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Client Alert

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# Intercreditor Dispute Raises Questions Regarding Authority to Object to Chapter 11 Plan

*By Kristin K. Going and Ravi Vohra*

Intercreditor agreements between multiple lenders are part and parcel of lending to a company with several tranches of debt. Under section 510 of the United States Bankruptcy Code (the "**Code**"), "[a] subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law." 11 U.S.C. § 510(a) (West 2017).

This article will discuss how certain provisions in typical intercreditor agreements can be the basis for litigation in bankruptcy. Recently, a first and second lien trustee dispute arose over whether the second lien trustee was allowed to file a chapter 11 plan objection in the *Erickson, Inc.* (the "**Debtor**") bankruptcy case out of the Northern District of Texas. While the parties settled their dispute, it is worth discussing the provisions of the intercreditor agreement and their implementation in bankruptcy.

## Background

The Debtor filed a plan to which the second lien trustee objected, based upon the Debtor's alleged disparate treatment of second lien creditors and the plan's "death trap" provision. The first lien trustee responded to the plan objection and argued that the second lien trustee's objection to the Debtor's plan was in contravention to a certain Intercreditor Agreement between them. Relying upon the language of the intercreditor agreement, the first lien trustee argued that the second lien trustee's plan objection hindered, delayed and interfered with the efforts of the first lien noteholders to collect on the first lien debt. According to the first lien trustee, the only thing the second lien claimholders did not waive was the right to vote on the plan, and the plan was overwhelmingly accepted by the second lien claimholders, making the second lien trustee's plan objection unauthorized.

## Analysis

The relevant provisions of the Intercreditor Agreement are as follows:

> 3.3 **Second Lien Permitted Actions.** Anything to the contrary in this Section 3 notwithstanding, any Second Lien Claimholder may:
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> (d) vote on any plan of reorganization and make any filings, arguments, and motions that are, in each case, not in contravention of the provisions of this Agreement with respect to the Second Lien Debt and the Collateral.

This provision appears to leave it up to the parties to the intercreditor agreement to decide what is and is not in contravention of the agreement. The language lacks the specificity that is required for a court to hold that plan objections are not authorized under an intercreditor agreement. Such a case is discussed below. The intercreditor agreement goes on to provide:

> 3.5 **Non-Interference.** Subject to any specific provisions of this [Intercreditor] Agreement to the contrary, Second Lien Agent hereby:
>
> (a) agrees that Second Lien Agent and the other Second Lien Claimholders will not take any action that would restrain, hinder, limit, delay, or otherwise interfere with any Enforcement Action by First Lien Agent or any other First Lien Claimholder, or that is otherwise not prohibited hereunder, including any Disposition of the Collateral, whether by foreclosure or otherwise;
>
> (b) until the Payment in Full of First Lien Priority Debt and subject to Section 3.7, waives any and all rights it or the Second Lien Claimholders may have as a junior lien creditor or otherwise to object to the manner in which First Lien Agent or the First Lien Claimholders seek to enforce or collect the First Lien Debt or the Liens securing the First Lien Debt granted in any of the Collateral, regardless of whether any action or failure to act by or on behalf of First Lien Agent or the First Lien Claimholders is adverse to the interest of the Second Lien Claimholders.

It is debatable whether a proposed chapter 11 plan in a voluntary chapter 11 case is an "Enforcement Action" as defined by the intercreditor agreement to include "the exercise of any right or remedy provided to a secured creditor under the First Lien Documents or Second Lien Documents ... ." Also, this agreement provides that the second lien claimants may not even exercise their rights as unsecured creditors.

> 7.3 **No Waiver of Lien Priorities.**
>
> (d) Until the Payment in Full of First Lien Priority Debt, Second Lien Agent agrees not to assert and hereby waives, to the fullest extent permitted by law, any right to demand, request, plead or otherwise assert, or otherwise claim the benefit of, any marshaling, appraisal, valuation, or other

> similar right that may otherwise be available under applicable law with respect to the Collateral or any other similar rights a junior secured creditor may have under applicable law.

At the confirmation hearing the first lien trustee and the Debtor settled their dispute with the second lien trustee, with the second lien trustee obtaining some concessions from the Debtor—including payment of its fees and expenses, and exculpation and releases under the plan.

While the court didn't decide the intercreditor dispute on the merits, the cases that have decided the issue have found that the intercreditor agreement has to very clearly preclude or constrain the action. *See Ion Media Networks, Inc. v. Cyrus Select Opportunities Master Fund Ltd. (In re Ion Media Networks, Inc.)*, 419 B.R. 585, 597 (Bankr. S.D.N.Y. 2009) (holding that a creditor lacked standing to object to a plan where the intercreditor agreement expressly prohibited the action). In *Ion Media Networks, Inc.*, the second lien lender objected to confirmation of a chapter 11 plan under which the first lien lenders were to recover the value of certain FCC broadcasting licenses. The secondlien lender maintained that the FCC licenses were unencumbered assets under the terms of the security agreement. The intercreditor agreement between the lenders explicitly recognized the priority of the first lien lenders' interests, stating:

> Each of the Secured Parties acknowledges and agrees (x) to the relative priorities as to the Collateral (and the application of the proceeds therefrom) as provided in the Security Agreement ... and acknowledges and agrees that such priorities (and the application of proceeds from the Collateral) shall not be affected or impaired in any manner whatsoever including, without limitation, on account of ... (iii) any nonperfection of any lien purportedly securing any of the Secured Obligations (including, without limitation, whether any such Lien is now perfected, hereafter ceases to be perfected, is avoidable by any bankruptcy trustee or otherwise is set aside, invalidated, or lapses)

*Id.* Moreover, the intercreditor agreement included language prohibiting challenges to this priority scheme, stating:

> [U]pon the commencement of a case under the Bankruptcy Code by or against any Grantor ... (b) each secured party agrees not to take any action or vote in any way inconsistent with this Agreement so as to contest (1) the validity or enforcement of any of the Security Documents ... (2) the validity, priority, or enforceability of the Liens, mortgages, assignments, and security interests granted pursuant to the Security Documents ... or (3) the relative rights and duties of the holders of the first Priority Secured Obligations

*Id.* Focusing on the use of the term "purportedly securing," the court determined that the second lien lender "agreed to grant an indisputable first lien interest ... [in] 'purported' Collateral," including the FCC broadcasting licenses. The court noted that the intercreditor agreement contained "plain and purposeful" language, requiring the second lien lender to "remain silent in the event of a chapter 11 case." *Id.*

On the other hand, poorly drafted intercreditor agreements will be interpreted against the party wishing to chill objections. *In re Boston Generating, LLC*, 440 B.R. 302, (Bankr. S.D.N.Y. 2010) (subordinated creditors permitted to object to sale of all bankruptcy estate assets because subordination agreement was "poorly drafted" and not "clear beyond peradventure" regarding waiver of rights).

In *Boston Generating*, section 3.1(b) of the intercreditor agreement at issue gave the first lien collateral agent the "exclusive right to enforce rights, exercise remedies ... and make determinations regarding the release, sale, disposition or restrictions with respect to the Collateral ... ." *Id.* at 316. Further, section 3.1(g) allowed the Second Lien Agent to "file any pleadings, objections, motions or agreements which assert rights or interests available to unsecured creditors of the Loan Parties arising under any Insolvency or Liquidation Proceeding or Applicable non-Bankruptcy Law, in each case not inconsistent with the terms of this Agreement ... ." *Id.* at 320. The parties stipulated that the actions taken, or about to be taken, by the first lien agent with respect to the sale were not an "exercise of remedies."

After extensive briefing and oral argument, the court held that the second lien agent had not waived its right to object to a 363 sale, citing "the perfect storm of a poorly drafted agreement, the ill-defined scope of section 3.1(g)'s retained right to object as an unsecured creditor, and the fact that, pursuant to the Secured Parties' own stipulation, there [was] "no exercise of remedies" as its primary reasons for its holding. *Id.*

## Conclusion

Intercreditor agreements need to contain specific language regarding what a second lien creditor can and cannot do in a bankruptcy case. Intercreditor agreements that use broad statements like those found in section 3.5 of the *Erickson* intercreditor agreement are difficult to enforce in bankruptcy. If you have any questions about this alert, please do not hesitate to contact the authors or your usual Drinker Biddle contact.

# Corporate Restructuring Group

Primary Contacts

**Kristin K. Going**
Partner
New York
(212) 248-3273
kristin.going@dbr.com

**Ravi Vohra**
Associate
New York
(212) 248-3192
ravi.vohra@dbr.com