



Unitranche in a Time Crunch

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In a business climate where merger and acquisition activity has been uneven, and political and economic uncertainty continues to grip the United States and Europe, any additional deal certainty and cost efficiency can give private equity firms a significant advantage. Whether your firm is seeking to buy a new portfolio company, refinancing an existing credit facility or planning to take a leveraged dividend, financial decision-makers should carefully evaluate the advantages and disadvantages of a unitranche loan facility when determining how best to protect and enhance the value of their investments.

What Is a Unitranche Loan?

Unitranche loan facilities feature a blended interest rate (calculated using the weighted average interest rates of the senior and junior debt facilities), single credit agreement, single set of security documents and their own pre-packaged version of the intercreditor agreement known as the "Agreement Among Lenders," which specifies the priority of various lien components in a manner similar to traditional financing documents. The Agreement Among Lenders also addresses issues related to application of collateral proceeds after the exercise of remedies, control of the exercise of remedies, voting and consent rights with respect to waivers and amendments, and the rights of lenders to purchase debt of other lenders after certain triggering events.

One important characteristic that distinguishes a unitranche loan from traditional syndicated facilities is that the initial unitranche lender provides all of the financing on the closing date, thereby avoiding some of the uncertainty, delay and cost that may arise as a result of the negotiation of the intercreditor agreement between the senior and junior lenders. Following the consummation of the transaction, the unitranche lender has the option of splitting the loan into "first-out" and "last-out" tranches to be allocated among new lenders buying into the facility. The first-out tranche will have a lower effective interest rate than the last-out tranche to account for the different levels of risk. The blended interest rate paid by the borrower, however, remains the same.

Advantages of Unitranche Facilities

Speed and Certainty

A unitranche facility requires only one set of credit and collateral documents, which allows for a more cost-efficient, certain and timely closing. Given that only one initial lender usually commits to the unitranche facility, the borrower will be able to avoid the process of obtaining additional debt ratings and can circumvent the logistical difficulties of finalizing the syndication process. Furthermore, there is no need for an intercreditor agreement given that the Agreement Among Lenders does not need to be negotiated among various lenders prior to closing.

Predictability in Pricing

Since the syndication of a unitranche facility is generally not a condition precedent to closing, unitranche loans are not subject to provisions that allow arrangers to increase the pricing and modify the structural terms of a proposed facility in order to complete the syndication process. The absence of these terms, commonly referred to as "market flex provisions," means that the cost of the facility agreed to in the unitranche term sheet is the cost that will be paid throughout the life of the loan.

Covenant Compliance

Loan payments, financial reporting, notices, consents and modifications to the unitranche credit facility only involve a single agent, and the unitranche borrower must comply with only one package of financial covenants.

Weighing the Cost

The primary drawback to a unitranche facility is the higher pricing. However, the private equity fund should compare the cost of the pricing to the costs saved upfront in the documentation of the loan, the decrease in warrants (and ultimate dilution of its equity interest in the portfolio company), the long-term interest savings generated by an amortization of the entire facility (as opposed to just the senior debt) and the savings associated with completing a proposed transaction before a structural change in market conditions (such as an increase in federal tax rates) takes effect. The exact calculus will depend on the cash flow of the portfolio company and its strategy for paying down debt.

Protect Your Valuable Brands

By Jennifer M. Mikulina, Partner, IP Prosecution, Transactions and Strategy Practice Group

Many private equity funds may be overlooking a relatively easy and cost-effective way for their portfolio companies to protect their valuable trademarks. For many companies, policing and enforcing the unauthorized use of trademarks by overseas licensees, manufacturers, former business partners and other third parties has proved a difficult task. U.S. Customs and Border Protection (Customs) procedures can assist trademark owners in meeting this challenge by offering portfolio companies the ability to record trademark registrations in a special database that Customs officials can access when they receive a suspicious shipment of goods at a U.S. port of entry. Further, the database allows Customs to share information about potentially infringing products with trademark holders.

For items originating in countries where overseas enforcement of trademarks may be difficult, the Customs review process allows companies to monitor products when they enter the U.S. market. Once Customs receives a suspicious shipment, the officer may detain it for up to 30 days. During this period, the officer will check to see if a registration for the trademark appearing on the suspicious goods has been recorded with Customs. If so, the officer will contact a representative of the trademark owner to determine if the product is legitimate. This initial contact is typically via e-mail and includes pictures of the suspicious goods. If the trademark owner can provide Customs with information that the goods are not legitimate, Customs will seize the shipment and send a letter to the trademark owner reporting the seizure.

Upon receipt of seizure letter, the trademark owner can request a sample of seized goods for testing. The seizure letter also provides additional information regarding the specific parties involved in shipment (the importer, exporter, *etc.*). This additional information allows the trademark owners to initiate further investigations into the source of the counterfeit goods and/or the U.S. importer, and it typically provides enough data to bring a trademark infringement/counterfeiting lawsuit. Customs may also work with the trademark owner to fine the companies involved in the importation of counterfeit goods.

Customs focuses its efforts on certain types of goods, including the following:

- Goods that can threaten consumer safety (pharmaceuticals, toys, electrical equipment, medical devices, *etc.*)
- Critical infrastructure components (networking equipment, semiconductors, software, *etc.*)
- Goods that threaten international safety (anything with potential military use)
- Luxury brands (counterfeit shoes and other accessories)

The recordation process is relatively inexpensive (the government fee is only \$190 per mark and per class or category of goods) and can be completed online. Portfolio companies must provide the following information (if reasonably available) to Customs:

- Ownership of trademark registration
- Place of manufacture of goods bearing mark
- Identity of foreign licensees or subsidiaries permitted to use mark
- Description of goods authorized for importation into United States

After it has recorded the trademark registrations, the private equity funds should have its portfolio company prepare a product identification training guide to help Customs identify counterfeit goods. These guides are confidential and should provide more detailed information, including the following:

- Company information (including list of trademarks and brands)
- Contact information for company representatives (or outside counsel) who can provide immediate assistance if Customs has questions about a shipment
- Descriptions of physical characteristics of genuine articles (and packaging), including pictures comparing genuine articles with unauthorized goods
- Information on approved manufacturers, licensees, importers and channels of distribution
- Information about known violators, infringers or other past issues with counterfeit goods

Once the guide is created, officers of the portfolio company typically schedule a meeting with Customs at select ports to introduce the guide and discuss any specific questions or concerns with the officers.

McDERMOTT PRIVATE EQUITY HIGHLIGHTS

- Boot Camp for Private Equity Investment Professionals: Understanding Critical LBO Terms through an Interactive Case Study, February 12
- 2013 Healthcare Services Private Equity Symposium, March 20-21
- McDermott Advises J.W. Childs on Sale of Healthcare Services Company

Questions concerning the information contained in this newsletter may be directed to your regular McDermott Will & Emery lawyer or you can contact the Firm at privateequity@mwe.com.

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