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Unitranche Facilities and the Jurisdiction of Bankruptcy Courts: RadioShack's Chapter 11 Leaves Questions Unanswered

“Unitranche” facilities have been gaining popularity over the last decade. Although unitranche facilities offer advantages such as efficiency and lower costs, one concern of the lenders party to these loan facilities has been whether or not the agreement among lenders setting forth the relative priorities of the lenders under the facility is enforceable in a borrower’s bankruptcy proceeding. Because of this concern, many lenders were relieved to hear that the bankruptcy court in the RadioShack bankruptcy proceeding¹ had considered and provided its thoughts with respect to the enforcement of certain provisions of an agreement among lenders in relation to a unitranche facility under which RadioShack was the borrower, but was not a party to the agreement among lenders.

Although the RadioShack proceeding sheds light on how bankruptcy courts may interpret an agreement among lenders, unfortunately, it still remains unclear as to whether U.S. bankruptcy courts will assert jurisdiction to consider arguments arising under an agreement among lenders. In RadioShack, all of the relevant parties in the case had consented to the bankruptcy court’s jurisdiction to consider the agreement among lenders in the underlying dispute, thus allowing the court to disregard the baseline issue of whether or not the court’s jurisdiction over the agreement among lenders existed.

The Unitranche Facility and Bankruptcy

Unitranche facilities have become a popular alternative to separate first lien and second lien facilities in middle market transactions. In a typical unitranche facility, the lenders will document their loans under a single credit facility, with one set of collateral documents. The relative intercreditor rights and priorities of the “first-out lenders” and the “last-out lenders” are memorialized in a separate agreement among lenders, to which the borrower may not be a party. This differs from a traditional first lien/second lien facility where the borrower is typically a party to the intercreditor agreement.

The U.S. Bankruptcy Code and the bankruptcy courts have long recognized the jurisdiction of the bankruptcy courts to entertain intercreditor disputes surrounding subordination agreements. Specifically, Section 510 of the Bankruptcy Code provides that a subordination agreement is enforceable in a bankruptcy proceeding to the same extent as under state law.² Indeed, the bankruptcy courts have long recognized their jurisdiction to hear disputes regarding subordination agreements where “the equitable reordering of the debtor-creditor and creditor-creditor relations cannot be accomplished in [the] case without resolution of the intercreditor dispute.”³ With respect to a unitranche facility, however, because the borrower typically is not a party to an agreement among lenders, it

has remained unclear whether a bankruptcy court would entertain an intercreditor dispute between the first-out and last-out lenders under an agreement among lenders.

The RadioShack Proceeding

The Underlying Documents⁴

In December 2013, RadioShack as part of a turnaround plan had entered into a \$585 million asset-backed credit facility (the “ABL Facility”). This ABL Facility was acquired by affiliates of Standard General, L.P. (“Standard General”) in October 2014 and the existing debt was reallocated to a \$275 million term-out revolving loan facility, a \$50 million term loan facility, a \$120 million letter of credit facility, and a \$140 million revolving facility. Standard General then assigned the \$275 million term-out revolving loan facility and the \$50 million term loan facility to a group of lenders (the “First-Out Lenders”). As part of the transaction, the First-Out Lenders and Standard General, as last-out lender entered into an agreement among lenders (the “AAL”). The AAL set forth the respective intercreditor rights of Standard General and the First-Out Lenders, including certain rights of the parties in the event of a bankruptcy proceeding. RadioShack was not a party to the AAL.

Pursuant to the AAL, the obligations owed to the First-Out Lenders were senior to the obligations owed to Standard

General, as the last-out lender. The obligations owed to the First-Out Lenders included the loans held by the First-Out Lenders and all fees, costs, expenses, other charges and indemnification obligations incurred by the First-Out Lenders. Importantly, the underlying ABL Facility, and the DIP Credit Agreement to which the First-Out Lenders were a party, contained extensive indemnification provisions. Additionally, pursuant to the AAL, Standard General explicitly did not waive its right to credit bid under the U.S. Bankruptcy Code, so long as the credit bid was in an amount sufficient to pay out the First-Out Lenders “in full” in cash.

The Sale Process

As a part of the sale process, Standard General submitted a credit bid for the Debtors’ assets (the “*Standard General Bid*”) based on its last-out claims and proposed to fully repay the principal and interest owed the First-Out Lenders in cash. The First-Out Lenders recognized that the Standard General Bid was the only realistic option to preserve the debtors as a going-concern. The First-Out Lenders asserted, however, that the Standard General Bid constituted a breach of the AAL, because the bid did not account for potential indemnification claims made by the First-Out Lenders for actions that could potentially be brought by the unsecured creditors committee and for an adversary action that had been brought by Salus Capital Partners LLP. The First-Out Lenders argued that the failure to cover the potential indemnification claims was not a payment to the First-Out Lenders “in full.”

The Hearing

Over the course of a marathon four-day hearing, the Delaware bankruptcy court heard arguments with respect to the fairness of the Standard General Bid and the relative treatment of the First-Out Lenders. Although the bankruptcy court entertained arguments arising under the AAL, it never had the opportunity to determine whether it had jurisdiction to hear those arguments because the parties consented to the court’s jurisdiction.⁵

Because it was not required to determine the jurisdictional issues, the court considered the issue in dispute between the First-Out Lenders and Standard General — “whether or not [the AAL could] directly provide for the transfer of assets free and clear of all of [the First-Out Lenders’] liens, claims, encumbrances [including indemnification claims],” given the language of the AAL.⁶ The court noted: “to me, it boils down to a question of treatment of a secured creditor. That secured creditor has rights that must be respected under the documents and rights that must be respected under the Code.”⁷ The court made these statements in an effort to push the First-Out Lenders and Standard General to settle their issues, which eventually occurred, permitting the bankruptcy court to approve the Standard General Bid.⁸

While the bankruptcy court *did* consider the arguments of the First-Out Lenders and Standard General with respect to the AAL and the enforceability of that agreement, it only provided guidance to the parties. The court *did not* issue an opinion with respect to either its jurisdiction to hear arguments with respect to the AAL or the enforceability of that document. Thus, whether or not a bankruptcy court has jurisdiction to hear issues arising under an agreement among lenders and to enforce such agreements remains an unresolved issue.

Conclusion

The bankruptcy court in *RadioShack*, understanding that Standard General’s bid was the only option for RadioShack to operate as a going concern, went to great lengths to encourage the First-Out Lenders and Standard General to settle their intercreditor dispute. Although the RadioShack court entertained arguments with respect to the AAL and offered its guidance as to the proper interpretation of the AAL throughout the sale hearing process, the court never issued a final decision on these issues, preferring to offer its thoughts to guide a settlement of the parties. The court’s actions were explicitly permitted because all of the parties in *RadioShack* consented to the court’s jurisdiction and the main goal of all of the parties was to permit a timely sale of RadioShack’s assets.

Despite the *RadioShack* proceeding, it remains unclear what a bankruptcy court would do when issues arising under an agreement among lenders in a borrower’s bankruptcy proceeding are actually litigated. It is unclear whether a bankruptcy court would view issues arising under an agreement among non-debtor entities as “core” to a debtor’s bankruptcy proceeding, thus permitting the bankruptcy court to hear the action.⁹ While the *RadioShack* case may be a helpful indication of how a bankruptcy court would interpret the provisions of an agreement among lenders, whether or not a bankruptcy court actually possesses jurisdiction to hear such claims has been reserved for another day.

1 *In re RadioShack Corp.*, No. 15-10197 (Bankr. D. Del.).

2 11 U.S.C. § 510(a).

3 *In re Best Products Co., Inc.*, 168 B.R. 35, 68 (Bankr. S.D.N.Y. 1994).

4 The following background is based upon the pleadings filed by the parties in the RadioShack proceeding.

5 Transcript of Record at 62:23-25, 63:1-3, *In re RadioShack Corp.*, No. 15-10197 (Bankr. D. Del.) (ECF No. 1746). The court provided: “I note, at the outset, that the parties have acknowledged and consented to my jurisdiction to construe

and enforce the AAL and other loan documents in these cases.”

- 6 *Id.* at 86:23-25; 87:1.
- 7 Transcript of Record at 19:12-17, *In re RadioShack Corp.*, No. 15-10197 (Bankr. D. Del.) (ECF No. 1746).
- 8 The parties ultimately settled on an expense reserve for \$5 million and an indemnification reserve of \$7 million, while retaining any rights that they may have against each other under the AAL and related documents. On March 31, 2015, as a result of this settlement and the resolution of other objections to the sale process, the bankruptcy court approved Standard General's credit bid.
- 9 *See, e.g., Stern v. Marshall*, 131 S.Ct. 2594 (2011) (discussing the relatively narrow jurisdiction of the bankruptcy courts in so-called non-core matters).

For More Information

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