii) *Is the Agent Bank a Fiduciary?* The Credit Agreement typically provides that the Agent Bank has no fiduciary relationship with the other lenders. This provision, among others, is important to protect the Agent Bank from potential liability. A typical provision in a Credit Agreement acknowledging the fact that the Agent Bank has no fiduciary relationship with the Lenders may read as follows:

“Notwithstanding any provision to the contrary elsewhere in this Agreement, the Agent shall not have any duties or responsibilities except those expressly set forth herein, or any fiduciary relationship with any Lenders, and no implied covenants, functions, responsibilities, duties, obligations or liabilities shall be read into this Agreement or any other Loan Document or otherwise exist against the Agent.”

Nevertheless, it is important to note that an Agent Bank should access carefully all actions it may take in its own self interest which may be detrimental to the interests of the bank group for which it is the agent. Along the same lines, an Agent Bank should carefully access whether, as a result of acting in several different capacities in one transaction, it may implicate certain conflicts of interests. For a further discussion of certain related issues, see Part VI hereof.

- (iii) *Steering Committee.* In certain workout situations, a steering committee may be formed to participate in negotiating the terms of a workout, which may include a restructuring and recapitalization. It is interesting to note that while steering committees are commonplace in the syndicated loan market, there is usually no contractual basis for their formation and they owe no duty to the lender group. Moreover, because there is no contractual basis underlying their activities, duties and powers, issues such as voting, retention of professionals and other governance issues, are generally resolved on a case-by-case basis.

(1) *Advantages of Steering Committee.* A steering committee may facilitate greater communication among the bank group and may instill greater confidence in the decision-making process. It may also help an Agent Bank to build a broad consensus of support for a proposal prior to selling such proposal to the bank group at large.

(2) *Disadvantages of Steering Committee.* The old adage “too many cooks spoil the broth” may be true. A steering committee may make it difficult for the Agent Bank to engage in an open dialogue with the Borrower.

B. Assignments

- (i) *Assignment of Position.* Lenders may, under certain circumstances, sell to a purchasing lender all of their right, title and interest under and in connection with a Credit Agreement. Generally, an instrument called an Assignment and Acceptance will effect this sale transaction. A typical provision permitting an assignment of position may read as follows:

“Any Lender, in the ordinary course of its commercial banking business and in accordance with applicable law, at any time may sell to any Lender or any Affiliate thereof and, with the consent of the Borrower and the Agent (which in each case shall not be unreasonably withheld), to one or more additional banks or financial institutions (each, a “*Purchasing Lender*”) all or any part of the assigning Lender’s rights and obligations under this Agreement, the Notes and the other Loan Documents pursuant to an Assignment and Acceptance, executed by the Purchasing Lender, the assigning Lender (and, in the case of a Purchasing Lender that is not then a Lender or an Affiliate of a Lender, by the Borrower and the Agent) and delivered to the Agent for its acceptance and recording in the Register. Such Assignment and Acceptance shall specify an Effective Date which is not less than five Business Days after the date of execution thereof. Upon such execution, delivery, acceptance and recording, from and after the Effective Date determined pursuant to such Assignment and Acceptance, (a) the Purchasing Lender thereunder shall be a party hereto and, to the extent provided in such Assignment and Acceptance, have the rights and obligations of a Lender hereunder with a Commitment as set forth therein, and (b) the assigning Lender thereunder shall, to the extent provided in such Assignment and Acceptance, be released from its obligations under this Agreement (and, in the case of an Assignment and Acceptance covering all or the remaining portion of an assigning Lender’s rights and obligations under this Agreement, such assigning Lender shall cease to be a party hereto). Such Assignment and Acceptance shall be deemed to amend this Agreement to the extent, and only to the extent, necessary to reflect the addition of such Purchasing Lender and resulting adjustment of Commitment Percentages arising from the purchase by such Purchasing Lender of all or a portion of the rights and obligations of such assigning Lender under this Agreement and the Notes. On or prior to the Effective Date determined pursuant to such Assignment and Acceptance, the Borrower, at its own expense, shall execute and deliver to the Agent in exchange for the surrendered Note, a new Note to the order of such Purchasing Lender in an amount equal to the Commitment assumed by it pursuant to such Assignment and Acceptance and, if the assigning Lender has retained a Commitment hereunder, a new Note or Notes to the order of the assigning Lender in an amount equal to the Commitment retained by it hereunder. Such new Note or Notes shall be dated the Closing Date and otherwise shall be in the form of the Note or Notes replace thereby. The Note or Notes surrendered by the assigning Lender shall be returned by the Agent to the Borrower marked “cancelled.””

- (ii) *Assignment of Position as Novation.* An assignment of position technically results in a novation of the existing credit agreement (*i.e.*, the old credit agreement is extinguished and a new credit agreement is created with the same content, but with a different lender). Generally, a novation (and, hence, an assignment of position) requires the consent of the borrower. However, in many

cases, the borrower will waive its consent right where, *inter alia*, the purchasing lender is already a lender under the credit agreement or a default or event of default has occurred and is continuing under the Credit Agreement. The relative bargaining power of the parties will ultimately determine under what circumstances the Borrower will waive its consent right.

- (iii) *Who can Become a Purchasing Lender.* At one time, credit agreements contained prohibitions as to who may become a purchasing lender. Typical restrictions included minimum capital requirements and prohibitions against competing entities. However, the trend today is to permit assignments to any number of financial institutions without limitation.
- (iv) *Obligations Under Credit Agreement in Connection with Assignment of Position.* Once an assignment of position has been consummated, the purchasing lender becomes a party to the credit agreement and the assignor is relieved of its obligations under the Credit Agreement, to the extent of the interest transferred. The Credit Agreement is deemed amended to give effect to the transfer, and the lenders' respective commitment percentages are modified. The borrower is obligated to deliver new notes the assignor (if it kept an interest in the loans) and the assignee in amounts that reflect their respective shares in the loans.

C. Participations.

- (i) *Participations Generally.* Lenders may sell participating interests in their loans under the credit agreement. Participants do not become parties under the credit agreement and do not have privity with the borrower. Lenders selling participating interests remain liable for all of their obligations under the credit agreement. A typical provision permitting an assignment of position may read as follows:

“Any Lender may, in the ordinary course of its commercial banking business and in accordance with applicable law, at any time sell to one or more banks or other entities (each, a “Participant”) participating interests in any Loan owing to such Lender, any Note held by such Lender, any Commitment of such Lender or any other interest of such Lender hereunder and under the other Loan Documents.

In the event of any such sale by a Lender of participating interests to a Participant, (1) such Lender's obligations under this Agreement to the other parties to this Agreement shall remain unchanged, (2) such Lender shall remain solely responsible for the performance of such obligations, (3) such Lender shall remain the holder of any such Note for all purposes under this Agreement and the other Loan Documents, (4) the Borrower and the Agent shall continue to deal solely and directly with such Lender in connection with such Lender's rights and obligations under this Agreement and the other Loan Documents and (5) in any proceeding under the Bankruptcy Code the Lender shall be, to the extent permitted by law, the sole representative with respect to the obligations held in the name of such Lender, whether for its own account or for the account of any participant.”

- (ii) *No Consent.* Generally, a lender need not obtain the Borrower's consent to sell one or more participating interests.

- (iii) *Limited Voting Rights.* Participants generally have limited voting rights *vis a vis* the selling Lender. However, the selling lender may need to obtain its participant's vote before the selling lender can agree to change interest rates or extend maturity dates. In connection with any workout, it is advisable for counsel to the Agent Bank to assess the contractual rights of participants to the Lenders (to the extent such information is available) to understand whether there will be any impact on voting issues.
- (iv) *Advantages and Disadvantages to Lender.* A lender can sell participating interests and thus reduce its exposure under the credit agreement without having to obtain the borrower's consent. However, as noted above, the lender remains liable under the credit agreement and its obligations in respect of the credit agreement remain outstanding.

D. Dealing with Non-Par Lenders. An important issue that commonly arises in connection with syndicated lending facilities is how to manage the relationship between non-par holders and the original lenders. A non-par holder's agenda may differ from that of an original lender's. The non-par holder has, in most distressed situations, purchased its interest in the credit agreement for far less than 100 cents on the dollar. Consequently, it may, in connection with a workout, (i) be more likely to agree to a conversion to equity or (ii) may seek to obtain a blocking position (approximately 33% interest where "required lenders" equals 66-2/3%) to exercise certain control over potentially material voting issues under the Credit Agreement. Additionally, to the extent that the non-par lender's risk profile differs significantly from that of the original lender's (e.g. the non-par lenders are funds or are non-financial buyers), there may be significant differences between the non-par lenders and the original lenders in terms of investment strategy and approach to a workout situation.

IV. Certain Intercreditor Issues

- A. Multi-Tranche Structure. In many of today's complex credit structures, there are often multiple tranches of indebtedness under a Credit Agreement. For example, there may be a revolving credit facility, a Term Loan A, a Term Loan B and a Term Loan C. Moreover, the remainder of the Borrower's capital structure (in respect of indebtedness) may also include one or more tranches of subordinated indebtedness (*i.e.*, senior subordinated notes and subordinated notes). In syndicated loan workouts, a variety of complex issues may arise because certain institutions may hold interests in one or more tranches of indebtedness but not all tranches. For example, bank A may hold interests in the revolving credit commitments and Term Loan A, insurance company B may hold interests in Term Loan A and Term Loan B and mutual fund C may hold interests in Term Loan C only. To further complicate matters, it is possible that insurance company B also holds interests in the Borrower's senior subordinated notes and mutual fund C holds interests in the Borrower's subordinated notes. In connection with working out multi-tranche syndicated loans, the following issues may arise:
- (i) *Priority of Revolver Following a Default.* Assume that the Credit Agreement provides that all tranches of indebtedness are secured *pari passu* by the collateral. Assume further that certain lenders hold only revolving credit commitments and Term Loan A while other lenders hold only Term Loans B and C but no revolving credit commitment. If a default occurs, to the extent the lenders determine to work out the problem and amend or waive defaults under the credit

facility, in light of the heightened risk profile during the workout phase, the revolving credit lenders may not want to bear incremental credit risk by funding the Borrower for the benefit of the Term Loan B and C lenders without receiving additional compensation and/or protection. One solution to the problem is for the lender group to agree that post-default revolving credit loans rise to the top of the waterfall and are entitled to priority status (*i.e.*, a LIFO facility) in respect of the collateral. In certain situations, the same approach is taken but the revolving credit lenders get LIFO status only with respect to working capital assets (*i.e.*, accounts receivable and inventory). The LIFO approach, while being accomplished out of bankruptcy court, relies on the analytical framework of a DIP financing under Bankruptcy Code Section 364 to provide additional protection to the post-default revolving credit lenders.

- (ii) *Voting Issues.* Voting issues take on paramount importance in the context of workouts of multi-tranche credit facilities. It is axiomatic that the fewer 100% vote issues there are the better. However, this is not always the case. In a large syndicated deal, any vote (*e.g.*, release of *any* collateral) that requires 100% approval by the lenders creates an incentive for small holders to “hold out” in an attempt to cause certain large holders to take them out. Another interesting voting issue arises where a default exists due to breach of a financial covenant which may be waived by a majority vote of the lenders. If, as in the example above, certain lenders are only in the revolver and certain other lenders are only in one of more tranches of term debt, then it is possible that a majority of the lenders (including term lenders only) can waive default to force the revolving lenders to make additional advances to keep the Borrower alive for the benefit of, among others, the term lenders. In certain credit agreements, this problem is resolved by requiring a tranche by tranche vote – *i.e.*, to waive a default which forces the revolving credit lenders to fund additional advances requires not just the required lenders in the aggregate but the required revolving credit lenders. A further interesting voting issue involves the use of motivational devices to obtain a requisite lender vote to amend or modify the credit agreement. For example, an Agent Bank may structure an amendment such that the amendment fee will be paid only to those institutions which agree to sign the amendment. While this is sometimes effective, it also may lead to disharmony among the lending syndicate. Accordingly, it should be utilized prudently.
- (iii) *Causing a Capital Event.* In connection with working out a multi-tranche syndicated loan, lenders may seek to force the Borrower to engage in a capital event (*i.e.*, asset sale, merger, capital raise, refinancing, etc.) to enable the lenders to exit the credit. The practice in the syndicated loan market today is to motivate the Borrower to explore and consummate a capital event by utilizing a variety of “carrot and stick” approaches. For example, to force an exit of the credit, amendments to the credit agreement may include escalating interest rates over time, the imposition of overage fees based on leverage, the issuance of warrants, a series of special fees which may be waived in whole or in part, all of which will be contingent upon the Borrower satisfying certain benchmarks on a satisfactory timeline – *i.e.*, receiving a satisfactory letter of intent from a bona fide potential purchaser, obtaining board approval of the transaction at a valuation level satisfactory to the lenders, executing and delivering a purchase and sale agreement and closing said transaction. A typical provision in an amendment to a Credit Agreement using “motivational” devices may read as follows:

Amendment Fee. The Borrower shall pay to the Administrative Agent, for the account of each Lender on a *pro rata* basis, an amendment fee (the "*Amendment Fee*") payable as follows: (i) \$2,000,000 in cash on the Effective Date, (ii) \$500,000 in cash on November 1, 2001 only in the event the Borrower shall have failed to achieve the Documentation Benchmark with respect to the Type A Capital Event on or before October 31, 2001, (iii) \$1,000,000 in cash on January 15, 2003 in the event that (A) the Borrower shall have failed to consummate the Type A Capital Event on or before December 31, 2001 and (B) the Borrower shall not have paid in full, in cash, all Obligations owing to the Administrative Agent and the Lenders under the Credit Agreement on or before January 15, 2003, (iv) \$500,000 in cash on March 1, 2002 in the event the Borrower shall have failed to achieve the Documentation Benchmark with respect to the Type B Capital Event on or before February 28, 2002 and (v) in addition to any fee owing pursuant to clause (iii) above, \$1,000,000 in cash on January 15, 2003 in the event that (A) the Borrower shall have failed to consummate the Type B Capital Event on or before April 30, 2002 and (B) the Borrower shall not have paid, in full, in cash, all Obligations owing to the Administrative Agent and the Lenders under the Credit Agreement on or before January 15, 2003. The Amendment Fee shall be deemed earned in full on the Effective Date.

Warrants. In the event the Borrower shall have failed to achieve the Documentation Benchmark with respect to the Type A Capital Event on or before December 31, 2001, the Borrower shall issue to the Lenders, on January 1, 2002, detachable and freely transferable five year Warrants for the purchase of common stock of the Borrower representing in the aggregate 5% of the fully diluted common stock upon the Effective Date; *provided, however*, that in the event the Borrower shall have consummated the Type A Capital Event on or before February 28, 2002, such Warrants shall be cancelled. In addition to any Warrants issued pursuant to the preceding sentence, in the event the Borrower shall have failed to achieve the Documentation Benchmark with respect to the Type B Capital Event on or before April 30, 2002, the Borrower shall issue to the Lenders, on May 1, 2002, Warrants representing in the aggregate 5% of the fully diluted common stock upon the Effective Date; *provided, however*, that in the event the Borrower shall have consummated the Type B Capital Event on or before June 30, 2002, such Warrants shall be cancelled. All such Warrants would be exercisable on the earlier of (i) the fifth anniversary of the issuance thereof or (ii) upon the occurrence of an Event of Default at a nominal strike price."

Certain Definitions:

"Type A Capital Event" means (i) any issuance or sale of equity securities or junior debt securities or instruments, (ii) any Asset Disposition or (iii) any combination of events identified in clauses (i) and (ii) above, in any case, on terms and conditions satisfactory to the Administrative Agent and the Required Lenders, that shall result in a payment in cash to the Lenders in an amount not less than \$35,000,000.

"Type B Capital Event" means (i) any issuance or sale of equity securities or junior debt securities or instruments, (ii) any Asset Disposition, or (iii) any combination of events identified in clauses (i) and (ii) above, in any case, on

terms and conditions satisfactory to the Administrative Agent and the Required Lenders, that shall result in a payment in cash to the Lenders in an amount not less than \$15,000,000, *provided* that if a Type A Capital Event results in a payment in cash to the Lenders in excess of \$45,000,000, , then such amount in excess of \$45,000,000 shall be deemed to arise from a Type B Capital Event.”

- (iv) *How to Structure New Money from a Sponsor in a Private Equity Deal.* In certain workouts involving a private equity sponsor, the equity sponsor, so as to preserve any possible upside for its original equity investment, may agree to infuse new money into a distressed situation. The challenge is to figure out how to induce the equity sponsor to put the new money so it does not believe that it is throwing good money after bad. The first level of negotiation is the priority of the new money. It is to be expected that the equity sponsor will seek to put such new money in as LIFO dollars, with a priority on the lenders' collateral. However, while such a structure may work in certain situations, it is far more typical for the lenders to permit an equity sponsor to put new money in behind the lenders' position in the collateral. Nevertheless, in a transaction that has subordinated debt and antecedent trade debt, the equity sponsor will seek to create a structure whereby it can “leapfrog” over the subordinated debt and trade credit but remain behind the banks. One approach is to allow the equity sponsor to purchase a pre-funded junior, subordinated interest in the revolver – to the extent there remains unutilized commitment. Accordingly, to the extent of new advances, the equity sponsor will rank junior to the banks but presumably ahead of the subordinated debt and the trade. It is important that counsel for the Agent Bank carefully assess all possible issues relative to possible lender liability allegations. Generally, so long as there remains room under an pre-existing commitment to extend the new money, counsel should be comfortable with the arrangement because in the aggregate unsecured creditors remain behind the same amount of bank debt previously contemplated by the original commitment under the credit agreement. A typical provision in an “equity sponsor” participation agreement may read as follows:

“Sale and Purchase of Junior and Subordinated Participating Interest in the Revolving Credit Loans. Upon and subject to the terms and conditions of this Participation Agreement, on the date hereof (the “*Initial Purchase Date*”), each Bank wishes to sell, transfer and convey to the Participant, and the Participant wishes to purchase, acquire and take from such Bank, an undivided junior and subordinated participating interest in each such Bank's *pro rata* share of the Revolving Credit Commitment in an aggregate amount not to exceed of \$5,000,000.

Subordination of Participating Interests. Participant hereby agrees that with respect to its junior and subordinated participating interests (i) any such junior and subordinated participating interest (including interest thereon) shall be a “last-out”, “first-loss” participation and shall otherwise be junior and subordinated to each Bank's right to prior payment in full of all amounts and other obligations due to such Bank, as well as to such Bank's interest in any Loans, Notes, Collateral, the Credit Agreement and any other Loan Documents (including, without limitation, interest on the Loans, whether or not such interest shall constitute an allowed claim in bankruptcy or similar proceeding), (ii) the Agent and the Banks shall retain the exclusive right to carry out the provisions of

the Credit Agreement and the Loan Documents, to enforce and collect the Loans made thereunder, and to exercise and enforce all rights and privileges accruing to the Agent or such Bank by reason of the Credit Agreement and the Loan Documents and other agreements, security agreements, guarantees given in connection with the Credit Agreement, all in the Agent's or the Bank's sole business judgment; *provided, however*, that upon the indefeasible payment in full in cash of the Obligations, the Participant shall be subrogated to the rights of the Agent and the Banks in respect of the Credit Agreement and the other Loan Documents and (iii) the Agent and the Banks may, in their sole discretion in each instance, without prior notice to Participant (a) agree to any amendment, modification or waiver of any of the terms of the Credit Agreement, any Note or any other Loan Document, (b) consent to any action or failure to act by the Borrower or any party under the Credit Agreement or any other Loan Document, (c) exercise or refrain from exercising any rights or remedies which the Agent or such Bank may have under the Credit Agreement, any Note or the other Loan Documents, including, without limitation, the right at any time, in their sole discretion to (1) to declare, or refrain from declaring, any Loan and any Note due and payable when permitted to do so pursuant to the Credit Agreement, (2) to foreclose and sell and otherwise deal with, or refrain from foreclosing and selling or otherwise dealing with, any Collateral or (3) to enforce, or refrain from enforcing, the Credit Agreement or other Loan Documents; *provided, however*, that without the prior written consent of Participant, no Bank may forgive any portion, or modify the rate of interest, of any indebtedness of the Borrower which constitutes any portion of the Participant's junior and subordinated participating interest."

- (v) *True-Up Issues in the Context of a Debt Restructure and Equity Recapitalization.* In an out-of-Bankruptcy Court workout that results in a debt restructuring and an equity recapitalization such that the holders of bank debt under a multi-tranched Credit Agreement agree to convert a portion of their bank debt into equity of the Borrower – so as to “fix” the Borrower’s balance sheet, difficult issues may arise with respect to agreeing on a debt-for-equity conversion ratio because the holders of different tranches of debt under the Credit Agreement typically have differing contractual rights. For example, while the Term Loan A might have a contractual priority to certain asset sale proceeds, the Term Loan B and Term Loan C might bear interest at increasingly higher rates. Accordingly, the holders of bank debt may disagree as to an appropriate debt-for-equity conversion formula with respect to each tranche of debt.

It is worth noting the typical Credit Agreement fails to address this issue as a contractual matter. Nevertheless, assuming that all tranches of bank debt under a Credit Agreement are secured *pari passu* by the collateral, one simple approach is to cause all holders of bank debt to agree on a single debt-for-equity conversion ratio. The key to this simple approach is to persuade the bank debt holders that the contractual differences among the several tranches are irrelevant because if the restructuring and recapitalization were to occur pursuant to a confirmed plan of reorganization in a chapter 11 case, then the only pertinent issue under the Bankruptcy Code is whether the bank debt is secured or undersecured. Accordingly, if persuaded, the bank debt holders may agree to ignore any contractual differences among the several tranches and agree to a *pro rata* debt-for-equity conversion ratio. To accomplish the *pro rata* debt-for-equity

conversion ratio, it is necessary for the restructuring document to provide for true-up provisions such that all debt holders (and their participants, if applicable) agree to swap their positions in all tranches of bank debt so all holders ultimately hold a *pro rata* share of all tranches of bank debt immediately prior to giving effect to the restructuring and recapitalization. It is important to note that if the simple (bankruptcy oriented) approach to true-up fails, then the possibilities for resolving the debt-for-equity conversion ratio based on the parties' differing contractual rights are myriad.

- (vi) *Waiver Versus Forbearance Under Senior Debt.* Under certain default circumstances, a senior lender group may choose to provide the Borrower with continued access to a capped revolver (so as to provide continued liquidity) while seeking an exit or alternative solution to a distressed situation. However, while the senior lending group may be willing to work with the Borrower as aforesaid, the senior lending group may nonetheless want to exercise rights against the subordinated debt (see Part B below). Accordingly, in this situation, the senior lending group will typically give the Borrower a forbearance arrangement (which preserves – but does not waive – any existing default). At the same time, the senior lending group will simultaneously exercise their rights against the subordinated debt by sending a blocking notice on account of the existing defaults – which, again, are not waived but acknowledged by the Borrower in the forbearance agreement. Typical provisions in a senior debt forbearance agreement agreeing to forbear on account of a specified default but allowing the Borrower to access the revolver may read as follows:

“Forbearance. Notwithstanding the occurrence and continuance of the Specified Events of Default, subject to the terms and conditions hereof, the Agent and the Lenders hereby agree to forbear, during the Forbearance Period, from the exercise of any and all rights or remedies under the Credit Agreement, the other Loan Documents and applicable law solely in respect of the Specified Events of Default.

Forbearance Events of Termination. Upon the occurrence of any of the following events:

- (a) the Borrowers or any other Loan Party shall default in the observance or performance of any agreement or covenant contained in this Forbearance Agreement;
- (b) the occurrence of a Default or Event of Default (other than the Specified Events of Default); or
- (c) the exercise of any rights or remedies, including without limitation, the acceleration of any amounts due or to become due, by any Subordinated Lender under or with respect to the Note Purchase Agreement or the Subordinated Debt issued pursuant thereto.

Continued Availability. Notwithstanding the occurrence and continuance of the Specified Events of Default, during the Forbearance Period, the Borrowers shall, subject to the terms and conditions of the Credit Agreement and the other Loan Documents, be permitted to (a) borrow, prepay and reborrow Revolving Credit

Loans and (b) open Letters of Credit; it being understood that the foregoing is not and shall not be construed as an amendment, waiver or modification of Sections 8.10, 8.11, 8.21(B), or 13.1(b) or 13.1(e) of the Credit Agreement (*provided, however, that solely for the purpose of permitting the Borrowers to satisfy Section 5.2(i) of the Credit Agreement with respect to the existence of Events of Default, the Specified Events of Default shall be deemed waived solely to the extent of the forbearance contained in Article II of this Forbearance Agreement.*)”

B. Subordination

- (i) *Contractual Subordination.* Contractual subordination arises when one or more tranches of debt agree(s) to become subordinated in right of payment to one or more tranches of senior debt. There are at least two key aspects of senior debt’s contractual superiority: (1) if there exists an event of default under the senior debt instrument, the borrower is generally prohibited from making any payment to subordinated debt and (2) in the event of an insolvency or bankruptcy, senior debt will generally be required to be paid in full before any distribution can be made to subordinated debt.
- (ii) *Structural.* In many cases, senior debt will have, and subordinated debt will not have, claims (by way of guarantees or otherwise) against a borrower’s operating subsidiaries. Accordingly, subordinated debt will, in many cases, be structurally subordinated to the subsidiaries’ obligations in respect of senior debt. Only if there is equity value in the subsidiaries after satisfaction in full of the senior debt will any equity value derived from such subsidiaries be permitted to be upstreamed to the borrower to satisfy subordinated debt.
- (iii) *Legal.* In many cases, the borrower will grant senior debt liens on its assets, but will not grant liens to subordinated debt. Accordingly, the proceeds of the collateral will be applied to the senior debt. Subordinated debt will not be entitled to any proceeds until the senior debt has been paid in full.

C. Blocking Periods.

- (i) *Generally.* In most cases, an event of default under the senior debt instrument will *not* constitute an event of default under the subordinated debt instrument. Rather, an event of default under the subordinated debt instrument will only arise once the senior debt has been accelerated. Upon the occurrence and during the continuance of an event of default under the senior debt instrument, senior debt will **generally** be entitled to enforce its rights against the subordinated debt, **including**, without limitation, exercising its right to block the subordinated debt (discussed below).
- (ii) *Automatic Blocking Period.* To the extent that an event of default under the senior debt instrument arises from a payment default (*i.e.*, principal or interest), the subordinated debt is generally not permitted to enforce any remedies or receive any payments or other distributions to which it may otherwise be entitled, until such time as the payment event of default under the senior debt instrument has been either cured or waived.

(iii) *Optional Blocking Period.* To the extent that an event of default under the senior debt instrument arises from a default, other than a payment default, senior debt will generally be entitled to, upon providing proper notice thereof, block the subordinated debt from enforcing any remedies or receiving any payments or other distributions to which it may otherwise be entitled, until the earlier of (1) the date on which the event of default has been either cured or waived or (2) a period of time generally ranging from 150-200 days. Senior debt usually will only be able to invoke this blocking period once per year and in certain cases, subject to an aggregate number of times.

D. Subordinated Debt Enforcement Rights

- (i) *Enforcement.* Subordinated debt may accelerate the debt under the subordinated notes and/or commence a lawsuit to recover monies lent to the borrower. However, in many cases, subordinated debt will enforce its rights only after exhausting all possibilities because, among other things, (1) the senior debt may be contractually, structurally and/or legally superior to the subordinated debt, (2) the senior debt may enforce blocking periods and (3) the borrower may file for bankruptcy protection to prevent the subordinated debt from fully exercising its rights.
- (ii) *Involuntary Proceeding.* Subordinated debt may accelerate the subordinated notes and file an involuntary petition against the borrower. However, this is a “scorched earth” approach and in most cases will not be utilized unless subordinated debt is at “war” with senior debt. Subordinated debt will, in many cases, fare far worse than senior debt in a bankruptcy, because, among other things, (1) the absolute priority rule (discussed below) will provide the senior debt with priority over unsecured lenders with respect to the collateral securing the borrower’s obligations and (2) subordinated debt may be subordinated to interest accruing on senior debt after the commencement of a bankruptcy case (discussed below). Accordingly, so long as a deal and/or restructuring may be worked out, it may not be economically rational for the subordinated debt to force an involuntary bankruptcy filing.

E. Priority in Bankruptcy

- (i) *Absolute Priority Rule.* The Bankruptcy Code imposes the absolute priority rule in respect of payments to various classes of debt. According to the absolute priority rule, the most senior class of debt must be paid in full, prior to the next most senior class being paid anything. Secured debt is superior to unsecured debt, and, accordingly, secured lenders will have priority over unsecured lenders with respect to the collateral securing the borrower’s obligations to the secured lenders.
- (ii) *X-Clause.* The X-Clause is an exception to the subordination provisions typically found in subordinated debt instruments. It permits subordinated debt to receive, in the context of a bankruptcy filing, a distribution of subordinated securities notwithstanding that the senior debt has not been paid in full. However, to the extent senior debt is structurally superior to subordinated debt, the X-Clause becomes far less significant because the claims of the senior debt at the operating

level must be satisfied before any value is available to upstream to the borrower to satisfy subordinated debt.

- (iii) *Rule of Explicitness.* Generally, bankruptcy law does not allow an under-secured creditor to accrue post-petition interest. Nonetheless, courts have been willing to enforce subordination provisions providing for the payment of senior debt's post-petition interest from distributions otherwise payable to subordinated debt. The subordination provisions must meet the "rule of explicitness" (*i.e.*, must be undeniably clear that the senior obligations include post-petition interest, whether or not constituting an allowable claim in bankruptcy or similar proceeding).

F. Dealing with Private Subordinated Debt versus Public Subordinated Debt

While it is beyond the scope of this paper to address the issues raised by dealing with the different types of subordinated debt, it is worth noting that the identity and type (public versus private or highly concentrated) of subordinated debt holders may affect the outcome of a workout. Moreover, if the subordinated debt is public, the federal securities may be implicated which introduce a further layer of complication into workouts.

V. **Certain Bankruptcy Issues.**

A. Claims in Bankruptcy and Debt Trading

- (i) *Proofs of Claim.* Bankruptcy Rule 3001(b) states that proofs of claim may be filed by a creditor or an agent of the creditor. Agency must be conferred by agreement or statute. Generally, in order for a creditor to file a proof of claim, it must be in privity with the debtor. A creditor that has purchased a participating interest in a Credit Agreement cannot file a proof of claim because it is not in privity with the debtor.
- (ii) *Voting.* Section 1126(e) of the Bankruptcy Code permits the Bankruptcy Court to refuse to count the votes of those "whose acceptance or rejection of [a] plan was not in good faith." By way of example, the Bankruptcy Court disallowed a creditor's vote against a debtor's plan of reorganization where the creditor purchased two classes of claims and made a public tender offer to purchase an additional two classes of claims. *See In re Allegheny International, Inc.*, 118 B.R. 282 (Bank. W.D. Pa. 1990). The Bankruptcy Court concluded that the creditor's vote was cast in bad faith because the creditor purchased the claims to vote against the debtor's plan of reorganization and to further its takeover attempt and was not taken to advance the creditor's interest as a creditor. *Id.* However, defining good faith is a fact intensive and court sensitive evaluation. For example, the Bankruptcy Court allowed the vote of a creditor against a debtor's plan of reorganization notwithstanding the fact that it purchased 21 of the debtor's 34 unsecured claims for the purpose of voting against the debtor's plan of reorganization. *See Figter Ltd. v. Teachers Ins. and Annuity Ass'n of America (In re Figter Ltd.)*, 118 F.3d 635 (9th Cir. 1997). The Bankruptcy Court concluded that the creditor purchased the claims because it feared that if the debtor was not successful in implementing its plan of reorganization, which was based upon the conversion of rental units to condominiums, the creditor would lose substantial value in its collateral and be stuck with a security interest in a building that was part rental and part condominium. *Id.*

- (iii) *Debt Trading.* Prior to the 1991 amendments, Bankruptcy Rule 3001(e) was used by Bankruptcy Courts to police debt trading. Although the 1991 amendments to Bankruptcy Rule 3001(e) were designed, in part, to clarify that this rule was not intended to restrict debt trading, it is unclear whether an objecting transferor may object to a transfer based upon fraud or misrepresentation or whether a court can, *sua sponte*, challenge a transfer.

B. DIP Lending

- (i) *Reasons to become DIP lender.* Generally, lenders to a pre-petition credit facility will want to lend into a post-petition credit facility because (1) post-petition lenders may be entitled to super-priority claims (as explained below), (ii) post-petition lenders may be entitled to liens on assets not previously encumbered, junior liens on previously encumbered assets and super-priority liens (as explained below) and (iii) pre-petition lenders may be primed by post-petition lenders if they do not become part of a post-petition syndicate.
- (ii) *Super-Priority Status.* To the extent that a trustee or debtor-in-possession is unable to obtain unsecured credit as an administrative expense, it may, after notice and a hearing, provide DIP lenders, with claims that rank in priority above all other claims (other than secured claims), subject, generally, to carve-outs for professional fees and statutory expenses. *See* Section 364(c) of the Bankruptcy Code
- (iii) *Additional Liens.* To the extent that a trustee or debtor-in-possession is unable to obtain unsecured credit as an administrative expense, it may, after notice and a hearing, provide post-petition lenders with liens on assets not previously encumbered and junior liens on assets previously encumbered by third parties. *See* Section 364(c) of the Bankruptcy Code.
- (iv) *Super-Priority Liens.* A trustee or debtor-in-possession may be able to provide post-petition lenders with liens that prime previously existing liens if, after notice and a hearing, (1) the trustee or debtor-in-possession is unable to otherwise obtain secured or unsecured credit and (2) there is adequate protection of the current lienholder's interest in such assets. *See* Section 364(d) of the Bankruptcy Code.
- (v) *Wrap-Around Facilities.* One method of protecting a pre-petition lender's secured status and reducing its exposure under a pre-petition credit facility, *vis-à-vis* a post-petition credit facility, is to use a "wrap-around facility". A wrap-around facility works to replace pre-petition debt with post-petition debt and thereby allows a pre-petition lender to take advantage of the security interests and priority claims afforded lenders under the post-petition credit facility. As the debtor uses cash collateral otherwise belonging to the post-petition lenders, the cash collateral is automatically deemed to prepay the pre-petition facility and be re-loaned through the post-petition facility.

VI. Certain Confidentiality Issues.

The following points should be considered in connection with the workout of syndicated loan facilities:

- A. How to manage the flow of confidential information to one or more lenders that play multiple roles in respect of the Borrower. For example, the Agent Bank, may also be a lender, an underwriter in respect of subordinated debt and an investment banking arm of the Agent Bank may play a role as the borrower's investment banker. Also, one or more lenders may be a holder of subordinated debt.
- B. What is the impact of confidentiality provisions in credit agreements with respect to sharing information with one or more of a lender's affiliates?
- C. Whether is it possible to obtain a consent from the borrower to share information among the lender's affiliates as part of an amendment or forbearance agreement.
- D. (i) Whether sharing the content of strategy discussions among members of a syndicate with a lender's affiliate may cause harm to the syndicate and (ii) whether a lender's role as the Agent Bank or simply as a syndicate member impacts the decision to share.
- E. Whether it is appropriate for a lender that is a member of the senior lending syndicate and is also a holder of subordinated debt, to have the same officer manage both loan facilities or whether it is necessary to erect "walls" between relationship managers.