The Unitranche – What it is, and Why it Matters (Last of a Series)

THE LEAD | November 4, 2015

This week we wrap up our unitranche series by asking the $64,000 question that always surfaces in discussions about the future of the unitranche: How will it fare in bankruptcy?

With providers that do not bifurcate the unitranche between first-out and second-out lenders, there are no intercreditor issues to consider.

But for those that do, how second-outs are treated relative to first-outs is critical. Can they object to a sale of the company by the first out lenders? How about a DIP provided by the first-outs? Should the second-outs be granted post-petition interest?

Leslie Plaskon, a partner with Paul Hastings, outlined three themes related to intercreditor issues. “The first is enforceability,” she says. “That’s been helped with more AALs being acknowledged and signed by borrowers. So bankruptcy courts are more likely to view the AAL no different than ‘regular way’ intercreditor agreements.”

One case catching the industry’s attention was RadioShack. Financing for the electronics retailer, which filed Chapter 11 in February, included *two* unitranche facilities. Although there was a dispute as to the amount of the indemnification, the court recognized the first-out lender’s rights to indemnification under the AAL. “The bankruptcy court’s willingness to dive into the AAL should give some comfort to lenders that their rights generally should be affirmed under the AAL,” Attorney Plaskon told us.

Whether bifurcated tranches receive single debt treatment is another worry. Bankruptcy judges may deem collateral value insufficient to cover both tranches, leaving first-out *and* last-out unable to collect post-petition interest, fees and costs. By contrast in traditional first/second-lien financings firsts likely receive those items immediately in a bankruptcy without seeking it otherwise from the last-out through waterfall provisions.

How workouts and restructurings play out will be interesting. First and second-out lenders seem “tied at the hip” on voting and assignment rights. It’s not uncommon to see pages of provisions dealing with issues like ROFOs (rights of first offer), ROFRs (rights of first refusal), cross-over voting restrictions, minimum holds and drag-alongs.

As unitranche financings develop over the next few years, expect to see more one-stop structures used in cross-border deals. Because borrowers and credit parties may be in multiple jurisdictions, bankruptcy and insolvency risks need to be considered for each.

With exponentially more complicated inter-lender and assignment issues, bifurcated unitranche deals may stay more club-like during a workout. That means less of a secondary market available to lenders and sponsors alike which could impact liquidity.

Leslie Plaskon noted, however, if bifurcated unitranches migrate to the large cap market, there may be pressure among lenders to “standardize” AALs and loosen restrictions on assignments. “Coalescing of market terms may make AALs less proprietary,” she said. “But having a secondary market might make the primary market more competitive.”

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