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ARTICLES

REDUCING BATTLES BETWEEN FIRST AND SECOND LIEN HOLDERS THROUGH INTERCREDITOR AGREEMENTS: THE ROLE OF THE NEW ABA MODEL INTERCREDITOR AGREEMENT TASK FORCE

GARY D. CHAMBLEE*

I. INTRODUCTION TO THE SECOND LIEN MARKET

The second lien market experienced explosive growth over the last several years. According to the Loan Pricing Corporation (LPC), second lien issuance in the North American market in 2003 totaled nearly $8 billion.¹ In 2005 the issuance of second liens hit almost $22 billion and in 2006 totaled over $29 billion.² LPC reported that in the first quarter of 2007 the volume of second lien financing reached $13.61 billion and was followed in the second quarter by $15.21 billion in second lien financing, the highest quarter recorded for second lien issuance since its inception.³ All of that increase in volume was largely before the credit tightening that hit the financial markets in the summer of 2007. In the third quarter of 2007, second lien financing dropped to $7.10 billion and in the last quarter of 2007 fell further to $4.56 billion.⁴

Second lien loans are usually structured as term loans and bear interest based on a margin above LIBOR.⁵ For borrowers,

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2. Id.
3. Id.
4. Id.
5. London Interbank Offered Rate (LIBOR), which is a fluctuating interest rate
second lien loans obtained in conjunction with a senior credit facility secured by all of the borrower's assets offer a lower cost alternative to traditional unsecured mezzanine financing, and without the need to issue stock warrants or other equity interests in the company. According to LPC, in the first quarter of 2007, the spread of second lien loans over LIBOR averaged 598 basis points while spreads for first lien loans averaged 281 basis points. By the fourth quarter of 2007, following the slowdown in the credit markets, the spread of second lien loans over LIBOR averaged 720 basis points while spreads for first lien loans averaged 396 basis points. The traditional structure for first and second lien loans is for the first lien financing to consist of a revolver and a term loan (usually referred to as “Term Loan A”) and the second lien loan to consist of a second lien term loan (usually referred to as “Term Loan B”). The second lien loan is subordinate in priority to the first lien loan, but payment is not subordinated. Second lien loans may also be used to raise additional capital, eliminating or reducing the need to issue high-yield bonds. Although originally designed to meet the needs of financially-troubled companies, second lien loans now play a regular role in secured financing packages for acquisitions, recapitalizations, leveraged buyouts, and other large financing transactions.

From the first lien lender's perspective, permitting a second lien loan allows the first lien lender to meet its customer's borrowing needs without extending its own credit beyond limits it

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6. Mezzanine debt typically involves “a non-amortizing subordinated loan that ranks between senior bank debt and equity in the capital structure of a company and is often used to fill the gap between the available financing by senior banks and the investment by equity sponsors.” Mezzanine Management, http://www.mezzanagem ent.com/mezzanine.html. Mezzanine financing will require payment of a higher interest rate than a senior loan and will rank behind the senior loan in terms of payment and the priority of any security. Id. A “mezzanine loan is typically structured to offer the mezzanine lender some form of equity upside, providing the chance to share in any uplift in the company's equity value through [stock] warrants [or] options.” Id.


8. Id.
INTERCREDITOR AGREEMENTS considers prudent. It also frees up borrower cash flow when compared to the greater demands placed on available cash by traditional unsecured mezzanine loans, since those loans are usually priced at higher interest rates than second lien loans.

In addition to earning a higher return than the first lien lender for its higher risk, the second lien lender also has the advantage over the typical mezzanine lender of being secured. To the extent that the borrower’s assets are sufficient to support both the first lien lender and the second lien holder’s debt, the second lien holder obtains a position in the event of bankruptcy that is superior to unsecured creditors, including trade creditors, and that is usually behind only the first lien lender’s first lien on the borrower’s assets.

II. INTERCREDITOR AGREEMENTS BETWEEN FIRST AND SECOND LIEN HOLDERS

Intercreditor agreements between first and second lien holders are often fiercely negotiated because the stakes are high, both parties are usually sophisticated lenders with knowledgeable counsel, and the fundamental economic interests of the lenders are diametrically opposed. In 2006, the Syndications and Lender Relations Subcommittee of the Commercial Finance Committee of American Bar Association’s Business Law Section formed a Model Intercreditor Agreement Task Force. The purpose of the task force was to develop a market-based form of intercreditor agreement for intercreditor arrangements between first and second lien institutional lenders holding liens on the same collateral.9

A. Lien Subordination

The parties to an intercreditor agreement usually have no problem in agreeing on the basic proposition that the lien held by the first lien lender (or the collateral agent for a group of

9. The author chairs the Task Force. Information about the Task Force can be obtained from the author at gchamblee@wcsr.com. The Task Force’s website is at http://www.abanet.org/dch.committee.cfm?com=CL190029.
syndicated first lien lenders) to secure the first lien obligations will in all circumstances be prior and superior to the lien held by the second lien lender on the same collateral. In the typical intercreditor agreement, only the second lien holder’s lien will be subordinated, not its right to payment.

A typical lien subordination provision taken from the current draft of the Model Intercreditor Agreement is as follows:

Relative Priorities. Notwithstanding the date, time, method, manner or order of grant, attachment or perfection of any Liens securing the Second Lien Obligations granted on the Collateral or of any Liens securing the First Lien Obligations granted on the Collateral and notwithstanding any provision of the UCC, or any other applicable law or the Second Lien Loan Documents or any defect or deficiencies in, or failure to perfect or lapse in perfection of, or avoidance as a fraudulent conveyance or otherwise of, the Liens securing the First Lien Obligations or any other circumstance whatsoever, the Second Lien Agent, on behalf of itself and the Second Lien Lenders, hereby agrees that . . . any Lien on the Collateral securing any First Lien Obligations now or hereafter held by or on behalf of the First Lien Agent or any First Lien Lenders or any agent or trustee therefor, regardless of how acquired, whether by grant, possession, statute, operation of law, subrogation or otherwise, shall be senior in all respects and prior to any Lien on the Collateral securing any Second Lien Obligations . . . .

10. The current draft of the Model Agreement is available at the Task Force’s ABA website. See Current Draft of Model Intercreditor Agreement, http://www.abanet.org/buslaw/committees/CL190029pub/materials/20070722-draft.pdf [hereinafter Model Intercreditor Agreement] (last visited Jan. 18, 2008). For clarity, references in the current draft of the Model Agreement to the defined terms “First Lien Claimholder” and “Second Lien Claimholder” have been changed to “First Lien Lender” and “Second Lien Lender” in the provisions of the Model Agreement quoted in this article.

11. Id. § 2.1.
B. Contests to Perfection, Priority, or Enforceability

1. No Contest Provisions

The first lien lender and the second lien lender will also typically include a provision in which both lenders agree not to contest the priority, perfection, or enforceability of the lien held on the joint collateral by the other lender. Because attacks on priority or perfection can be time-consuming either inside or outside of bankruptcy, this type of “no contest” provision can be very valuable to either a first lien lender or second lien lender who is eager to proceed with its own remedies. Most intercreditor agreements, including the draft Model Intercreditor Agreement, also include provisions giving either party the right to enforce the intercreditor agreement by specific performance in an effort to make the rights granted in the intercreditor agreement meaningful when one party is contesting the right of the other party to proceed with enforcement. The “no contest” provision in the current draft of the Model Intercreditor Agreement reads as follows:

Prohibition on Contesting Liens. Each of the Second Lien Agent, for itself and on behalf of each Second Lien Lender, and the First Lien Agent, for itself and on behalf of each First Lien Lender, agrees that it will not (and hereby waives any right to) contest or support any other Person in contesting, in any proceeding (including any Insolvency Proceeding), the priority, validity, perfection or enforceability of a Lien held by or on behalf of any of the First Lien Lenders in the First Lien Collateral or by or on behalf of any of the Second Lien Lenders in the Second Lien Collateral, as the case may be, or the provisions of this Agreement; provided that nothing in this Agreement shall be construed to prevent or impair the rights of the First Lien Agent or any First Lien Lender to enforce this Agreement, including the
provisions of this Agreement relating to the priority of the Liens . . . . 12

2. Alternative Proposal Preserving the Second Lien Lender’s Ability to Contest the First Lien Lender’s Position

If the second lien lender has sufficient bargaining power, it would prefer, of course, not to concede at the outset that the liens held by the first lien lender will be deemed perfected and enforceable, even if that proves not to be the case. In a transaction where the second lien lender has significant power, it may reserve the right to attack the priority or perfection of the first lien. An optional provision in the Model Intercreditor Agreement favoring second lien lenders preserving that right provides:

The subordination of Liens provided for in this Agreement shall not be effective on any date with respect to any part of the Collateral in which the Liens of the First Lien Agent and the First Lien Lenders are invalid, unenforceable, void, avoidable, subordinated, or not allowed as a result of any action taken by the First Lien Agent, or any failure by the First Lien Agent to take any action, with respect to any financing statement (including any amendment to or continuation thereof), mortgage, intellectual property filing or other perfection document, in which event the Second Lien Agent and the Second Lien Lenders shall be entitled to receive and retain all Proceeds with respect to such Collateral to the extent the Liens of Second Lien Agent and the Second Lien Lenders are valid, enforceable, not void, not avoidable, not subordinated, and allowed with respect to such Collateral . . . . 13

12. Id. § 2.2.
13. Id. § 2.1(c)(i) (optional provision favorable to second lien lenders).
Once the parties move beyond the basic subordination provisions, however, there is little in the way of market standards to guide them. In the earlier stages of development of second lien financing, the first lien lenders often permitted second liens only in the form of a “silent” second. For a first lien lender, the ideal second lien is a junior lien in which the second lien holder has few approval rights (if any) over modifications of the first lien loan and plays only a passive role in enforcement actions by the first lien lender or in bankruptcy proceedings. As second lien financings have increased, and both second lien lenders and borrowers (including in particular private equity “sponsors” of borrowers) have increased their economic leverage over the terms of financing transactions, second lien holders have increasingly demanded a greater role in all aspects of the intercreditor relationship, including approval rights over material modifications of the first lien loan and lien enforcement decisions.

1. Control of the Enforcement Process

Control of the enforcement process is of key importance to first lien lenders. If the first lien lender is forced into a race to the courthouse by the second lien lender, the first lien lender may find itself with little leverage to arrange a workout or other voluntary settlement with the borrower. On the other hand, if approvals are required from the second lien lender to exercise remedies and the second lien lender disagrees with the strategic decisions made by the first lien lender, the first lien lender may find itself unable to foreclose on collateral owned by a borrower whose financial position is deteriorating. For the second lien lender, the concern is that the first lien lender will delay action if it considers itself adequately secured while the second lien holder’s position grows weaker.

A) STANDSTILL PERIOD ON ENFORCEMENT BY SECOND LIEN HOLDER

The typical solution to this tension between the interests of first and second lien holders is to impose a “standstill” period (often 90 to 180 days although this period is subject to considerable variation) during which the first lien lender has the exclusive right to exercise remedies, including foreclosing on the collateral, and the second lien holder agrees not to contest any foreclosure proceeding or other remedial action by the first lien lender under the first lien loan documents. If the first lien holder fails to act during the standstill period, then the junior creditor is free to pursue its own remedies, including initiating a foreclosure proceeding on the shared collateral. If the first lien lender begins exercising its remedies during the standstill period, however, then the intercreditor agreement typically provides that the junior lien holder will continue to suspend the exercise of any remedies as long as the first lien lender diligently pursues the exercise of its rights and remedies with respect to the shared collateral.

The “standstill” provisions in the current Model Intercreditor Agreement are typical of this type of provision:

Exercise of Remedies. Until the Discharge of First Lien Obligations has occurred, whether or not any Insolvency Proceeding has been commenced by or against the Borrower or any other Grantor, the Second Lien Agent and the Second Lien Lenders . . . will not take any Enforcement Action with respect to any Lien held by it under the Second Lien Collateral Documents or any other Second Lien Loan Document or otherwise; provided, however, that the Second Lien Agent may take Enforcement Action after the passage of a period of at least [120-180] days has elapsed since the later of: (i) the date on which the Second Lien Agent declared the existence of any Event of Default under any Second Lien Loan Documents and demanded the repayment of all the principal amount of any Second
Lien Obligations; and (ii) the date on which the First Lien Agent received notice from the Second Lien Agent of such declarations of an Event of Default, (the "Standstill Period"); provided, further, however, that notwithstanding anything herein to the contrary, in no event shall the Second Lien Agent or any Second Lien Lender take any Enforcement Action with respect to any Lien held by it under the Second Lien Collateral Documents or any other Second Lien Loan Document or otherwise if, notwithstanding the expiration of the Standstill Period, the First Lien Agent or First Lien Lenders shall have commenced and be diligently pursuing Enforcement Action with respect to all or any material portion of the Collateral . . . .

B) PROVISIONS PROTECTING THE SECOND LIEN HOLDER DURING THE STANDSTILL PERIOD

In order to protect the second lien holder's position while the first lien lender forecloses, the intercreditor agreement usually gives the second lien holder the right to take certain limited actions. For example, the current draft of the Model Intercreditor Agreement permits the second lien holder to file a claim in any insolvency proceeding, to take actions to create, perfect, or preserve its lien on the collateral, to file a proof of claim in any bankruptcy proceeding, and to vote on any plan of reorganization. The provisions in the current draft of the Model Intercreditor Agreement specifying those rights provides:

(c) Notwithstanding the foregoing, the Second Lien Agent and any Second Lien Lender may:

(1) file a claim or statement of interest with respect to the Second Lien Obligations in any Insolvency Proceeding commenced by or against the Borrower or any other Grantor;

15. Model Intercreditor Agreement, supra note 10, § 3.1(a).
(2) take any action (not adverse to the priority status of the Liens on the Collateral securing the First Lien Obligations, or the rights of any First Lien Agent or the First Lien Lenders to exercise remedies in respect thereof) in order to create, perfect, preserve or protect its Lien on the Collateral;

(3) file any necessary responsive or defensive pleadings in opposition to any motion, claim, adversary proceeding or other pleading made by any person objecting to or otherwise seeking the disallowance of the claims of the Second Lien Lenders, including any claims secured by the Collateral, if any, in each case in accordance with the terms of this Agreement;

(4) vote on any plan of reorganization, file any proof of claim, make other filings and make any arguments and motions that are, in each case, in accordance with the terms of this Agreement, with respect to the Second Lien Obligations and the Collateral;

(5) exercise any of its rights or remedies with respect to the Collateral after the termination of the Standstill Period to the extent permitted by [this Agreement]; and

(6) exercise any rights or remedies, file any pleadings, objections, motions or agreements which assert rights or interests available to unsecured creditors of the Grantors arising under any Insolvency Proceeding, the Bankruptcy Laws or applicable non-bankruptcy law, so long as such actions would not conflict with an express agreement of the Second Lien Agent or Second
INTERCREDITOR AGREEMENTS

Lien Lenders contained in this Agreement; provided that in the event that any Second Lien Lender becomes a judgment lien creditor in respect of Collateral as a result of its enforcement of its rights as an unsecured creditor with respect to the Second Lien Obligations, such judgment lien shall be subject to the terms of this Agreement for all purposes (including in relation to the First Lien Obligations) as the other Liens securing the Second Lien Obligations are subject to this Agreement.\(^\text{16}\)

The Model Intercreditor Agreement provides in subsection (6) above that any judgment lien obtained by the Second Lien Lenders is subject to the terms of the intercreditor agreement for all purposes and is treated the same as the other liens securing the second lien obligations. This provision is intended to prevent the second lien lender from attempting to avoid the lien subordination and other provisions of the intercreditor agreement by obtaining a judgment against the borrower or the guarantors on their obligations to the second lien lender.

2. Modification of the Intercreditor Agreement

A) BY THE FIRST LIEN LENDER

Both the senior and junior lien holder want the ability to modify their respective loan documents without the consent of the other lender and, at the same time, to prevent the other lender from modifying its loan documents in a way that prejudices the rights of the opposing lender (for example, by increasing the amount of the loan). The usual compromise in an intercreditor arrangement is to give both lenders approval rights over certain material modifications to the other lender's loan documents.

The current draft of the Model Intercreditor Agreement provides that the second lien holder's approval is required in order for the first lien lender to take any of the following actions:

\(^\text{16}\) Id. § 3.1(c).
(1) provide for a principal amount of, without duplication, term loans, revolving loan commitments and letters of credit, bonds, debentures, notes or similar instruments . . . in the aggregate in excess of $_____________ (the "Maximum First Lien Indebtedness Amount");

(2) increase the interest rate or yield provisions applicable to the First Lien Obligations by more than [_____]% per annum in the aggregate . . . ;

(3) shorten the scheduled maturity of the First Lien Credit Agreement or any Refinancing thereof or extend the scheduled maturity of the First Lien Credit Agreement or any Refinancing thereof beyond the scheduled maturity of the Second Lien Credit Agreement or any Refinancing thereof;

(4) modify . . . the mandatory prepayment provisions of the First Lien Credit Agreement in a manner adverse to the lenders under the Second Lien Credit Agreement;

(5) increase . . . the amount of, or the type of, dispositions of Collateral, the proceeds of which are not required to be used to prepay the First Lien Obligations and which may be retained by the Grantors for use as working capital to an amount greater than that permitted under the Second Lien Credit Agreement; or

(6) extend any scheduled amortization payments (other than any such payments due at the final Maturity Date) . . . .

17. Id. § 5.3(a).
B) BY THE SECOND LIEN LENDER

The draft Model Intercreditor Agreement gives the first lien lender similar approval rights over modifications by the second lien lender, and a few additional rights of approval, including the right to approve any change by the second lien holder in the events of default under its loan documents.

3. Release of the Liens

In the absence of an effective intercreditor agreement, a borrower and the first lien lender may have trouble implementing release provisions in the first lien loan documents. For example, a provision permitting the borrower to sell certain assets and obtain a release of the first lien lender's lien on the sold assets provided that the borrower applies the proceeds to payment of the first lien loan will not work if the second lien documents do not contain corresponding release provisions. To address that problem, most intercreditor agreements, including the draft Model Intercreditor Agreement, contain provisions like the following release on disposition provision:

If in connection with any sale, lease, exchange, transfer or other disposition of any Collateral by any Grantor (collectively, a “Disposition”) permitted under the terms of the First Lien Loan Documents other than an Enforcement Action and not expressly prohibited under the terms of the Second Lien Loan Documents . . . , the First Lien Agent . . . releases any of its Liens on any part of the Collateral, . . . then the Liens, if any, of the Second Lien Agent . . . on such Collateral . . . shall be automatically, unconditionally and simultaneously released . . . .

Similarly, if the first lien lender decides in connection with the enforcement of its remedies that it wishes to release certain

18. Id. § 5.1(b).
collateral from its lien, including a private sale of collateral by the borrower to a third party, or, if the first lien lender decides to release a guarantor as part of a workout agreement, the first lien lender wants the flexibility to proceed with such releases without the need to obtain the second lien lender's consent. To meet that need and preserve the first lien lender's role in controlling the enforcement of remedies with respect to the shared collateral, the Model Intercreditor Agreement provides as follows:

If in connection with any Enforcement Action by the First Lien Agent in respect of the Collateral, the First Lien Agent, for itself or on behalf of any of the First Lien Lenders, releases any of its Liens on any part of the Collateral or releases any Guarantor Subsidiary from its obligations under its guaranty of the First Lien Obligations, then the Liens, if any, of the Second Lien Agent, for itself or for the benefit of the Second Lien Lenders, on such Collateral, and the obligations of such Guarantor Subsidiary under its guaranty of the Second Lien Obligations, shall be automatically, unconditionally and simultaneously released...

4. Purchase of the Collateral by the Second Lien Lender

If the first lien lender arranges a private sale of the collateral to a third party at a price sufficient to satisfy both the first lien obligations and the second lien obligations, then the second lien lender will be protected by its rights as a secured party second only to the first lien lender and with a claim superior to all unsecured creditors. If the first lien lender pursues a public sale of the collateral under Article 9 of the Uniform Commercial Code (UCC), however, the first lien lender can credit bid and purchase the collateral at the sale. Since the first lien lender will not bid more than the amount of its debt, the second lien lender's lien on the collateral will be extinguished unless it elects to outbid the first lien lender.

19. Id. § 5.1(a).
lien lender at the public sale. A more orderly alternative to the uncertainties of a private or public sale of the collateral under the UCC is for the second lien lender to be granted a right in the intercreditor agreement to purchase the first lien debt following an acceleration of the first lien debt, the filing of bankruptcy proceedings, or for short period of time (e.g., 60 days) following an uncured payment default. Intercreditor agreements typically provide that the purchase price for the first lien loan will be at par (i.e., at an amount equal to 100% of the outstanding principal and interest) plus, in most cases, any prepayment premiums payable with respect to the debt. Because first lien credit facilities often include hedge arrangements provided by the first lien lender or an affiliate of the first lien lender, the Model Intercreditor Agreement includes specific provisions for the unwinding of any hedging obligations.

The Model Intercreditor Agreement contains the following language regarding the right of the second lien lender to purchase the first lien debt at par:

**Purchase Right.** Without prejudice to the enforcement of the First Lien Lenders remedies, the First Lien Lenders agree at any time following (a) an acceleration of the First Lien Obligations in accordance with the terms of the First Lien Credit Agreement, (b) a payment default under the First Lien Credit Agreement that has not been cured or waived by the First Lien Lenders within 60 days of the occurrence thereof or (c) the commencement of any Insolvency Proceeding, the First Lien Lenders will offer the Second Lien Lenders the option to

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21. Hedging is a process in which an existing risk or exposure (whether it be foreign exchange, interest rates, stocks, etc.) is reduced by adding another position. See Global Derivatives, Overview of Hedge Fund Strategies, http://www.global-derivatives.com (last visited Jan. 18, 2008). In the context of a loan transaction, hedging includes the borrower entering into one or more interest rate protection agreements based on a derivatives transaction which provides for an interest rate swap, interest rate cap, interest rate floor, interest rate collar (i.e. both a cap and a floor), forward foreign exchange transaction, currency swap, or any combination of such transactions for the purpose of hedging the borrower's exposure under the loans to fluctuations in interest rates or currency valuations.
purchase the entire aggregate amount of outstanding First Lien Obligations (including unfunded commitments under the First Lien Credit Agreement) for a purchase price equal to the sum of (A) in the case of all loans, advances or other similar extensions of credit that constitute First Lien Obligations (including unreimbursed amounts drawn in respect of letters of credit, but excluding the undrawn amount of then outstanding letters of credit), 100% of the principal amount thereof and all accrued and unpaid interest thereon through the date of purchase (including . . . any acceleration prepayment penalties or premiums), and (B) in the case of any Hedge Agreement constituting a First Lien Loan Document, the net aggregate amount then owing thereunder to each Hedge Agreement Provider pursuant to the terms of the respective Hedge Agreement, including without limitation all amounts owing to such Hedge Agreement Provider as a result of the termination (or early termination) thereof, without warranty or representation or recourse, on a pro rata basis across First Lien Lenders.22

5. Rights of the First and Second Lien Lenders in the Borrower’s Bankruptcy

Another area of dispute between first and second lien holders are the respective rights of the parties in bankruptcy. The first lien lender will often insist that the second lien lender waive certain of its rights in any bankruptcy proceeding as a condition to permitting the second lien. For example, the first lien lender may require that the junior lien holder agree that it will not contest any request by the first lien holder for adequate protection and that it will not object to the first lien lender’s use of cash collateral or to

any debtor-in-possession (DIP) financing under Section 364 of the Bankruptcy Code.23

A) USE OF CASH COLLATERAL AND DIP FINANCING

The Model Intercreditor Agreement permits the first lien lender to seek use of cash collateral and DIP financing on the following terms:

-use of cash collateral and financing issues. Until the Discharge of First Lien Obligations has occurred, if the Borrower or any other Grantor shall be subject to any Insolvency Proceeding and the First Lien Agent shall desire to permit the use of “Cash Collateral” (as such term is defined in Section 363(a) of the Bankruptcy Code), on which the First Lien Agent or any other creditor has a Lien or to permit the Borrower or any other Grantor to obtain financing, whether from the First Lien Lenders or any other Person under Section 364 of the Bankruptcy Code or any similar Bankruptcy Law (“DIP Financing”), then the Second Lien Agent, on behalf of itself and the Second Lien Lenders, agrees that it will raise no objection to such Cash Collateral use or DIP Financing . . . provided that, the aggregate principal amount of the DIP Financing plus the aggregate outstanding principal amount of First Lien Obligations outstanding at such time . . . does not exceed $______________ (the “Maximum First Lien Indebtedness Amount”) and the Second Lien Agent and the Second Lien Claimholders retain the right to object to any ancillary agreements or arrangements regarding Cash Collateral use or the DIP Financing that are materially prejudicial to their interests.24

B) SALE OF COLLATERAL

The bankruptcy provisions in the intercreditor agreement may also address sales of collateral under Section 363 of the Bankruptcy Code and require the second lien holder to consent to such sales as long as the second lien attaches to the proceeds of the sale. The Model Intercreditor Agreement follows this pattern and provides as follows:

Sale of Collateral. The Second Lien Agent on behalf of the Second Lien Lenders, agrees that it will raise no objection to or otherwise contest or oppose a sale or other disposition of any Collateral (and any post-petition assets subject to adequate protection Liens in favor of the First Lien Agent) free and clear of its Liens or other claims under Section 363 of the Bankruptcy Code if the requisite First Lien Lenders have consented to such sale or disposition of such assets, so long as the interests of the Second Lien Lenders in the Collateral (and any post-petition assets subject to adequate protection liens, if any, in favor of the Second Lien Agent) attach to the proceeds thereof, subject to the terms of this Agreement, and the motion to sell or dispose of such assets does not impair the rights of the Second Lien Claimholders under Section 363(k) of the Bankruptcy Code.26

C) ENFORCEABILITY OF INTERCREDITOR AGREEMENT PROVISIONS IN BANKRUPTCY

Despite the prevalence of these types of agreements and waivers in intercreditor agreements, there have been relatively few cases addressing the enforceability of such provisions in bankruptcy, and those cases have reached differing results. Section 510(a) of the Bankruptcy Code acknowledges the continued

effectiveness in bankruptcy of a "subordination agreement."\textsuperscript{27} However, courts have reached different results where the rights waived by the second lien lender in the intercreditor agreement involve basic bankruptcy rights beyond lien subordination or payment subordination. In \textit{Bank of America, National Ass'n v. North LaSalle Street. Ltd. Partnership (In re 203 N. LaSalle St. P'ship)},\textsuperscript{28} for example, the intercreditor agreement granted the first lien creditor the right to vote the junior lien holder's claims in bankruptcy.\textsuperscript{29} The bankruptcy court held that the subordination agreement could not affect the voting rights of the junior lienor in bankruptcy pursuant to section 510(a) of the Bankruptcy Code which provides that the holder of a claim may vote to accept or reject a plan under Chapter 11.\textsuperscript{30} In the recent case of \textit{Blue Ridge Investors, II, Ltd. Partnership v. Wachovia Bank, National Ass'n. (In re Aerosol Packaging, LLC)},\textsuperscript{31} on the other hand, the Court held to the contrary. The intercreditor agreement in \textit{Aerosol} also granted the first lien lender the right to vote the claims of the second lien holder in any bankruptcy proceeding.\textsuperscript{32} When the debtor proposed a plan under Chapter 11 of the Bankruptcy Code, the second lien lender voted against the plan and claimed that the voting restriction in the intercreditor agreement was invalid under the authority of \textit{LaSalle} and similar cases.\textsuperscript{33} The first lien lender used the grant of voting rights by the second lien lender in the intercreditor agreement to vote in favor of the plan on behalf of the second lien lender.\textsuperscript{34} The \textit{Aerosol} Court interpreted the scope of Section 510(a) broadly as permitting the enforcement of subordination agreements (including delegation of voting rights) so long as such agreements are enforceable under applicable nonbankruptcy law.\textsuperscript{35} Since the subordination agreement was enforceable under applicable Georgia nonbankruptcy law, the

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\textsuperscript{28} 246 B.R. 325 (Bankr. N.D. Ill. 2000).
\textsuperscript{29} Id. at 327-28.
\textsuperscript{30} Id. at 331-32.
\textsuperscript{32} Id. at 45.
\textsuperscript{33} Id. at 45-46.
\textsuperscript{34} Id. at 45.
\textsuperscript{35} Id. at 46.
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bankruptcy court upheld the right of the first lien lender to vote on behalf of the second lien lender pursuant to the delegation of authority in the intercreditor agreement.36 One purpose of the commentary in the Model Intercreditor Agreement will be to provide some guidance in this difficult area.

III. CONCLUSION

Nothing will eliminate disputes between first and second lien holders following a default by a borrower, particularly in the context of a bankruptcy proceeding. The attempt to resolve many of the most likely sources of dispute in a comprehensive intercreditor agreement that takes into account the needs of both parties should go a long way towards reducing such disputes. One of the main goals of the Model Intercreditor Agreement Task Force is to develop an agreement which both first lien lenders and second lien lenders will consider to be a balanced market-driven approach to resolving the most common disagreements between such lenders.

36. Id. at 47.