Anglo-American relations: A special relationship with subtle differences

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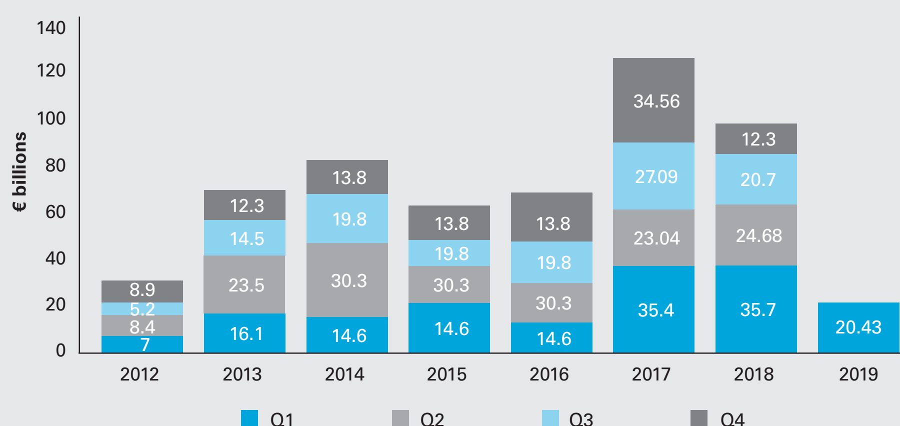
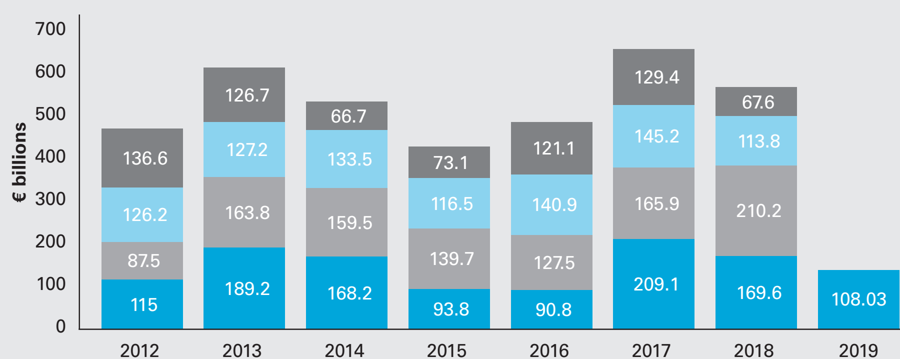
Much has been written about the influence of US terms on European transactions and particularly the steady migration of US concepts into English law facilities agreements, resulting from the supply-demand imbalance in the leveraged loan market and sponsors' (and their counsel's) knowledge of US market terms. Terms such as covenant-lite and covenant-loose are regular features of the European leveraged finance market now, where once upon a time four maintenance covenants were considered the norm. High yield bond incurrence style covenants are another example, making a regular appearance in our debt incurrence capacity negotiations alongside requests for unrestricted subsidiaries that may operate outside the constraints of the facilities agreement. Greater flexibility for making restricted payments is the (relatively) new addition to the arena, which appears to be fusing together European, high yield bond and US concepts to allow payments to sponsors at a higher leverage level than previously seen in the European market. However, in this era of conformity, the legal framework and intricacies of loan documentation on either side of the Atlantic prevents a completely uniform approach. This article seeks to explore some key provisions that still differ, for now, between the US and European leveraged finance markets; providing a rationale for these where possible or potentially uncovering trends for the future.

European leveraged loan volumes



US leveraged loan volumes



Source: S&P, *Leveraged Commentary & Data*

Documentation

For the English leveraged loan market, the Loan Market Association (LMA) has produced a recommended form of loan agreement, which can be used as a starting point. The LMA also periodically updates its documents to reflect legal developments or matters affecting the market. Historically lenders' counsel would use the most recent LMA recommended form and adapt it according to the commercial agreement reached in the term sheet. This approach helped to create familiarity of terms amongst investors, and in particular has helped trading in the secondary markets. In recent times, top-tier sponsors have been creating their own precedents, largely following the format of the LMA recommended form, but heavily amending provisions such as the representations, undertakings, prepayments, financial covenants and transfer provisions to reflect their latest commercial position. It is also common to see a hybrid structure,

The proportion of reverse-Yankee issuances as a percentage of European loan volumes in 2018

Source: S&P, *Leveraged Commentary & Data*

	LMA/England	LSTA/New York
Documentation	Top-tier sponsors will have their own precedent which loosely follows the LMA format. LMA is used for boilerplate and structure and then adapted.	Typically based on one or more agreed precedents, although certain LSTA provisions (e.g. EU bail-in recognition) are commonly incorporated.
Acquisition/Capex Facilities	Specific-purpose acquisition and capex facilities can be committed or uncommitted.	Not seen (covered through incremental facilities).
Incremental Facilities	Typically included.	Typically included.
Swingline Facility	Not typical.	Same-day-funded "swingline" loans in which RCF lenders have deemed participations. Each swingline loan reduces RCF availability.
Ancillary Facilities	Bilaterally provided by an RCF lender (or its affiliates'), reducing that lender's RCF commitments. Typically used for operational flexibility for facilities which are not provided by way of cash (for example, overdrafts or LCs).	Unusual (except for deals with a company generating a material portion of its cashflows outside of the US).
Letter of Credit Facility	The RCF can be utilised by way of LCs. Historically issued by an Issuing Bank on behalf of all lenders under the RCF but now more common for LCs to be provided as ancillary facilities or for a fronting bank (typically one of the RCF lenders).	RCF lenders have deemed participations in each LC. Typically a sub-limit of the RCF. Each LC reduces RCF availability. Many non-regulated banks are not able to issue or resist issuing trade LCs.

whereby bond-style covenants are scheduled to the loan agreement. The schedule will usually be New York law governed, with the remainder of the loan agreement governed by English law. As is becoming clear, whilst the LMA recommended form still has a part to play with respect to more boilerplate provisions, the more heavily negotiated provisions are scarcely recognisable. In the US, the opposite has been true. Whilst the Loan Syndications and Trading Association (LSTA) has produced model credit agreement provisions and, more recently, a model credit agreement, the model credit agreement is rarely used as the starting point although certain model provisions are commonly used. Each major lender historically maintained its own form of credit agreement and other documentation, with this now being replaced by the borrower's (or more likely, its counsel's) form of credit agreement or a credit agreement from an agreed precedent transaction, incorporating LSTA language where appropriate.

US$1 trillion

US leverage loan market exceeded this number in 2018

Source: S&P, *Leveraged Commentary & Data*

Certain funds

With its genesis in the Takeover Code, the English "certain funds" concept applies to public companies requiring that a bidder only announce a bid if it can fulfil its payment obligations. However, in the English leveraged finance market, this concept has been applied to private companies, not as a requirement of law, but to give sellers comfort that private equity houses, investing through special purpose vehicles, are equally able to satisfy their payment obligations under an agreed acquisition agreement. Accordingly, for private companies the requirements are heavily driven by market practice. In Europe, this has been translated into commitment papers that are usually accompanied by interim facilities agreements, under which funds can be made available within periods as short as one business day. These commitment documents will require lenders to make debt available on a limited conditionality basis (namely, a limited number of conditions precedents which are satisfied at bid stage or are otherwise within the control of the borrower), but most importantly the list of drawstop events which could hinder the borrower's ability to complete the acquisition is limited to key defaults only, such as non-payment, insolvency, illegality and change of control, in each case, in respect of the bidco only (and not the target). In the US, the concept of "certain funds" goes by the name of "SunGard provisions" (named after one of the first deals to utilise such terms). However, at the commitment stage in the US, there is no interim facility agreement, but rather an agreement as to the precedent documentation to be used to form the basis of the loan documentation to reduce documentation risk at a later stage; it will only be at that later stage that all of the conditions are satisfied. This approach results from the duty under New York law to negotiate documents in good faith, which is not a feature of English law and which mitigates against the documentation risk which would exist in English law financings but for the inclusion of the interim facilities agreement as an integral part of the commitment papers. Financing commitments in the US generally tend to contain a higher level of conditionality than found in the European market, though the vast majority of such conditions are also within the borrower's control. In particular, US deals typically include a material adverse effect drawstop event with respect to the target (rarely seen in Europe), although this will match the "no material adverse effect" condition in the acquisition agreement so the only substantive difference is that the lenders have the ability to determine if a material adverse effect has occurred (on the same terms as the bidder). The other drawstop events are similar to those seen in Europe, although they cover the target group as well, but only to the extent that the purchaser is receiving corresponding representations from the seller under the purchase agreement.

Guarantees and security

Guarantor and security coverage is another key area of difference. In the US, the expectation is that the entire group will provide guarantee support (with limited exceptions for immaterial subsidiaries), coupled with broad asset security, which can be taken over most assets (other than real estate) by way of a security and/or pledge agreement complete with a UCC filing. Whilst guarantee limitation language is included, it is included to deal with matters such as fraudulent conveyance and does not as a matter of course limit the value of the guarantee. Not infrequently, all foreign (i.e. non-US) subsidiaries are simply excluded from providing guarantees or security due to the potential for non-US credit support for US borrower obligations to give rise to adverse US tax consequences, although recent changes to the US tax code limit the circumstances where this applies and technically expand the ability to get non-US credit support. In Europe, however, there is no single approach to guarantees. Each European jurisdiction applies its own rules and regulations, based mostly on an analysis of corporate benefit and financial assistance, to determine firstly whether a guarantee can be given and, if so, the scope of the guarantee. This can result in significant limitations on the value of the guarantees given. A further nuance of the European market is the use of the guarantor coverage test, whereby the overall guarantor count need only add up to a minimum threshold agreed (currently anywhere between 70 – 85 percent is being seen in the market) comprising "material companies" and any other entities within the group required to achieve the threshold. The complexity of the process is heightened by the security arrangement, where again, there is no uniform approach across Europe. Whilst the UK follows a similar model to the US with the ability to use a single all-asset security agreement, in a number of European jurisdictions it is common to have a separate security agreement per asset class, which may need updating from time to time for asset information or lender details. Superficially, Europe appears to have a more relaxed approach to security and guarantees than the US; however, the reality is that both jurisdictions approach guarantor and security coverage from different perspectives.

In the US, the focus is on maximising the value of the lenders' secured claim in a US bankruptcy scenario (see below for further details on this). Conversely, in Europe, greater emphasis is placed on ensuring that there is a single point of enforcement in a creditor-friendly jurisdiction (most likely via share security at the parent level), thereby allowing for the sale of the business as a going concern (again, see below for further discussion on this). It is this difference in approach that manifests itself through the guarantor and security package that is ultimately requested on either side of the Atlantic Ocean.

Mandatory prepayments and events of default

Whilst a change of control is a mandatory prepayment under an English law facilities agreement, it generally constitutes an event of default under a US facilities agreement. The difference is an important one as it means that, in the US, a change of control would give the lenders the option to accelerate the loan and potentially trigger a cross default to the group's other loan agreements. Under an English loan agreement, it would result in an automatic prepayment of the facilities. Increasingly, in Europe, there has been a relaxation of the change of control provisions, such that, rather than triggering an automatic mandatory prepayment, each lender has the option to demand repayment upon a change of control (this is effectively a lender by lender decision now). Separately, there is also a steady rise in the inclusion of portability clauses, allowing sponsors to exit the transaction (upon certain conditions being met) without triggering a mandatory prepayment. A similar relaxation in approach is also arising with respect to events of default. Whilst it is scarcely seen in the US, it was typical in the European market for a material adverse effect event of default to be included. However, again, perhaps a reflection of the supply-demand imbalance in Europe, recent top-tier sponsor deals are now syndicating successfully

Roughly representing the volume of leverage buyouts out of the total European market in the first 11 months of 2018

Source: S&P, *Leveraged Commentary & Data*

	LMA/England	LSTA/New York
Guarantor coverage test	Always included.	Not included given general requirement for guarantees and security from all entities (other than excluded subs, immaterial subs, subs unable to provide security due to existing restrictions, etc.).
	Typically 70 – 85 percent guarantor coverage (but denominator will usually exclude those entities that cannot/are not required to give guarantees pursuant to the Agreed Security Principles).	N/A
	Increasing prevalence for guarantor threshold (5 – 10 percent) to be based just on EBITDA (as opposed to EBITDA and assets).	N/A
Guarantee limitations	Often extensive guarantee limitation language to address corporate benefit, financial assistance, thin capitalisation and similar rules.	Guarantee limitation language to deal with fraudulent conveyance. Recently, US tax code "deemed dividend" issue for corporations largely removed.
Unrestricted subsidiaries	Sometimes seen but not always (not contemplated by LMA at all).	Standard.

without its inclusion. Legislative and market changes are also playing a role in documentation; for example, it is now common to see specific provisions stating that Brexit will not cause any breaches of the loan agreement, which may also explain the recent push for the removal of the material adverse effect event of default, whereby triggers that are outside the control of the group are being removed from documentation.

Amendments

The process for amendments is also notably different in Europe and the US. Whilst majority lenders make most decisions, the US sets that threshold at 50.1 percent, whilst in Europe it is 66.67 percent (although the 50.1 percent threshold is becoming more common in Europe for sponsors that are also active in the US). Certain decisions are reserved for all lender consent, which in the US translates to affected lenders only, rather than unanimity. As one would expect, unanimous decisions are limited to fundamental issues which in Europe include changes to payment dates, amounts and currencies, even if the change does not affect all lenders. To address this, European documents often contain other consent thresholds. For example, the concept of "structural adjustments" attempts to limit decisions on certain matters (for example, upsizing one facility only) to majority plus affected lenders and a "super-majority" threshold (of between 75 – 90 percent) for matters relating to releasing guarantees and security. Separately, whilst both US and European documents incentivise lenders to vote in favour of decisions for fear of yank-the-bank provisions, European documentation goes further and also includes snooze-you-lose provisions whereby a lender's commitment is disregarded for voting purposes if that lender falls to respond within an agreed time period and the decision will be binding on that lender if approved.

The upcoming replacement of LIBOR as the market benchmark interest rate is prompting increased discussion in the area of amendments. In Europe, most top-tier sponsors have their own variations of the LMA's Replacement of Screen Rate clause, which effectively ensures that amendments to documentation following the withdrawal of LIBOR can be made with majority consent, rather than with unanimous consent (plus borrower consent). In the US, there is more variation in when and how a LIBOR replacement rate is selected. One common approach is to (i) set forth the situations in which a LIBOR replacement rate may be selected, (ii) permit the administrative agent and the borrower to select the LIBOR replacement rate and (iii) have the selected LIBOR replacement rate become effective unless a majority (50.1 percent) of lenders objects within a given time period. As with LMA, LSTA is actively working with the market in the US to prepare for the replacement of LIBOR in an effort to aid market participants in replacing LIBOR in an orderly and predictable manner.

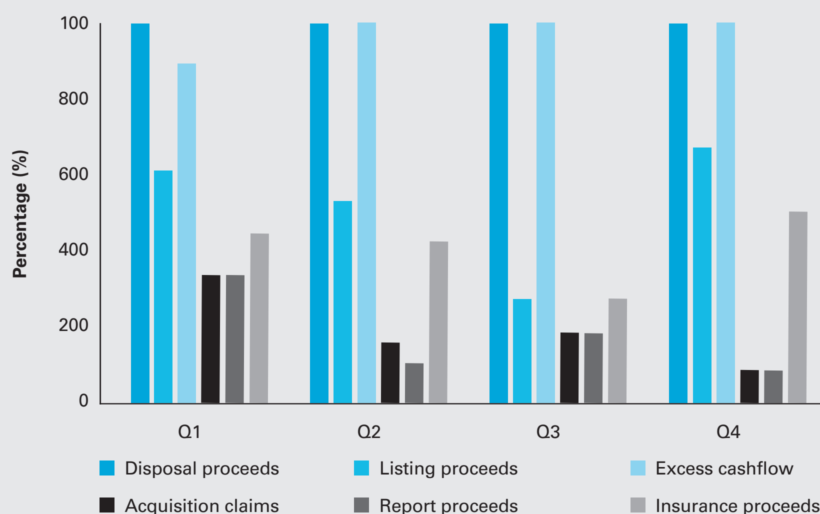
In April 2019, the Alternative Reference Rates Committee ("ARRC"), which was convened by the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York and includes private-market participants, published recommended fallback

	LMA/England	LSTA/New York
Mandatory Prepayments	LMA lists proceeds recovered under acquisition agreement, disposals, reports, insurance (typically subject to exceptions). Becoming increasingly uncommon to see these in transactions.	Recovery event sweep covers insurance but typically does not cover payments under acquisition agreement or reports.
Change of Control	Change of Control typically triggers a mandatory prepayment. Increasingly a prepayment option (at par) exercisable by each individual lender (rather than automatic).	Change of Control typically treated as an Event of Default. Prepayment option not seen.
Events of Default	Business MAE Event of Default customary.	No MAE Event of Default.
Acceleration	Subject to a positive decision on the part of the lenders (but automatic acceleration should apply in case of US bankruptcy event affecting any entity).	Automatic acceleration in respect of any US bankruptcy event.

More than 80% of the US market is deemed "cov-lite"

Source: S&P, *Leveraged Commentary & Data*

2018—European market mandatory prepayments



Source: Debt Explained

2018—voting thresholds in Europe

Majority lender

	Q1 2018	Q2 2018	Q3 2018	Q4 2018
More than 66.67%	28%	26%	–	–
66.67% or more	33%	11%	27%	25%
50.1% or more	39%	53%	55%	58%
50.1% or more but 66 ²/₃% for acceleration	–	11%	18%	8%

Source: Debt Explained

language for market participants to consider for syndicated loans. The recommended fallback language provides for two approaches: (i) a "hardwired approach", which first looks to the secured overnight financing rate published by the Federal Reserve Bank of New York (commonly called "SOFR") as the replacement rate (which is subject to adjustments), and (ii) an "amendment approach", which is similar to the common approach being seen in the European market.

US$10.8 billion

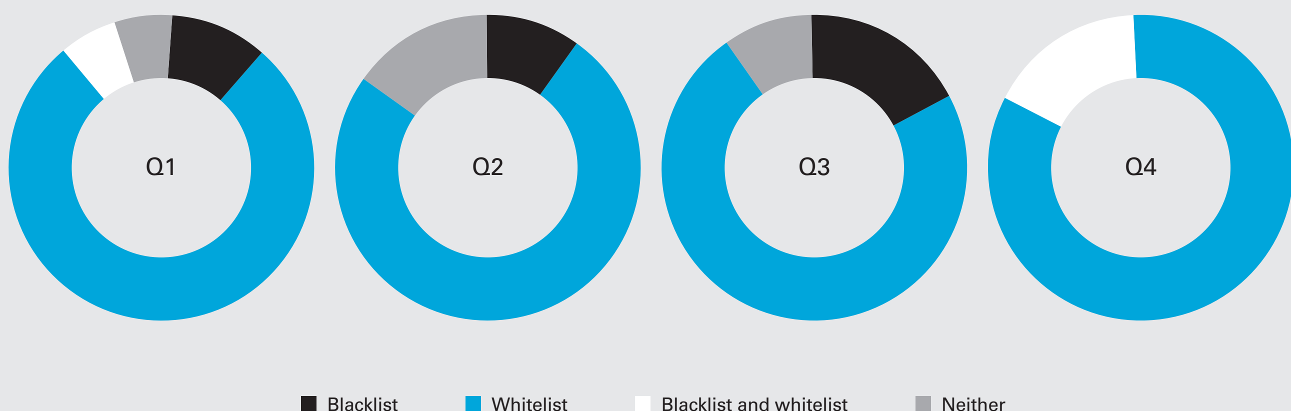
Syndicated second-lien paper issued in the US in 2018

Source: *S&P, Leveraged Commentary & Data*

Transfers

Up until relatively recently, the position with respect to transfers was largely settled in Europe, with transfers requiring the consent of the borrower (consent not to be unreasonably withheld and deemed given within 5 – 10 business days) unless the transfer was (i) to a lender or to an affiliate or related fund of a lender; (ii) to an entity set out on an approved list; or (iii) made whilst an event of default is continuing. However, with sponsors concerned about the composition of their syndicate, particularly in an enforcement scenario, lenders have seen further reductions in their ability to make transfers (with restrictions on transfers to disqualified lenders and industrial competitors being included) but most importantly with limits on when these restrictions fall away. The most onerous of these terms sees restrictions applying indefinitely (for example, in the case of transfers to industrial competitors) and in other cases disapplied in only limited cases (for example, the fall-away for all events of default being limited to key defaults only, such as non-payment or insolvency). In the US, the approach is similar, although it is more common to utilise a list of disqualified lenders to whom loans may not be transferred (which will also include competitors). On its face, therefore, the US and Europe seem to have somewhat converged. However, in some respects the European position appears to be more onerous as Europe now grapples with both such concepts (having to comply with whitelists and indirectly with blacklists through the introduction of the industrial competitors concept; and in some cases, all three). Furthermore, whilst transfers to lenders on whitelists are permitted, the sponsors usually retain the right to remove names (usually up to five names per year) from the list. There is usually no obligation to add to the list,

2018—Transfer restrictions in Europe



Source: Debt Explained

although sponsors can be requested to consider new additions in good faith. Europe is therefore finely poised between a depleting list of transferees on the one hand and a list of absolute restrictions on the other.

Intercreditor agreements

The use and importance of intercreditor agreements is also another distinguishing factor between the two regimes. In the US, intercreditor agreements are not used on every deal. Instead, they are most often used on first-lien/second-lien deals and split-collateral deals in order to create contractual subordination in respect of security (but not of payment, though it is, of course, possible to agree to payment subordination as well) and, unlike in European deals, do not include as parties other groups of secured creditors (such as hedge counterparties and cash management providers). Members of the borrower group sign the intercreditor agreement only to acknowledge the terms of it and have no obligations themselves. However, this approach is on the premise that most corporate restructurings in the US involve federal bankruptcy court proceedings. This is conducted under the supervision of a US Bankruptcy Court and gives creditors defined rights under the US Bankruptcy Code to restructure the debtor's debt. The reorganisation process is protected under a court-ordered automatic stay on any creditor action (importantly, this includes all creditors, including trade creditors) against the debtor. Under this framework, intercreditor agreements often include express lien priorities and advance waivers (mostly from the junior creditors) relating to enforcement, release of guarantors and collateral and rights in bankruptcy proceedings. Further, in certain circumstances the US Bankruptcy Code allows for the discharge of collateral (especially to the extent the amount of the secured claim exceeds the value of the collateral after deducting the amount of the senior claims) and for the discharge of remaining and unsecured claims when done pursuant to a Bankruptcy Court-approved plan of reorganisation. One of the distinguishing factors of the regime is that it binds all creditors of the given debtor (or group of debtors) with senior secured lenders exercising significant influence through this process as a result of holding senior secured claims

Intercreditor terms—comparison

Term	London/Europe	US
Payment subordination	■	
Lien subordination	■	■
Recovery waterfall	■	■
Enforcement restrictions	■	■
Turnover provision	■	■
Release mechanics for junior debt, intercompany debt and shareholder debt on distressed enforcement	■	
Purchase option	■	■
Hedging voting rights	■	
Amendment restrictions	■	■

US$43.6 billion

The volume of large global deals sold into Europe in 2018

Source: S&P, *Leveraged Commentary & Data*

Percentage of US financing structures that included first-lien and second-lien term loans in 2018

Source: S&P, *Leveraged Commentary & Data*

on all (or substantially all) of the assets of a US borrower group such that the role that intercreditor agreements play is often in the nature of strengthening the position of a senior creditor that already has substantial control.

In contrast, there is no unifying European bankruptcy code that can be used to implement a restructuring across different European jurisdictions. This means that creditors of European debtor companies that have assets and operations in multiple European jurisdictions may need to navigate multiple insolvency laws. In Europe, the location of the debtor and its assets can have a significant impact on the restructuring options available to creditors. Against that background, lenders in Europe place great emphasis on out-of-court enforcement methods (such as ensuring there is a single point of enforcement in a creditor-friendly jurisdiction) and looking to intercreditor agreements to regulate the relationship between the various creditors. European intercreditor agreements seek to contractually replicate the position offered by the US Bankruptcy Code. Accordingly, contrary to the position in the US, in Europe not only is it common for hedge counterparties to be party to the intercreditor agreements, they are usually also entitled to vote on a *pari passu* basis with the debt holders in their class on certain enforcement actions. The borrower group would also be a party to the intercreditor agreement and not merely to acknowledge its terms, but to agree to its subordinated position. Whilst the US Bankruptcy Code will apply the results of a restructuring to all creditors of a debtor, a European restructuring by way of an intercreditor agreement will only apply to those creditors of a debtor that are party to the intercreditor agreement.

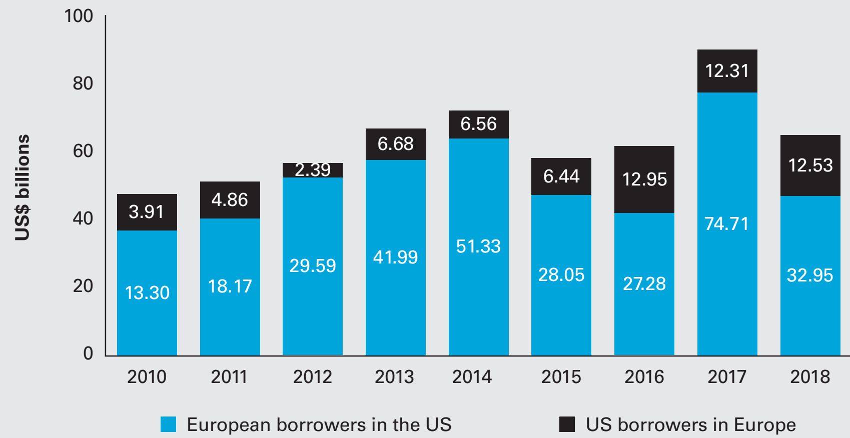
Likewise, European intercreditors contractually give senior creditors the right to enforce a standstill period (akin to the US automatic stay) which limits the rights of junior creditors to bring enforcement action and give the senior creditors time to implement a disposal if they so choose. Furthermore, in Europe it is common for the intercreditor agreement to include an express contractual release provision to compel the release of junior creditors' claims (both guarantees and security) upon a sale of secured assets by the senior creditors, subject to fair value protections. These provisions would equally apply in releasing all claims that the borrower group may have as against each other; again solidifying the rationale behind having all such creditors party to the intercreditor agreements. These points highlight that whilst the legislative backdrop in the US gives parties the freedom

to provide loans without needing an intercreditor agreement in all occasions, the European model seeks to contractually give parties the same rights, such that the end position is more similar than dissimilar.

Conclusion

This article highlights that whilst there is already a significant convergence on a number of commercial points, the different legal framework and the needs of participants locally still involves a number of significant differences in documentation in the US and the UK. However, with the market developing over time, it remains to be seen which points can survive the test of time (particularly in light of legal restraints) and which are on "borrowed" time.

Yankee and reverse-Yankee loan volume



Source: LCD, an offering of S&P Global Market Intelligence