

# Assignments and Participations in Various Legal Environments

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# Basic Loan Agreement Provisions/Drafting Considerations

Subject to the conditions set forth herein, any Lender may assign all or any portion of its rights and duties under the Loan Documents to one or more assignees:

# Basic Assignee Definition

## So long as such prospective assignee is an Eligible Assignee

"Eligible Assignee" means (a) any Lender (other than a Defaulting Lender) or any Affiliate of any Lender; (b) a commercial bank or savings bank organized under the laws of the United States or any state thereof (or the laws of another country operating through a United States branch), and having total assets in excess of \$1,000,000,000; and (c) any other entity (other than a natural person) that is an "accredited investor" (as defined in Regulation D under the Securities Act) that extends credit as one of its businesses and has total assets in excess of \$1,000,000,000.

# Parties with Consent Rights

With the prior written consent (not be unreasonably withheld or delayed) of:

Borrower; provided, that no consent of Borrower shall be required (1) if an Event of Default has occurred and is continuing or (2) in connection with an assignment to a Person that is a Lender or an Affiliate of a Lender; and, that Borrower shall be deemed to have consented to a proposed assignment unless they object thereto by written notice to Agent within 5 Business Days after having received notice thereof; and

Agent and Issuing Bank.

# Additional Limitations on who may be an Assignee

## No assignment may be made to a Competitor

"Competitor" means any Person which is a direct competitor of Borrower if, at the time of a proposed assignment, Agent and the assigning Lender have actual knowledge that such Person is a direct competitor of Borrower; or

"Competitor" means [specific list of parties].

- Consider exclusion for entities that have only a financial interest in a Competitor.

# Additional Limitations on who may be an Assignee

No assignment may be made to a Loan Party or an Affiliate of a Loan Party; or

Assignments may be made to a Loan Party or an Affiliate of a Loan Party; provided, that any such Loan Party or Affiliate that becomes a Lender hereunder shall be subject to limitations on voting rights.

Consider also:

- Limiting the number of Loan Party Affiliate Lenders
- Limiting the percentage of the Loans that may be held by Loan Party Affiliates
- Including provisions regarding agreements on voting for amendments and in bankruptcy
- Excluding Loan Party Affiliates from “Lender only” information or meetings.

# Administrative Limitations

The amount of the Commitments and the other rights and obligations of the assigning Lender hereunder and under the other Loan Documents subject to each such assignment shall be in a minimum amount of \$1,000,000.

# Maintaining a Loan Register

Agent (as a non-fiduciary agent on behalf of Borrowers) shall maintain a register (the "Register") on which it enters the name and address of each Lender as the registered owner of the Loan held by such Lender (each, a "Registered Loan"). A Registered Loan may be assigned or sold in whole or in part only by registration of such assignment or sale on the Register.

# General Provisions for Participations

Any Lender may at any time sell to one or more Persons (a "Participant") participating interests in all or any portion of its Obligations, its Commitment, or other interests hereunder and under the other Loan Documents; provided, that

(i) such Lender shall remain a "Lender" for all purposes of this Agreement and the other Loan Documents,

(ii) Borrowers, Agent, and the Lenders shall continue to deal solely and directly with such Lender in connection with the rights and obligations hereunder and

(iii) no Participant shall have any direct or indirect voting rights except with respect to events requiring unanimous approval (and each Lender agrees that the foregoing requirements shall be incorporated into any applicable participation agreement).

# What Assignment Issues Typically Arise in Bankruptcy Cases?

Assumption and Assignment of Executory Contracts

Purchase of Pre-Petition Claim – Transfer and Assignment of Rights

Pre-Petition Contractual Assignment of Voting Rights

# Do Assignments Of Voting Rights Violate The Bankruptcy Code And/Or Its Policies – A Tale Of Two Recent Viewpoints

*In Re Coastal Broadcasting Systems, Inc.*,  
Case No. 11-10596 (Bankr. D. N.J. July 6,  
2012), 2013 WL 3285936 (June 28, 2013)

VS.

*In Re SW Boston Hotel Venture*, 460 B.R. 38  
(Bankr. D. Mass. 2011)

# *In Re Coastal Broadcasting Systems, Inc.*

Corporation redeems stock of certain of its shareholders

In exchange, the corporation issues a secured promissory note in favor of the shareholders

The selling shareholders agree to subordinate their note to the corporation's secured, senior lender and sign a subordination agreement to this effect

The subordination agreement provides that the senior, secured lender was irrevocably authorized to “take such other actions (including without limitation, voting the Subordinated Debt) as it may deem necessary or advisable.”

# *In Re Coastal Broadcasting Systems, Inc.*

Corporation files chapter 11

The corporation and its shareholders file competing plans of reorganization

The senior, secured lender argued that it was entitled to vote the shareholders' debt claims against the corporation by virtue of the subordination agreement - of course, the senior, secured lender intends to vote for the company plan which stiffs the shareholders

## *In Re Coastal Broadcasting Systems, Inc.*

Bankruptcy Court held the assignment of voting rights did not violate the Bankruptcy Code – on appeal the USDC affirmed

Section 510(c) of the BC provides for enforcement of subordination agreements as a whole – it does not distinguish between components of such agreements – e.g., those addressing priority or voting rights

# *In Re Coastal Broadcasting Systems, Inc.*

Next, section 1126(a) of the BC permits the “holder of a claim” to vote to accept or reject a plan

You can assign your right, as a creditor/claimant, to vote for or against a plan as a holder of that claim

What about public policy? Is a claimant’s right to vote fundamental (like the automatic stay which benefits a debtor) such that you cannot permit attempts to dilute the right by waiver or assignment?

# *In Re Coastal Broadcasting Systems, Inc.*

Automatic stay rights have been recently diluted by a number of courts who have found they can be waived

Also, it makes little sense that a creditor could sell all its rights to a claim yet prohibit a portion of those rights

What about Bankruptcy Rule 3018? – limits voting rights to “creditor or equity security holder or authorized agent” ---was the senior, secured lender an “authorized agent” of the shareholders?

# In Re Coastal Broadcasting Systems, Inc.

- **Creditor Position**: the senior, secured lender was not acting in the creditors' best interests but its own and not at their direction – so how can they be an authorized agent?
- **Court**: BR 3018 does not require interests of an agent to be aligned with those of the creditor or equity holder for whom it is acting by assignment. Rather, it requires only that the agent provide the instrument – e.g., the subordination agreement – under which it was empowered to act on behalf of the creditor
- **Cases in Accord**: *Blue Ridge Investors II, L.P. v. Wachovia Bank (In re Aerosol Packaging, LLC)*, 362 B.R. 43 (N.D. Ga. 2006); *Avondale Gateway Center Entitlement, LLC v. National Bank of Arizona*, No. CV10-1772-PHX-DGC, 02-09-BK-12153-CGC, 2011 WL 1376997, at \*2 (D. Ariz. Apr. 12, 2011)

# *In Re SW Boston Hotel Venture, LLC*

- In this recent case, the senior lender, Prudential Insurance Company of America, objected to debtor's chapter 11 plan of reorganization because it did not enforce a subordination agreement between Prudential and the City of Boston as required by section 510(c) of the BC
- An Intercreditor Agreement with the City required the City to assign its voting rights in any bankruptcy to Prudential in any case filed by debtor and provided it could vote the City's claim

# In Re SW Boston Hotel Venture, LLC

- Prudential voted the City's claim to reject the debtor's plan
- The City voted its claim to accept the plan
- The Court refused to enforce pre-petition assignment of voting rights between first and second lien lenders - holding that such agreements impermissibly alter substantive provisions of the Bankruptcy Code
- The agreement nullifies provisions of the BC and alters substantive rights – therefore, it is invalid
- Such a provision is contrary to section 1126(a) (“The holder of a claim or interest allowed under section 502 of this title may accept or reject a plan....”)

# *In Re SW Boston Hotel Venture, LLC*

- Creditors cannot waive plan voting rights – Congress did not intend to permit creditors to alter substantive provisions of bankruptcy law
- Without much deep analysis, and recognizing contrary judicial authority, the court found other authority more persuasive -- e.g., *Bank of America v. N. LaSalle Street Ltd. P'ship, (In re 203 N. LaSalle Street P'ship)*, 246 B.R. 325, 331 (Bankr. N.D. Ill. 2000)

# In Re SW Boston Hotel Venture, LLC

- *Bank of America v. N. LaSalle Street Ltd. P'ship, (In re 203 N. LaSalle Street P'ship)*
  - Debtor had 2 secured creditors – its general partner and BofA
  - BofA loans money to debtor – non-recourse, secured by the debtor's office building
  - Later, debtor's general partner loaned money to debtor – expressly providing it was subordinate to the BofA debt
  - The general partner entered into an Inter-Creditor Agreement with BofA which affirmed subordination of the debt and later entered into a broader "Consent and Subordination Agreement" which provided that BofA could vote the general partner's claim in any bankruptcy reorganization

# *In Re SW Boston Hotel Venture, LLC*

- Debtor files for protection under chapter 11
- Competing plans were proposed by debtor and BofA
- BofA filed a declaratory judgment action asking the court to determine the rights of the parties under the subordination agreements
- The court held that the determination of voting rights is governed by BC section 1126(a) and, by contract, North LaSalle holds the claim, but assigned its right to vote the claim in the event of bankruptcy – Question: can the parties deviate from the express language of section 1126(a)?

# *In Re SW Boston Hotel Venture, LLC*

Simply because the parties agreed to allow BofA to vote the claim is not dispositive – pre-bankruptcy agreements do not override contrary provisions of the BC --- “[S]ince bankruptcy is designed to produce a system of reorganization and distribution different from what would obtain under non-bankruptcy 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.”

Section 510(a), although directing enforcement of subordination agreements, says nothing about waiver of voting rights under section 1126(a)

Bankruptcy Rule 3018(c) does not allow the voting of subordinated creditor’s claim by a senior creditor

# In Re SW Boston Hotel Venture, LLC

The Court holds assignment of voting rights conflicts with the policy behind the BC: “Subordination affects only the priority of payment, not the right to payment. If the assets in a given estate are sufficient, a subordinated claim certainly has the potential for receiving a distribution, and Congress may well have determined to protect that potential by allowing the subordinated claim to be voted. This result assures that the holder of a subordinated claim has a potential role in the negotiation and confirmation of a plan, a role that would be eliminated by enforcing contractual transfers of Chapter 11 voting rights.”

*Accord: In re Croatan Surf Club, LLC*, No. 11-00194-8-SWH, 2011 WL 5909199, at \*1 (Bankr. E.D. N.C. October 25, 2011) (hold cram down provision in section 1129(b) may override general enforceability of subordination agreements under section 510(c)); *Beatrice Foods Co. v. Hart Ski Mfg. Co. (In re Hart Ski Mfg. Co.)*, 5 B.R. 734 (Bankr. D. Minn. 1980)

# So, Where Do We Stand?

There are cases on both sides of the issue – but none at the higher level (Circuit Court/Supreme Court)

Until the issue is decided at the circuit court level, lenders should be aware that in some jurisdictions the assignment of voting rights may be susceptible to challenges regarding enforceability