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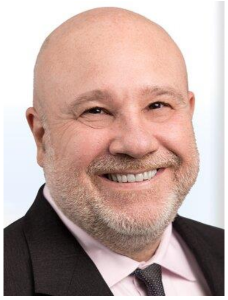
How Cooperation Contracts Can Ease Disorder In Loan Trades

By **Robert Waldner** (June 18, 2024, 5:02 PM EDT)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Increasingly, lenders of syndicated bank loans have been entering into defense-oriented so-called cooperation agreements, which restrict each cooperating lender's ability to act outside the group to cut a deal with the borrower or the noncooperating lenders at the expense of the other lenders party to the cooperation agreement.

In order to prevent leakage, should a participating lender decide to sell its position, these agreements typically limit the universe of buyers to which loans may be sold.

When these restrictions intersect with a credit agreement's requirement that the borrower consent to an assignment to a buyer who is not already a member of the lending syndicate, significant challenges to settling trades can arise. This discussion focuses on the unintended market disruption that may arise in this scenario.

Professor Samir D. Parikh at Lewis & Clark Law School has observed that, while cooperation agreements have been used sparingly for decades, "the last two years have seen a rejuvenation," citing BrandSafway, Caesars Entertainment, Carvana, Mitel, Rackspace Technologies and Travelport as recent examples.[1]

This uptick can be viewed as a direct outgrowth of the recent proliferation of so-called liability management transactions in the loan market. These transactions can be structured in various ways but, broadly speaking, they typically consist of borrowers working with some portion of their lender groups to obtain additional financing to the detriment of nonparticipating lenders.

Unsurprisingly, some of these arrangements have been controversial, but, for the foreseeable future, all indications are that we should expect to see more of them.

It is similarly unsurprising to find lenders exploring ways to protect themselves against winding up on the wrong end of these situations. One approach that has found favor recently is the cooperation agreement, whereby a group of lenders agrees to work together to explore potential restructuring transactions, vote in favor of any future group-approved restructuring proposal and, crucially, withhold consent to any proposal not endorsed by the group.

Cooperation agreements typically do not include borrowers as parties and do not provide specific details as to a restructuring proposal. They often arise early in a loan's life cycle, well before any default under the credit agreement, and cooperating lenders need not agree on specific terms for any proposed transaction. The signing lender's goal is simply to avoid being left out of future negotiations.

In order to preserve the group's bargaining power, cooperation agreements typically permit transfers of the loans only to other cooperating parties, or buyers that become cooperating parties upon consummation of their purchases. Once a group of cooperating lenders reaches critical mass, its members can take comfort that any deal with the borrower will need their approval.

Under most credit agreements, the borrower's consent is required in order to assign loans to a new lender, unless an event of default has occurred and is continuing. Generally, this consent is not sought until a seller and a buyer enter into a binding trade.

The standard terms for loan trades promulgated by the Loan Syndications and Trading Association Inc. address the possibility of required consents being withheld by requiring trading counterparties to settle trades by participation when they are unable to settle by assignment.

The ability to grant a participation becomes more problematic for a lender party to a cooperation agreement that permits sales only to parties that join the cooperation agreement. Typically, these agreements define "transfers" broadly enough to include participations, but are often unclear as to whether participants may sign on.

Even absent an explicit prohibition, parties to a cooperation agreement are often asked to make a representation that they have the power to vote on all matters concerning the loans. Under a standard Loan Syndications and Trading Association participation agreement, a participant's voting rights are purely derivative in that they have no direct voting rights under the loan agreement.

A participant's only voting power is the ability to direct the participation grantor, and even this power is constrained by the grantor's obligation to follow the instructions given by the majority of its participants, rather than each or any individual participant, and the ability to disregard instructions that would, in its reasonable judgment, either prejudice its relationship with any regulatory authority or damage its reputation.

Without a bespoke participation agreement that provides the buyer with unqualified voting rights, it seems difficult for a participant to represent that it has the voting power required by a typical cooperation agreement.

A dealer intermediating a sale of loans from a cooperation agreement party to a prospective new lender could wind up in a difficult situation if the borrower denies consent to the assignment to the ultimate buyer.

In this scenario, in order to sell to the dealer, the seller will typically look to rely on an exemption from the cooperation agreement's transfer restrictions that allow loans to be transferred to a qualified market-maker not party to the cooperation agreement, on the condition that the market-maker deliver them to a cooperating party within a specified time frame.

Once a borrower's consent is denied, the dealer and the ultimate buyer would be obligated to attempt to settle their trade via participation, but, as discussed above, a participation may not provide the buyer with the unfettered voting rights required by the cooperation agreement.

At this point, the dealer finds itself unable to settle either the buy or sell trade, because it is unable to satisfy the cooperation agreement's requirement that a qualified market-maker deliver the loans to a cooperating party once it acquires them.

Unable to consummate their trades via either assignments or participations, the Loan Syndications and Trading Association standard terms would obligate the parties to explore — typically unsatisfying — "mutually agreeable alternative structures" for settlement.

It is worth noting that restructuring support agreements and plan support agreements often contain transfer restrictions that are substantially identical to those found in cooperation agreements, and the denial of borrowers' consents to assignments has not given rise to widespread complications in those contexts.

Unlike a cooperation agreement, restructuring support agreements and plan support agreements include the borrower as a party, and usually come into play after a borrower has defaulted, thereby losing its right to withhold consent to lender assignments.

Even if it still has the power to exclude new lenders, a borrower would naturally be less inclined to object to a buyer who is willing to support restructuring terms to which the borrower has already agreed.

On the other hand, a borrower may have little interest in the machinations of a cooperating lender group, or may actively oppose them by pursuing an alternative restructuring or refinancing transaction.

Market participants that are contemplating trading loans that are subject to a cooperation agreement should take care to understand the applicable transfer restrictions and the requirements that must be met in order for a new lender to join the cooperating group.

At the time of trade, each party should be clear about its counterparty's status under both the cooperation agreement and the credit agreement and, to the extent that the denial of a required consent for an assignment is a possibility, contingent approaches should be considered.

As is so often the case in the loan market, a few minutes spent working through these issues on the front end of a trade can save hours down the road.

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[1] Samir D. Parikh, Creditors Strike Back: The Return of the Cooperation Agreement, 73 Duke Law Journal Online 1, 23 (2023).