

Private Credit Restructuring Trends: No AAL, No Problem?

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*Bankruptcy Considerations for Unitranche Transactions with Super-Priority Revolvers
without an AAL*

Unitranche debt is not new to the private credit market. It has, however, evolved over time. In the earlier years of the private credit market, unitranche deals featured a single credit agreement with tranches of senior and subordinated term loans and a separate “agreement among lenders” (an “**AAL**”) setting forth the relative payment priorities and, sometimes, differing economics, between the first out and last out lenders. More recently, most private credit facilities – although still often termed “unitranches” – no longer feature two senior and subordinated term loans. Instead, these senior secured unitranche deals commonly are comprised of a single senior term loan. Indeed, Proskauer’s proprietary data shows that these first lien/unitranche structures account for 86% of Proskauer originated loans in 2022.

Over the last few years, another trend has emerged: unitranche facilities with a single senior term loan combined with a “super-priority” cash flow-based revolver. In some cases, rather than document payment priority and rights of the parties in an AAL, the relevant inter-lender payment priority is set forth in the waterfall provisions within the same credit agreement. In light of the absence of an AAL, clients have asked us about the enforceability of this structure in the event the borrower files for bankruptcy protection under chapter 11 as it relates to (i) enforcement of the relative priorities of the revolver and the term loan, (ii) entitlement to postpetition interest, and (iii) whether the two tranches will be in a single or separate class under a chapter 11 plan of reorganization. We address each point below.

1. **Enforcement of Relative Priority**

This is an easy one. As a general matter, the waterfall provisions of a unitranche credit agreement setting forth the order of repayment of loan obligations should be respected in a bankruptcy case, even in the absence of an AAL or language in a credit agreement expressly stating that the parties' agreement is intended to be a subordination agreement under section 510(a) of the Bankruptcy Code, which provides that a subordination agreement will be enforceable in bankruptcy "to the same extent that such agreement is enforceable under applicable non-bankruptcy law." The payment waterfall provision of a unitranche credit agreement is, fundamentally, a subordination agreement because it sets forth the relative payment priority between two tranches of debt. We believe that to hold otherwise would wrongly elevate form over substance. It should make no difference where the subordination is memorialized, whether in a credit agreement or an AAL. Indeed, at least one court has held that provisions governing priority found within credit agreements are enforceable subordination provisions, even if there is no separate agreement or contract executed between the competing lenders.[\[1\]](#)

2. Entitlement to Postpetition Interest

This is an unsettled issue. Bankruptcy Code section 506(b) provides for payment of postpetition interest “to the extent that an allowed secured claim is secured by property the value of which ... is greater than the amount of such claim.” In other words, over-secured creditors are entitled to payment of postpetition interest and under-secured creditors are not. Because the entitlement to postpetition interest is dependent on collateral value, this right may be not conclusively determined until later in the chapter 11 case when collateral is sold, or a plan is confirmed. In practice, postpetition interest is commonly paid on a current basis as a form of “adequate protection” in connection with debtor in possession financing or consensual cash collateral use. The right to recharacterize such payments as distributions on account of principal (rather than as postpetition interest) is customarily preserved, in case it turns out that the creditor is not over-secured. As to a unitranche facility with a super-priority revolver, if the entire facility is over-secured, then post-petition interest is clearly payable. But what happens when the collateral value breaks within the unitranche facility such that, for example, the super-priority revolver is over-secured and the term loan is under-secured? We are not aware of any courts directly addressing this question. The answer depends on whether a court will interpret “allowed secured claim” as encompassing all tranches in the unitranche secured by a single lien. If the phrase “allowed secured claim” were interpreted in this manner (rather than being broken down by tranche), then there is a risk that no tranche would be entitled to postpetition interest even if the super-priority tranche is over-secured. Many AALs address this possible scenario with a turn-over obligation from the junior tranche to the senior tranche until payment in full of the senior obligations.

3. Single or Separate Plan Class

It depends. A chapter 11 debtor has wide discretion in designing a reorganization plan when it comes to classifying claims. Classification can be a critical issue because a chapter 11 plan cannot be confirmed unless, among other things, it is approved by at least one class of non-insider creditors whose claims are impaired. Bankruptcy Code section 1122(a) simply states that a “substantially similar” claim can be in the same class. Note, however, that while section 1122 requires that claims placed into a single class be “substantially similar,” it does not demand that all “substantially similar” claims be placed into a single class – some “substantially similar” claims could be placed into separate classes. There may be, in any given scenario, factual arguments to support putting all unitranche lenders in the **same** class, namely, that the various unitranche loans arise under the **same** credit agreement, share the **same** lien on the debtor’s collateral, and may be considered part of the **same** secured claim. But there are also arguments to support ***separate*** classification, namely, distinct post-default payment priorities of the loans leading to potentially disparate recoveries depending on collateral value. Any turnover obligations or voting enhancements in favor of the super-priority revolving lenders under the credit documents could also support separate classification. As a result, we believe that a chapter 11 debtor (or plan proponent) will look to design a classification structure for a unitranche facility that best suits its strategic purpose. Hence, it is critical for unitranche lenders to have a seat at the negotiating table long before a chapter 11 plan gets filed.

Conclusion

Many aspects of unitranche deal structures have not been battle-tested. Even in the absence of an AAL, a credible attack on relative priority seems highly unlikely. Payment of postpetition interest is difficult to predict when value breaks within the unitranche and plan classification can be manipulated for strategic purposes.

[\[1\]](#) See, e.g., *In re Environmental Aspects, Inc.*, 235 B.R. 378, 396 (E.D.N.C. 1999) (“The lack of an agreement between the two creditors, however, does not necessarily mean that an effective subordination agreement did not occur.”).

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