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Walk the Line: Pushing Lenders' Rights to the Limits

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Walk The Line: Pushing Lenders' Rights to The Limits

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Topic: This panel will explore the enforceability of special purpose entities, springing guarantees, blocking directors, and intercreditor agreements.

I. Special Purposes Entities
II. Springing Guarantees
III. Blocking Directors
IV. Intercreditor Agreements

SPEs, "Springing" Guaranties, Blocking Provisions, and What Do They Have to Do With Me

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I. INTRODUCTION

While insolvent companies have the statutory right to file for bankruptcy protection, lenders have many devices at their disposal to discourage such actions. Amongst the most popular are "springing" guaranties and special purpose entities, which deter rather than outright bar a borrower's rights under the Bankruptcy Code. Some lenders have also creatively drafted loan agreements, forbearances, and the like to require amendments to a debtor's organizational documents, giving the lender a "golden share" or control of a "blocking director," all with the aim of discouraging, perhaps prohibiting a debtor's ability to file an unauthorized bankruptcy petition. The following provides a debtor's perspective on how financially distressed companies can mitigate the impact of such devices.

II. SPRINGING GUARANTIES

Waiver of a debtor's right to file for bankruptcy is unenforceable as against public policy.[1] Yet lenders are able to strongly disincentivize bankruptcy filing by negotiating a guaranty which triggers or "springs" the recourse obligations of the guarantor upon an adverse event – *i.e.* if the pledged collateral dips below a certain dollar value, if the borrower fails to produce a certain income stream, or the most common and most relevant to the discussions herein, where the borrower files for bankruptcy.

By triggering personal liabilities of guarantors, lenders are able to reduce bankruptcy risks. While proponents maintain that this mechanism allows lenders to receive the benefits of their bargains, this practice could be deceptive in certain contexts where "springing" guaranties are used by sophisticated lenders in financing deals with closely-held companies. By holding less savvy business owners liable for obligations that are non-recourse only in name, lenders are able to sidestep the bankruptcy process.

A review of recent Ninth Circuit and Tenth Circuit decisions demonstrates that courts generally uphold "springing" guaranties, despite them having substantially the same impact as a stipulated waiver of bankruptcy protection. However, a number of cases discussed below provide countermeasures for debtors and guarantors.

[1] *Bank of China v. Huang (In re Huang)*, 275 F.3d 1173, 1177 (9th Cir. 2002); *Continental Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.),* 671 F.3d 1011, 1026 (9th Cir.2012).

A. Public Policy Concerns

"It is against public policy for a debtor to waive the prepetition protection of the Bankruptcy Code."[2] As explained by one court, "since bankruptcy is designed to produce a system of reorganization and distribution different from what [one] would obtain under nonbankruptcy law, it would defeat the purpose of the Code to allow parties to provide by contract that the provisions of the Code should not apply."[3]

Despite having the practical effect of a bankruptcy waiver, courts have generally found "springing" guaranties to not run afoul of public policy.[4] Many courts do not consider the policy arguments, and instead decide to uphold actions against the guarantors on the plain language of the guaranty agreements.[5] In *U.S. Bank, Nat. Ass'n v. Kobernick*,[6] the subject "springing" guaranty provision required that upon filing by the debtor, assets of a non-debtor entity wholly-owned by the guarantor would become an asset in the bankruptcy, and based thereon, the guarantor challenged the provision on public policy grounds.[7] The court dismissed the bankruptcy case, and held that merely converting the loan to a fully recourse loan is not a waiver of bankruptcy rights.[8]

B. Ipso Facto Concerns

As concerns the enforceability of "springing" guaranties in the context of *ipso facto* challenges under 11 U.S.C. § 365(e)(1), courts have determined that because section 365 only applies in the context of executory contracts, it is generally inapplicable to loan agreements.

In *In re JPMCC 2007-C1 Grasslawn Lodging, LLC v. Dix*,[9] Transwest Hilton Head Property, LLC and Transwest Tuscon Property, LLC entered into a loan agreement with JP Morgan, in the amount of $209 million for the purchase and acquisition of two hotels in Tucson, Arizona. *Id.* Its principal executed and delivered a "Guaranty of Recourse Obligations of Borrower" for the benefit of JP Morgan, where he "absolutely and unconditionally, jointly and severally, guaranties to the lender the prompt and unconditional payment of the Guarantied Recourse Obligations of Borrower," and that "if Borrower shall have taken advantage of or be subject to the protection of any provision in the Bankruptcy Code . . . the Debt shall become due and payable, Lender may, as against Guarantor."[10]

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[2] *In re Huang*, 273 F.3d 1173 (9th Cir. 2002); *In re Cole*, 226 B.R. 647, 652 (B.A.P. 9th Cir. 1998).
[3] *In re 203 N. LaSalle St. P'Ship*, 246 B.R. 325, 331 (Bankr. N.D. Ill 2000)
[4] *See Bank of America, N.A., et al., v. Lightstone Holdings, LLC, et al.*, 2011 BL 396859 (N.Y. Sup. Ct. July 14, 2011); *BayNorth Realty Fund VI, L.P. v. Shoaf*, 27 Mass. L. Rptr. 502 (Mass. Super. Ct. Oct. 19, 2010); *In re Extended Stay Inc.*, 418 B.R. 49, 59 (Bankr. S.D.N.Y. 2009) ("public policy arguments relating to the guaranty claims [were] of minimal relevance.").
[5] *See GCCFC 2006-GG7 Westheimer Mall, LLC v. Okun*, 2008 WL 3891257 (S.D.N.Y. 2008); *Wells Fargo Bank N.A. v. Cherryland Mall L.P.*, 812 N.W.2d 799 (Mich. App. 2011).
[6] *U.S. Bank, Nat. Ass'n v. Kobernick*, 454 F. App'x 307 (5th Cir. 2011) (unpublished)
[7] *Id.* at 313.
[8] *Id.*
[9] *In re JPMCC 2007-C1 Grasslawn Lodging, LLC v. Dix*, 2013 WL 140039 (D. Ariz. 2013)
[10] *Id.* at *1-2

The guarantor argued that the guaranty is an unenforceable *ipso facto* clause under section 365(e)(1) of the Bankruptcy Code.[11] Based on the premise that *ipso facto* prohibitions are only applicable to executory contracts and unexpired leases, the Arizona District Court held that since the lender had already advanced funds pre-petition and no other material obligations remained on its part, the underlying loan agreement was not an executory contract, and section 365(e)(1) therefore does not apply.[12] A resulting judgment was entered against the guarantor in the total amount of approximately $307 million.

Despite the general enforceability of "springing" guaranties, distressed companies that have exhausted all workout options still have tools at their disposal to invoke their bankruptcy rights. The following section discusses ways in which "sprang" guarantors can successfully ward off recourse obligations.

C. Strategy for Debtors in the Ninth Circuit and Tenth Circuit to Counteract "Springing" Guaranties

1. Request for Injunctive Relief / Motion to Extend Automatic Stay to Guarantors

Generally in a chapter 11 case, the protections of 11 U.S.C. §362 do not extend to non-debtor third parties.[13] As such, under the statutory predicates of 11 U.S.C. §§362(a)(1), (a)(3) and 105(a), non-filing guarantors must affirmatively seek an order from the bankruptcy court to that effect.[14]

One strategy would be to seek to extend the stay until confirmation of the debtor's reorganization plan, on the basis that the guarantor "owns assets which will either be a source of funds for the debtor or when the preservation of the non-debtor credit standing will play a significant role in the debtor's attempt to reorganize."[15]

In the Ninth Circuit, section 105(a) empowers the bankruptcy court to stay actions that are not subject to the automatic stay but "threaten the integrity of a bankrupt's estate."[16] The burden of proof rests on the movant to balance a set of factors derived from the preliminary injunction standard: (1) the debtor's reasonable likelihood of a successful reorganization; (2) irreparable harm

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[11] *Id.* at *5.
[12] *Id.* at *6-7 (citing *In re Growth Properties, Inc.*, 451 B.R. 323, 330 (Bankr. S.D.N.Y. 2011); *see also First Nationwide Bank v. Brookhaven Realty Assoc.*, 223 A.D. 2d 618, 620 (N.Y. App. Div. 2d. Dept. 1996) ("the court properly found that section 365(e) did not apply herein because a mortgage is not an "executory" contract as defined under the Bankruptcy Code.").
[13] *See 11 U.S.C. §362(a)(1); see Oklahoma Federated Gold & Numismatics, Inc. v. Blodgett*, 24 F.3d 136, 141 (10th Cir. 1994); *see contra 11 U.S.C. §1301(a)(which extends the automatic stay to non-filing co-debtors)*.
[14] *See Otoe County Nat'l Bank v. W & P Trucking Inc.*, 754 F.2d 881 (10th Cir. 1985) (holding that guarantors of the debtor were required to seek an extension of stay under 11 U.S.C. §105); *see also C.H. Robinson Co. v. Paris & Sons, Inc.*, 180 F. Supp 2d 1002 (N.D. Iowa 2001).
[15] *In re Marley Orchards Income Fund I, Ltd. Partnership*, 120 B.R. 566, 570 (Bankr. E.D. Wash. 1990); *see Dominquez v. Schwarzenegger*, 596 F.3d 1087, 1092 (9th Cir. 2010) ("[W]here the claim against the third party would harm the debtor's ability to reorganize," "it makes sense to require a showing of a reasonable likelihood of a successful reorganization.").
[16] *In re Excel Innovations, Inc.*, 502 F.3d 1086, 1093 (9th Cir. 2007).

to the estate in the absence of preliminary relief; (3) the balance of harms and equities; and (4) interest of the public.[17]

Similar to the Ninth Circuit, the Tenth Circuit has held that section 362(a) may extend to non-debtor parties "when there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party defendant will in effect be a judgment or finding against the debtor."[18] Examples of "identity of interest" include: (1) where issues between the debtor and the non-debtor and opposing party are "intimately intertwined";[19] possibility of inconsistent results if both cases were to proceed on parallel tracks[20], the third party is entitled to indemnification from the debtor;[21] where enforcement against the guaranty would diminish an important property of the estate;[22] and where irreparable harm would be suffered by the debtor if actions were to proceed against the non-debtor party.[23]

From a practical perspective, proceeding with a motion on the foregoing bases serves to provide debtors and guarantors some much needed leverage to negotiate for an extension of the stay. Perhaps in exchange for a shortened timeframe to confirm a plan of reorganization. Even if the negotiation fall short, it would be wise to proceed expediently in seeking a preliminary injunction as creditors will likely proceed hastily to seek recourse pursuant to the guaranty. This strategy is especially compelling as "[i]n the early stage of the case, 'the burden of proof ... is satisfied if the debtor can offer sufficient evidence to indicate that a successful reorganization within a reasonable time is 'plausible.'"[24]

2. Plan Carve Out

Attaining an extension of the bankruptcy stay is only the first step, debtors and guarantors must prepare for the end-game vis-à-vis confirmation of their chapter 11 plans. Section 524(e) of the Bankruptcy Code presents an obstacle for guarantors: "[e]xcept as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."[25]

While prevailing law in the Ninth Circuit and the Tenth Circuit is to preclude bankruptcy courts from discharging liabilities of non-debtor guarantors[26], the Arizona District Court in *In re*

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[17] *Id.* 1095-96 (considered whether an arbitration proceeding against the debtor's former CEO should be stayed).
[18] *Oklahoma Federated Gold and Numismatic, Inc. v. Blodgett*, 24 F.3d 136, 141 (10th Cir. 1994); *see Fleet Business Credit, L.L.C. v. Wings Restaurants, Inc.*, 291 B.R. 550, 553 (N.D. Okla. 2003) (citing *In re North Star Contracting Corp. v. McSpedan, 125 B.RT. 368, 370-71 (S.D.N.Y. 1991).*
[19] *Leach v. SkyWi, Inc.*, 2010 WL 11618808, at *2 (D. N.M. 2010) (citing *In re Freidman's, Inc*., 336 B.R. 896, 897-98 (S.D. Ga. 2005).
[20] *Id.*
[21] *North Star Contracting Corp*, *supra*, at 371; *see In re Brentano's*, 27 B.R. 90 (S.D.N.Y. 1983) (an judgment against the guarantor would result in the indemnification liability of the debtor, and therefore, the guaranty action was in effect one against the debtor and qualifies for relief under section 362(a)(1)).
[22] *See In re Johns Manville Corp.*, 33 B.R. 254, 261 (S.D.N.Y. 1984).
[23] The Fourth Circuit applied this test in *Televest v. Bradshaw*, 618 F.2d 1029, 1032 (4th Cir. 1980).
[24] *In re Sun Valley Newspapers, Inc.,* 171 B.R. 71 (B.A.P. 9th Cir. 1994) citing *In re Holly's Inc.*, 140 B.R. 643, 700 (Bankr.W.D.Mich. 1992)
[25] 11 U.S.C. §524(e).
[26] *See Landsing Diversified Props.-II v. First National Bank & Trust Co. (In re Western Real Estate Fund, Inc.)*, 922 F.2d 592, 601-02 (10th Cir. 1992); *see also Resorts International, Inc. v. Lowenschuss*, 67 F.3d 1394 (9th Cir. 1995)

Linda Vista Cinemas, L.L.C.[27] left open the question of whether a *temporary* post-confirmation injunction can be enforced in favor of the debtor's guarantors.[28]

There, Linda Vista Cinemas, L.L.C. entered into a $5 million loan agreement with Bank of Arizona to develop a movie multiplex; the underlying note were secured by assets of the debtor, as well as "continuing guaranties" from several individuals and entities.[29] After falling behind on payments, Linda Vista filed a voluntary chapter 11 petition in May of 2010 to prevent Bank of Arizona from foreclosing on pledged collateral.[30] The bankruptcy court, shortly thereafter, entered an order enjoining the bank from foreclosing on assets of the guarantors under 11 U.S.C. §105(a). *Id.*

In September of 2010, the debtor filed its plan of reorganization, which included a "temporary conditional injunction" against Bank of Arizona. The injunction was described by the Debtor as "narrowly tailored' and "only sought to prohibit the bank from proceeding against the guarantors and their property so long as the debtor did not default under the terms of the plan."[31] Further, the plan terms expressly stated that "the Debtor's guarantor's liability to the Bank [of] Arizona was not extinguished or discharged, nor was any of their real or personal property released from the Bank's prepetition lien" and that it will "retain all of its prepetition rights against the guarantors and their collateral after confirmed of the proposed Plan." [32]

The bankruptcy court found the plan provision to violate section 524(e); however, the debtor successfully certified its direct appeal to the Ninth Circuit Court of Appeals.[33] In its opinion granting the direct appeal, the Arizona District Court held that "there is no controlling Ninth Circuit or Supreme Court authority addressing the issue," and that "there is substantial ground for difference of opinion as to whether a non-permanent injunction can be issue[d] post-confirmation."[34]

While the parties ultimately resolved the case before the Ninth Circuit appeal, the Arizona District Court's decision to grant immediate appeal bodes well for debtor attorneys to press forth with this strategy to offset the impact of "springing" guaranties. In fact, the most telling line of the opinion was offered *in dicta*: "[i]t does not appear the proposed Plan in this case would be inequitable – it does not involve a permanent injunction and does not affect the ultimate liability of the Guarantors."[35] At the very least, this opinion leaves room for guarantors to bargain for a temporary plan injunction.

"This court has repeatedly held, without exception, that § 524(e) precludes bankruptcy courts from discharging the liabilities of non-debtors.").

[27] *In re Linda Vista Cinemas, L.L.C.*, 2011 WL 1743312 (D. Ariz. 2010)

[28] Bankruptcy courts in other circuits have held such provisions to be enforceable. *See In re Seatco, Inc.*, 257 B.R. 469, 475 (Bankr. N.D. Tex. 2001) (chapter 11 plan provision which temporary enjoined a creditor from collecting against a guaranty did not violate section 524(e)).

[29] *Linda Vista*, *supra*, at *1.

[30] *Id.*

[31] *Id.*

[32] *Id.*

[33] *Id.* at *2.

[34] *Id.*

[35] *Id.* at *3.

III.
SPECIAL PURPOSE ENTITIES (SPE)

Single purpose entities ("SPE") provide additional safeguards for creditors. By structuring a financing arrangement where an entity is formed to own and operate isolated assets, creditors can minimize financial and bankruptcy risks in case the original entity becomes insolvent.

A. Policy Concerns

On one hand, the use of SPEs embodies freedom of contract and affords better financing terms to borrowers. Further, borrowers at least in principle may avoid certain inherent bankruptcy costs – *i.e.* the legal costs of participating in bankruptcy proceedings and delay in payment or the possibility of pledged collateral being encumbered or used to pay other debts. On the other hand, allowing a creditor – especially one who has no duty to shareholders/creditors – to have the ultimate say in blocking a distressed entity's right to seek bankruptcy relief is contrary to federal public policy.

B. Defending Against Dismissal Arising under Section 1112(b)

The bankruptcy remoteness of an SPE is created using negative covenants to preclude bankruptcy filings in organizational documents and/or the appointment of creditors/creditor-friendly parties as directors/members of the SPE with bankruptcy sufficient shares to veto a bankruptcy filing – better known as "golden shares."

1. Defeating Negative Covenants in Operating Agreements

Filing a petition in the face of embedded bankruptcy remote provisions are sure to be met with motions for dismissal under 11 U.S.C. §1112(b).[36] A debtor counsel's role is therefore to convince the court that such provisions arise to improper pre-petition waivers of federal bankruptcy rights, even in the face of applicable state law governing the formation and corporate governance of the debtor.

As explained by one bankruptcy court,

> A provision in a limited liability company governance document obtained by contract, the sole purpose and effect of which is to place into the hands of a single, minority equity holder the ultimate authority to eviscerate the right of that entity to seek federal bankruptcy relief, and the nature and substance of whose primary relationship with the debtor is that of creditor—not equity holder—and which owes no duty to anyone but itself in connection with an LLC's decision to seek federal bankruptcy relief, is tantamount to

[36] *In re Real Homes, LLC*, 352 B.R. 221, 225 (Bankr. D. Idaho 2005) (whether a case can be commenced or whether one has authority to file a petition is determined under state law).

> an absolute waiver of that right, and, even if arguably permitted by state law, is void as contrary to federal public policy.[37]

Where a bankruptcy remote provision is included in the loan agreement, rather than the operating agreement or the partnership agreement, as the case may be, courts are more likely to deem such provisions to be void as against public policy because they were coerced rather than consented to by borrowers.

Courts in the Ninth Circuit have taken a more debtor-friendly view; one recent case has held the above distinction to be a "distinction without meaningful difference."[38] In *In re Bay Club Partners – 472, LLC*, Bay Club was formed to acquire and operate an apartment complex in Mesa, Arizona. As part of its $23 million loan, the operating agreements of Bay Club incorporated a restrictive covenant to prohibit bankruptcy protection.[39] The loan terms were renegotiated four times in the first eight years, but by the ninth year, discussions of forbearance broke down, and upon receipt of the lender's notice of default, Bay Club's managing members signed a consensual resolution to effectuate a chapter 11 bankruptcy filing.[40]

The lenders responded with a motion to dismiss under section 1112(b) primarily on the basis that the operating agreement of the LLC strictly prohibited filing, and that the members of Bay Club had acquiesced to the negative covenant and that the decision had not been coerced by the lender vis-à-vis its loan agreements.[41] In denying the motion and deeming the waiver provisions as void as against public policy, the court found that lenders had negotiated for and insisted on the pre-petition waiver of the SPE's bankruptcy rights, which the court characterized as a "maneuver of an "astute creditor" and "cleverly insidious."[42]

Case law on this topic in the Tenth Circuit are few and far between. However, an unpublished case from the Bankruptcy Appellate Panel ("BAP") of the Tenth Circuit provides guidance. In *In re DB Capital Holdings, LLC v. Aspen HH Ventures LLC (In re DB Capital Holdings, LLC)*,[43] at issue were amendments in the operating agreement of a specially created LLC for the purpose of developing and selling luxury condos in Aspen, Colorado.[44] The amendments specifically prohibited the general partner from commencing bankruptcy proceedings on the debtor's behalf.[45] The manager commenced the case, which was met with the creditor's motion to dismiss.

The bankruptcy court found that the manager did not have the authority to file its petition and the case was dismissed shortly thereafter. The panel affirmed the bankruptcy court's ruling in finding the remote provision of the operating agreement to be valid. It held that "a bankruptcy

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[37] *In re Intervention Energy Holdings, LLC*, 553 B.R. 258, 265 (Bankr. D. Del. 2016).
[38] *In re Bay Club Partners – 472, LLC*, 2014 WL 1796688, at *5 (Bankr. D. Or. 2014).
[39] *Id.* at *1.
[40] *Id.*
[41] *Id.* at *1-2.
[42] *Id.* at *5.
[43] *In re DB Capital Holdings, LLC v. Aspen HH Ventures LLC (In re DB Capital Holdings, LLC)*,[43] 462 B.R. 142 (B.A.P. 10th Cir. 2010) (unpublished)
[44] *Id.*
[45] *In re DB Capital Holdings, LLC v. Aspen HH Ventures LLC (In re DB Capital Holdings, LLC)*, 462 B.R. 142, at *1 (B.A.P. 10th Cir. 2010) (unpublished)

case filed on behalf of an entity without authority under state law to act for that entity is improper and must be dismissed."[46] Despite the argument presented by filing manager that the bankruptcy remote provision was added "for the sole benefit of Debtor's main secured creditor," the panel noted that the creditor was not a party to any agreement waiving the debtor's right to seek bankruptcy protection and that members of the debtor decided amongst themselves to limit the power of a member to file for bankruptcy.[47]

The main takeaway from the above cases is that absent any showing of coercion, an agreement to control bankruptcy filing is not against public policy. No courts in the Ninth and Tenth Circuits have expanded upon the seminal case, *In re Kingston Square Associates,*[48] where the court held that a general partner's solicitation of votes in orchestrating an involuntary petition against the company, in order to bypass the bankruptcy remote provision in the debtor's corporate bylaws, is "suggestive of bad faith, [but] that fact alone was not sufficient grounds for dismissal [under 11 U.S.C. §1112(b)."[49] And that because the bankruptcy was necessary for prevent loss to the estate and that reorganization was possible, the case is not deserving of dismissal.[50]

Sparse case law on this topic makes it difficult for borrowers to fight against bankruptcy remote provisions. For companies entering into financing deals with securitization through an SPE, the best approach as of now is to carefully review loan agreements and SPE corporate documents for negative covenants regarding the authority to file.

2. Defeating Blocking Directors or Holders of "Golden Shares"

The decision of the Southern District of New York bankruptcy court in *General Growth Properties*[51] to allow a bankruptcy remote SPE to voluntarily file for chapter 11 bankruptcy has placed doubt in the future viability of "golden shares" in SPEs. The court there held, *inter alia*, that the debtor's replacement of two independent directors, 30 days prior to filing, was not deemed bad faith because there were legitimate business reasons for new directors – including their background in bankruptcy and real estate.[52]

Independent directors must participate in the management of SPE and perform board functions and adhere to the duty of loyalty of a director under relevant state law, particularly where the director has been named to the board based on the lender's requirement of the same to disincentivize a debtor from filing a bankruptcy petition without the lender's approval.[53] In line

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[46] *Id.* at *2.
[47] *Id.* at *2-3.
[48] *In re Kingston Square Associates*, 214 B.R. 713 (Bankr. S.D.N.Y. 1997)
[49] *Id.* at 734.
[50] *Id.*
[51] *In re General Growth Properties*, 409 B.R. 43 (Bankr. S.D.N.Y. 2009).
[52] *Id.* at 54-55.
[53] The key appears to be the fiduciary duties that have been undertaken by the independent director or holder of the "golden share." For instance, where a lender required debtor to amend its operating agreement to add lender as a "special member" but also explicitly disclaimed any fiduciary duties to the debtor, the lender's subsequent motion to dismiss the bankruptcy petition based on the lack of its consent was denied. *See In re Lake Mich. Beach Pottawattamie Resort, LLC*, 547 B.R. 899, 913 (Bankr. N.D. Ill. 2016) ("The essential playbook for a successful blocking director structure is this: the director must be subject to normal director fiduciary duties and therefore in some circumstances vote in favor of a bankruptcy filing, even if it is not in the best interests of the creditor that they

with this principle, in *In re Intervention Energy Holdings, LLC*,[54] the court held a blocking provision/golden share to be void against public policy, where in exchange for waiving all defaults, the debtor agreed to give creditor one common share in exchange for $1 and amended its operating agreement to require unanimous consent of all members in order to file bankruptcy.[55] In *In re Lexington Hospitality Group*, the court denied a motion to dismiss filed by the lender where the provisions in the amended operating agreement granted a lender-controlled entity a minority membership interest plainly intended to give the lender a veto right over the debtor's ability to file a bankruptcy petition.[56]

Recently, the Fifth Circuit discussed the question of whether golden share or blocking provisions are valid and enforceable, or contrary to bankruptcy policy.[57] In *In re Franchise Services of North America*, a party who was both the sole preferred shareholder, as a result of the debtor's reincorporation as a condition to obtaining the shareholder's new investment, and an unsecured creditor moved to dismiss the debtor's chapter 11 bankruptcy petition because the debtor did not allow the party to vote its shares in favor of (or in opposition to) the bankruptcy petition. The bankruptcy court agreed with the shareholder/creditor, dismissed the petition, and the Fifth Circuit affirmed, stating that "[f]ederal law does not prevent a bona fide shareholder from exercising its right to vote against a bankruptcy petition just because it is also an unsecured creditor."[58] The Fifth Circuit pointed out that the terms "golden share" and "blocking provision" are sometimes used interchangeably, but are not synonymous nor precisely defined: "[c]ourts appear to use the term 'blocking provision' as a catch-all to refer to various contractual provisions through which a creditor reserves a right to prevent a debtor from filing for bankruptcy", while, on the other hand, "a 'golden share' is a share that controls more than half of a corporation's voting rights and gives the shareholder veto power over changes to the company's charter."[59] The Fifth Circuit was persuaded that the moving party's $15 million equity stake was more meaningful to the party than its $3 million unsecured claim, making it highly unlikely that a creditor would invest $15 million to ensure the debtor's payment of its $3 million unsecured claim.[60] The court held that there was "no evidence that [the] arrangement was merely a ruse to ensure that [debtor] would pay [creditor's unsecured] bill" and distinguished the case from other decisions where creditors sought a seat at the directors' table precisely to compel the debtor to pay the outstanding obligation to the creditor.[61] In conclusion, the Fifth Circuit acknowledged "[a] different result might be warranted if a creditor with no stake in the company held the [shareholder's right to vote on filing a

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were chosen by."); *see also In re Lexington Hosp. Grp.*, 577 B.R. 676, 684 (Bankr. E.D. Ky. 2017) ("A requirement that an independent person consent to bankruptcy relief, properly drafted, is not necessarily a concept that offends federal public policy. The appointment of an independent person to help decide the need for a bankruptcy filing may suggest fairness on all sides. The input of a truly independent decision maker avoids the fear and risk that a member or manager will act in its own self-interest.")

[54] *In re Intervention Energy Holdings, LLC*, 553 B.R. 258 (Bankr. D. Del. 2016).

[55] *Id* at 264.

[56] *In re Lexington Hosp. Grp.*, 577 B.R. 676, 683 (Bankr. E.D. Ky. 2017) ("[C]ontractual provisions in operating agreements that essentially prohibit a company's availability to file bankruptcy without a creditor's consent are void.")

[57] *See In re Franchise Servs. of North America, Inc.*, 891 F.3d 198 (5th Cir. 2018).

[58] *Id.* at 203.

[59] *Id.* at 205.

[60] *Id.* at 208.

[61] *Id.*

bankruptcy petition]. So too might a different result be warranted if there were evidence that a creditor took an equity stake simply as a ruse to guarantee a debt."[62]

[62] *Id.* at 209.

Negotiating and Drafting Intercreditor Agreements

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I.
INTRODUCTION

Intercreditor agreements define the relative rights, remedies, and obligations of creditors extending financing to a common borrower. When that borrower files bankruptcy, the terms of intercreditor/subordination agreements may have a significant impact on a subordinate creditor's ability to meaningfully participate in the bankruptcy case. Intercreditor agreements that fail to address, or ambiguously address, the relative rights of the senior and junior lenders in an enforcement or bankruptcy context create circumstances prime for litigation between the creditors, which may adversely affect, or at least delay, the reorganization process.

While all terms of an intercreditor agreement are open to negotiation depending on the interests of the competing lenders and the context of the loans, most intercreditor agreements are based on standardized forms. In 2010, an ABA task force promulgated a 77-page annotated model form of Intercreditor Agreement for use in a traditional first lien/second lien/common collateral context.[63]

II.
INTERPRETATION AND ENFORCEMENT

The Bankruptcy Code recognizes the enforceability of subordination agreements. 11 U.S.C. §510(a). Nevertheless, some courts have expressed a willingness to restrict the enforcement of onerous intercreditor agreements that are perceived to impermissibly restrict the statutory rights granted creditors under the Bankruptcy Code, or otherwise to be inequitable. The intent of §510(a) (subordination) is to allow the consensual and contractual priority of payment to be maintained between creditors among themselves in a bankruptcy proceeding. There is no indication that Congress intended to allow creditors to alter, by a subordination agreement, the bankruptcy laws unrelated to distribution of assets.

> The Bankruptcy Code guarantees each secured creditor certain rights, regardless of subordination. These rights include the right to assert and prove its claim, the right to seek court-ordered protection for its security, the right to have a stay lifted under proper circumstances, the right to participate in the voting for confirmation or rejection of any plan of reorganization, the right to object to confirmation, and the right to file a plan where applicable. The above rights and others not related to contract priority of distribution pursuant to Section 510(a) cannot be affected by the actions of the parties prior to the commencement of a bankruptcy case when such rights did not even exist. To hold that, as a result of a subordination

[63] *See* Bell, K.E., et al., *Comparing Intercreditor Arrangements,* LSTA Loan Market Chronicle, 2015, for a discussion of the four most common types of intercreditor agreements -- first lien/second lien; split collateral; senior/mezzanine; and unitranche -- and typical provisions of each.

> agreement, the "subordinor" gives up all its rights to the "subordinee" would be totally inequitable.

In re Hart Ski Mfg. Co., 5 BR 734, 736 (Bankr. Minn. 1980).

Despite this broad pronouncement made by a bankruptcy court early after the enactment of the Bankruptcy Code, many courts have been willing to enforce provisions of subordination agreements that restrict the rights of junior creditors.

The balance of this article identifies key provisions that parties negotiating an intercreditor agreement may want to address and court decisions addressing the interpretation and enforceability of such provisions.

III.

PARTIES; PERMITTED ASSIGNS

The borrower is typically a party to an intercreditor agreement and obligated to make distributions in accordance with its terms.

Wilmington Trust Co. v. Tribune Co. (In re Tribune Co.), 2014 U.S. Dist. LEXIS 82782 (D. Del. 2014), *aff'd in part, rev'd in part*, 799 F.3d 272 (3rd Cir. 2015). A litigation trust created pursuant to a confirmed plan was found to be a successor to the debtor, and thus terms of a subordination agreement would be enforced in connection with distributions to be made by the litigation trust.

The agreement will typically define with some precision the circumstances under which any party may assign its rights under the agreement to another. Where the lenders are institutional, the agreements frequently authorize assignment to other institutional or qualified lenders, without the other parties' approval or consent. Assignment rights may be much more restricted where one of the lenders is affiliated to the borrower.

Buena Vista Home Entm't, Inc. v. Wachovia Bank, N.A. (In re Musicland Holding Corp.), 374 BR 113 (Bankr. S.D.N.Y. 2007). The intercreditor agreement provided that the senior lenders included "any other lender or group of lenders that at any time refinances, replaces or succeeds to all or any portion of the [senior debt] or is otherwise a party to the [senior loan agreements]" 374 BR at 117; and further provided that the junior lenders waived notice of, and automatically consented to, any amendment to the senior loan agreements. Thus, the senior lenders were contractually permitted to include additional advances from a second lender as part of the senior debt, further subordinating the junior lenders' position. The court denied claims of the junior creditors that the senior lender was in breach of the intercreditor agreement by facilitating additional advances by a second lender.

IV.

WHAT OBLIGATIONS ARE COVERED BY THE AGREEMENT?

- ✓ Clearly define the specific obligations which are subject to the subordination agreement.
- ✓ If the agreement is intended to cover subsequent lending by the senior lender, be precise.
- ✓ Is there a cap on the total senior indebtedness? Does it apply to:

- DIP financing
  - carveout granted by senior lender in DIP financing or cash collateral agreement in favor of professionals, unsecured creditors
- Contract interest, default interest, fees, and costs
- Protective advances
- Unaccrued interest/original interest discount
- Indemnification obligations
- Hedged obligations
- Currency fluctuations

✓ Are there corresponding caps on junior indebtedness?

✓ Does the agreement include a waterfall provision corresponding to the relevant caps?

✓ Is the junior lender subordinating to post-petition interest, fees, and costs, accruing on the senior loan, even if the senior lender is not entitled to recover those amounts under the Bankruptcy Code?

Silver Point Fin., LLC, v. Deutsche Bank Trust Co. Ams. (In re K-V Discovery Solutions, Inc.), 496 BR 339 (Bankr. S.D.N.Y. 2013). The court considered language in a subordination agreement which provided that Senior Indebtedness included "interest, including, with respect to the Credit Facility, all interest accrued subsequent to the commencement of any bankruptcy or similar proceeding, whether or not a claim for post-petition interest is allowable as a claim in any such proceeding . . . ." A dispute arose as to whether post-petition interest accruing under other loans made by the senior lender to the debtor also was included in Senior Indebtedness. While the senior lender suggested that the language was intended to mean "including, without limitation" post-petition interest on all obligations to the senior lender, the court found the language to say just the opposite, and restricted post-petition interest only to that arising under the specifically defined Credit Facility.

In re Ocean *Blue Leasehold Prop. LLC*, 414 BR 798 (Bankr. Fla. 2009). Intercreditor agreement precluded the junior lender from receiving any distribution *on account of its mezzanine loans* until the senior loans had been repaid in full. The court held that an administrative expense payment for substantial contribution was not a payment on account of the junior lender's mezzanine loans, and thus was not precluded by the intercreditor agreement.

V.

PAYMENT SUBORDINATION V. LIEN SUBORDINATION

> It is important to understand the difference between lien subordination and payment subordination. Under a lien subordination agreement, the subordinating party agrees to demote the priority of its lien to that of another secured creditor, thereby delaying its recourse to the identified collateral until the other party's secured claim has been satisfied.

Ryan E. Manns & Camisha L. Simmons, *Safeguarding Enforcement of Lien Subordination Agreements*, 32-5 AM. BANKR. INST. J. 52, 52 (2013). In contrast, payment, or debt, subordination, "entitles the senior creditor to full satisfaction of its superior debt before the

subordinated creditor receives payment on its debt." *In re First Baldwin Bancshares, Inc.*, 2013 Bankr. LEXIS 4086, 2013 WL 5429844, at *7 (S.D. Ala. Sept. 30, 2013).

A recent article explains the difference between the two types of subordination:

> Lien subordination involves two senior creditors with security interests in the same collateral, one of which has lien priority over the other. To the extent of any value derived from the collateral *(e.g.,* its liquidation proceeds upon a sale), the senior lien lender is repaid first from collateral proceeds, and the junior lien lender collects only from any remaining collateral value. If the collateral proceeds are insufficient to repay the senior lender in full, then both the senior lien and junior lien lenders, and all other unsecured senior creditors, rank equally in their right to repayment of their remaining debt from the other assets or resources of the borrower. By contrast, in payment subordination, the senior lender enjoys the right to be paid first from all assets of the borrower or any applicable guarantor, whether or not constituting collateral security for the senior or subordinated lenders. Because payment subordination depends only on the amount owed and not on the value of any particular collateral, it is a more fundamental form of subordination and is generally more advantageous to a senior lender.

Robert L. Cunningham & Yair Y. Galil, *Lien Subordination and Intercreditor Agreements*, THE REV. OF BANKING & FIN. SERVICES, May 2009, at 49, 50.

- ✓ Clearly define whether the agreement contemplates payment subordination, lien subordination, or both.
- ✓ To the extent payment subordination is contemplated, is the subordination triggered by an event of default, failing which the junior lender is entitled to ordinary course payments in the interim?
- ✓ To the extent lien subordination is contemplated, what happens if there is a defect in perfection of either lien, or either lien is avoided or itself subordinated in a subsequent bankruptcy filing by the borrower?
- ✓ To the extent the junior lender is subordinating payment to interest, fees, costs, penalties, etc., arising under the senior indebtedness, does that subordination include post-petition interest, even if the Bankruptcy Code would otherwise preclude recovery by the senior lender of some or all of these amounts?

U.S. Bank*, N.A. v. Wilmington Sav. Fund Soc'y (In re MPM Silicones, LLC),* 531 BR 321 (S.D.N.Y. 2015). The court considered the language of a subordination agreement which defined "Senior Indebtedness" to include "all indebtedness . . . unless the instrument . . . expressly provides that such obligations are subordinated *in right of payment* to any other indebtedness . . .", and which further provided that Senior Indebtedness did not include any "indebtedness . . . that by its terms is subordinate or junior in any respect to any other Indebtedness . . ." (emphasis added). Finding that these provisions referred only to payment subordination, and not lien subordination, the district court affirmed the bankruptcy court's ruling that second lien notes which were secured by a junior lien, but were not subordinated in

payment, were included in Senior Indebtedness and thus remained senior in priority of payment to subordinated unsecured notes.

Delaware Trust Co. v. Wilmington *Trust, N.A. (In re Energy Future Holdings Corp.)*, 546 BR 566 (Bankr. Del. 2016); 566 BR 669 (Bankr. Del. 2017. Adequate protection payments did not represent payments from the proceeds of the lenders' collateral and thus were not subject to the express language of the waterfall provisions of the intercreditor agreement.

Del. Trust Co. v. Computershare *Trust Co., N.A. (In re Energy Future Holdings Corp.),* 551 BR 550 (Bankr. Del. 2016). Certain senior lenders argued that they were entitled to make-whole premiums after being repaid their full principal and interest through the refinance of their indebtedness, and argued that subsequent distributions made to junior lenders must be delivered to the senior lenders under the intercreditor agreement. The court denied the senior lenders' requests, finding that, under the terms of their relevant agreements, the debtors were not liable for payment of make-whole premiums to the senior lenders under the facts presented, and the junior lenders were thus entitled to retain the partial payments they received.

MW Post Portfolio Fund *Ltd. v. Norwest Bank Minn. Nat'l Ass'm (In re Onco Inv. Co.*, 316 BR 163 (Bankr. Del. 2004). The debtor's plan of reorganization cured and reinstated the senior indebtedness, despite the senior lender's claim that it was entitled to a prepayment premium, in addition. The senior lender then sought recovery of the prepayment premium from the junior lender under the terms of their intercreditor agreement. The court denied the senior lender's request, finding that the senior lender received everything it was entitled to through the cure of its indebtedness, and thus was not entitled to a prepayment premium.

BOKF, N.A. v. JPMorgan *Chase Bank, N.A. (In re MPM Silicones, LLC),* 2014 Bankr. LEXIS 4353 (Bankr. S.D.N.Y. 2014). A payment to a junior lender as consideration for its entering into a backstop agreement to support a rights offering under a confirmed plan, and its receipt of stock in the reorganized debtor under the plan, were not in violation of an intercreditor agreement which only precluded junior lender from receiving proceeds of common collateral until senior debt was fully repaid; as neither represented proceeds of the collateral.

VI.

PERMITTED ACTIONS OF SENIOR LENDER

- ✓ What modifications may the senior lender make to the senior loan documents without the consent of the junior lender?
  - Increase in senior debt
  - Increase in interest rate
  - Extension of maturity date
  - Modification of mandatory prepayment provisions
  - Accept deed in lieu
    - Notice to junior lender prior to acceptance?

Salus Capital Partners*, LLC v. Std. Wireless Inc. (in re RadioShack Corp.*), 550 BR 700 (Bankr. Del. 2016). An intercreditor agreement defined the relative rights to payment and proceeds of collateral between asset-based lenders and lenders providing a term facility. The

agreement permitted either lending group to amend their loan documents, without the consent of the other group, subject to certain limitations. The asset-based loans were acquired by a new group of lenders and subsequently restructured, including converting a portion of an existing line of credit into a term facility. The term lenders argued that, as a result of that restructure, under the terms of the intercreditor agreement, amounts outstanding under the newly created term facility were subordinate in payment to their loans. The court rejected the term lenders' arguments, finding that the asset-based lenders had the right to restructure their facility without the consent of the term lenders, and the term lenders' rights were not adversely affected by the loan restructure.

VII.

PERMITTED ACTIONS OF JUNIOR LENDER

- ✓ What modifications may the junior lender make to its loan documents without the consent of the senior lender?
  - Increase in junior debt
  - Increase in interest rate
  - Extension of maturity date
  - Modification of mandatory prepayment provisions
- ✓ May the junior lender pursue enforcement action so long as no default in senior debt?
- ✓ Accept deed in lieu?
- ✓ Standstill period permitting only senior lender to act?
  - Extensions tied to diligent pursuit of remedies by senior lender?
- ✓ Seek appointment of examiner, receiver, trustee?
- ✓ Investigate borrower's operations, or validity or enforceability of senior liens?
- ✓ Pursue foreclosure on pledged equity in borrower?
  - Designation of replacement guarantor by junior lender if borrower provided guaranty in favor of senior lender and timing for delivery
  - Satisfaction of minimum net worth and liquidity requirements
  - Cure of senior loan defaults required as condition
    - Right or obligation to cure
    - Length of cure period
    - Cure limited to past-due payments, or total accelerated indebtedness?
    - Standstill by senior lender
- ✓ To pursue foreclosure on other collateral not securing senior debt?
- ✓ Option to purchase senior debt/underlying collateral
  - Limited by cap on total debt subject to subordination
  - Includes default interest/late fees/prepayment premiums?

- Termination of purchase option upon completion of foreclosure by foreclosure or deed in lieu by senior lender

✓ Exercise rights of general unsecured creditor?

BOKF, N.A. v. JPMorgan Chase *Bank, N.A. (In re MPM Silicones, LLC),* 2014 Bankr. LEXIS 4353 (Bankr. S.D.N.Y. 2014). Junior lender did not breach intercreditor agreement by objecting to components of senior lenders' claims where agreement did not expressly preclude junior lenders from doing so, and further permitted junior lenders to exercise rights of unsecured creditors.

VIII.

CASH COLLATERAL; DIP FINANCING; ADEQUATE PROTECTION

✓ Is the junior lender waiving the right to object to use of cash collateral or DIP financing proposed by the senior lender or a third party?

✓ What if the DIP financing includes a "roll-up" of pre-petition debt into the new DIP facility?

✓ What if the proposed DIP financing is junior to the senior lien but senior to the junior lien?

✓ Is the junior lender also subordinating to, or waiving its right to oppose, carve-outs granted by the senior lender in favor of professionals, other junior classes?

✓ Is it waiving any right to object to adequate protection granted to the senior lender?

✓ Is it waiving any right it might otherwise hold to demand adequate protection for itself?

Aurelius Capital Master, Ltd. v. Tousa Inc., 2009 U.S. Dist. LEXIS 12735 (S.D. Fla. 2009). The intercreditor agreement provided that the junior lender was deemed to have consented to the use of cash collateral and waived any right to seek any form of adequate protection in connection with the use of cash collateral. The district court affirmed the bankruptcy court's holding overruling the junior lender's objection to the proposed cash collateral order in favor of the senior lender, and further held that the junior lender had contractually waived its right to appeal entry of the cash collateral order.

Enstar Group v. Bank of New *York (In re Amret, Inc.,* 174 BR 315 (M.D. Ala. 1994). Pre-petition intercreditor agreement which subordinated related party obligations to senior debt, including "all obligations . . whether now existing or hereafter arising . . ." applied to post-petition financing provided by related party which failed to secure a waiver from senior lender or other protection from the senior lender in connection with the DIP financing.

IX.

CLAIMS; VOTING; PROPOSING PLAN; OBJECTING TO CONFIRMATION

✓ Is the junior lender ceding the right to the senior lender to file a proof of claim on its behalf?

✓ To vote its claim in connection with confirmation of any plan?

✓ May junior lender object to any components of senior lender's claim?

- ✓ To object to confirmation?
- ✓ To propose its own plan?
- ✓ To support plan proposed by debtor over objection of senior lender?
- ✓ May plan be confirmed that fails to honor terms of subordination agreement?

Law Debenture Trust *Co. et al. v. Tribune Media Co. (In re Tribune Media Co.),* 587 BR 606 (D. Del. 2018). Section 1129(b)(1) provides that the court "shall confirm" a plan over the objection of an impaired dissenting class "[n]otwithstanding section 510(a)." Thus, the district court held that, so long as the plan doesn't discriminate unfairly and is fair and equitable, the plan may be confirmed even if it does not enforce the terms of a subordination agreement. In the Tribune Media case, the subordination agreements provided that the holders of certain senior notes were entitled to receive distributions that would otherwise be paid on specific subordinated debt, until the senior notes were paid in full. The debtors' plan provided, instead, that the distributions that would otherwise be paid on the subordinated debt would be shared between the senior notes and another class of general unsecured creditors. Finding that the impact of this plan provision on the senior noteholders was *de minimis,* and thus did not unfairly discriminate against them, the district court affirmed the bankruptcy court's confirmation of the plan.

In re TCI 2 Holdings*, LLC,* 428 BR 117 (Bankr. N.J. 2010). Junior secured lenders proposed a plan of reorganization in conjunction with the debtor. The senior lenders objected to confirmation and sued the junior lenders for breach of the intercreditor agreement, contending numerous plan terms were in violation of the intercreditor agreement. The bankruptcy court struggled to interpret plan confirmation requirements, reconciling 11 U.S.C. §1129(b)(1) which permits a cram-down confirmation of a plan "notwithstanding section 510(a)," with §1129(a), which requires compliance with all provisions of the Bankruptcy Code, presumably including §510(a), as a condition of plan confirmation. The court determined that a plan may be confirmed under §1129(b) even if its terms violate the provisions of an enforceable intercreditor agreement.

Contra. In re Consul Restaurant Corp., 146 BR 979 (Bankr. Minn. 1992). The terms of an intercreditor agreement should be enforced under the discrimination and fair and equitable concepts of the cramdown section of the Code.

Wilmington Trust co. v. Tribune Co. (In re Tribune Co.), 2014 U.S. Dist. LEXIS 82782 (D. Del. 2014), *aff'd in part, rev'd in part*, 799 F.3d 272 (3rd Cir. 2015). Litigation trust created pursuant to confirmed plan was a successor to the debtor, and thus terms of subordination agreement would be enforced in connection with distributions to be made by the litigation trust.

Rosenfeld v. Coastal Broad Sys., Inc. (In re Coastal Broad Sys., Inc.) 2013 US Dist. LEXIS 91469 (D. N.J. 2013), *aff'd* 2014 U.S. App. LEXIS 11738 (3rd Cir. 2014); *Blue Ridge Investors II, LP v. Wachovia Bank (In re Aerosol Packaging, LLC),* 362 BR 43 (Bankr. N.D. Ga. 2006). *In re Inter Urban Broadcasting of Cincinnati, Inc.*, 1994 U.S. Dist. LEXIS 16546, 1994 WL 646176 (E.D. La. 1994); *In re Curtis Center Limited Partnership,* 192 BR 648 (Bankr. E.D. Pa. 1996). Subordination agreement authorizing senior lender to vote junior lender's claims in connection with confirmation of the plan was enforced by the bankruptcy court.

Contra., *In re 203 N.* LaSalle *St. Partnership* 246 BR 325 (Bankr. N.D. Ill. 2000) *Accord*, *In re SW Boston Hotel Venture, LLC*, 460 BR 38 (Bankr. Mass. 2011), *vacated in part on other grounds,* 479 BR 219 (BAP 1st Cir. 2012); *In re Croatan Surf Club, LLC,* 2011 Bankr. LEXIS 4517 (Bankr. E.D.N.C. 2011). 11 U.S.C. §1126(a) and Bankruptcy Rule 3018(c), which

provides that only the "holder of a claim" may vote on a plan, prohibit voting of subordinated creditor's claim by senior lender, despite intercreditor agreement expressly granting such right to senior lender.

X.

CHALLENGING VALIDITY, PRIORITY, OR ENFORCEABILITY OF SENIOR LIENS

- ✓ Is the junior lender waiving its right to challenge the amount, validity, priority, or enforceability of senior liens?
- ✓ Is the senior lender also waiving its rights to challenge the junior lien?
- ✓ Do the lien subordination provisions remain in effect if the senior lender's liens are determined to be unperfected, subject to subordination, or otherwise avoidable?
- ✓ Is the junior lender waiving the right to argue that a particular piece of collateral is not collateral for the senior debt?
- ✓ Is the junior lender waiving any right to demand marshalling or appraisal or other valuation of collateral?

Ion Media Networks, Inc. *v. Cyrus Select Opportunities Master Fund (In re Ion Media Networks, Inc.)*, 419 BR 585 (Bankr. S.D.N.Y. 2009). The debtor's reorganization plan was premised on the enforceability of provisions of an intercreditor agreement. The junior lender, which had acquired the subordinated debt at a steep discount and used "aggressive litigation tactics" to gain leverage, opposed confirmation and questioned whether the senior lender's lien attached to FCC licenses which were critical assets addressed in the reorganization. The court found that the junior lender's challenge to the extent of the senior lender's lien was barred by the terms of the intercreditor agreement which expressly precluded junior lender from challenging the priority of the senior lender's liens and claims in any bankruptcy proceeding by the borrower.

BOKF, N.A. v. JPMorgan *Chase Bank, N.A. (In re MPM Silicones, LLC),* 2014 Bankr. LEXIS 4353 (Bankr. S.D.N.Y. 2014). Junior lender did not breach intercreditor agreement by objecting to components of senior lenders' claims where agreement did not expressly preclude junior lenders from doing so, but instead precluded junior lenders from opposing the senior lenders' enforcement and exercise of their remedies against the shared collateral; and further permitted junior lenders to exercise rights of unsecured creditors.

XI.

SALES FREE AND CLEAR

- ✓ Is the junior lender waiving the right to object to, or comment on, proposed sale procedures?
- ✓ To oppose any asset sale to which the senior lender consents?
- ✓ Does junior lender retain right to raise any objection that could be raised by a general unsecured creditor?

- ✓ Is the junior lender waiving its credit bid right? To challenge senior lender's credit bid?
- ✓ Must the junior lien be released (or does the senior lender have the right to cause a release of the junior lien) upon a sale or other disposition of the collateral approved by the senior lender?

In re Boston Generating*, LLC*, 440 BR 302 (Bankr. S.D.N.Y. 2010). Junior lenders opposed the debtor's motion to sell assets free and clear of liens. The senior lender argued that the junior lenders had no standing to oppose the sale under the terms of their intercreditor agreement. The intercreditor agreement granted the senior lender the "exclusive" right to "enforce rights, exercise remedies . . . and make determinations regarding the release, sale, disposition or restrictions" regarding the collateral without consulting with, or the consent of, the junior lenders, so long as the junior lenders' lien attached to the sale proceeds; and that the "sole right" of the junior lenders was to receive their share of any proceeds of disposition, if any, after payment in full of the senior obligations. It further provided that the junior lenders agreed not to "take any action that would hinder any exercise of remedies" by the senior lender, but the junior lenders retained the right to make any objection that could have been made by an unsecured creditor. The senior and junior lender stipulated that the proposed asset sale was not an "exercise of remedies" by the senior lender. The bankruptcy court ruled that the junior lenders had standing to oppose the sale, even though it went "against the spirit of the subordination scheme," because there was no express waiver of standing in the intercreditor agreement, and a waiver of rights "must be clear beyond peradventure," and because the junior lenders were simply exercising rights that could have been exercised by unsecured creditors. The court nevertheless approved the sale on its merits. Note that the court contrasted the language in the intercreditor agreement with the language in the ABA model form in conducting its analysis.

XII.

OTHER RIGHTS AND REMEDIES

- ✓ Is junior lender waiving right to commence any enforcement action so long as senior debt is outstanding?
- ✓ To seek the appointment of an examiner, receiver, or trustee?
- ✓ To conduct discovery into the debtor's operations or validity and enforceability of senior liens?
- ✓ To seek a change of venue?
- ✓ To seek or oppose substantive consolidation of related estates?
- ✓ To challenge the bankruptcy court's jurisdiction to determine intercreditor issues?
- ✓ Is junior lender waiving rights under 11 U.S.C. §§506(c), 552?
- ✓ Is either lender waiving its rights under 11 U.S.C. §111(b)?

In re Erickson Ret. Cmtys., LLC, 429 BR 309 (Bankr. N.D. Tex. 2010). Junior lenders sought appointment of an examiner, which request was opposed by the senior lenders. The court denied the request premised on terms of a subordination agreement in which the junior lenders agreed not to "exercise any rights or remedies or take any action or proceeding to collect or

enforce any of the" subordinated debts without the prior consent of the senior lender, unless the senior debt was fully satisfied. The court ruled the junior lenders lacked standing and had contractually waived their right to seek appointment of an examiner, and that contractual waiver was enforceable. The court observed, however, that, even without the provisions of the subordination agreement which precluded the relief sought by the junior lenders, it would be hard pressed to find any useful purpose for the appointment of an examiner.

In re Caesars Entm't Operating Co., 562 BR 168 (Bankr. N.D. Ill. 2016). Court finds after analyzing relevant provisions of integrated loan documents, including intercreditor agreement, that senior lenders did not waive their rights under 11 U.S.C. §1111(b), even though the security agreement provides that loans to subsidiaries of the primary borrower were non-recourse.

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