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THE INTERNATIONAL COMPARATIVE LEGAL GUIDE TO:

Lending & Secured Finance 2014

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Published by
Global Legal Group Ltd.
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London SE1 3PL, UK
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Email: info@glgroup.co.uk
URL: www.glgroup.co.uk

GLG Cover Design
F&F Studio Design

GLG Cover Image Source
iStockphoto

Printed by
Ashford Colour Press Ltd.
April 2014

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ISBN 978-1-908070-95-1
ISSN 2050-9847

Strategic Partners

Editorial Chapters:

1	**Loan Syndications and Trading: An Overview of the Syndicated Loan Market** – Bridget Marsh & Ted Basta, The Loan Syndications and Trading Association	1
2	**Loan Market Association – An Overview –** Nigel Houghton, Loan Market Association	7
3	**Asia Pacific Loan Market Association – An Overview –** Janet Field, Asia Pacific Loan Market Association	11

General Chapters:

4	**An Introduction to Legal Risk and Structuring Cross-Border Lending Transactions** – Thomas Mellor & Marc Rogers Jr., Bingham McCutchen LLP	15
5	**Global Trends in Leveraged Lending** – Joshua W. Thompson & Caroline Leeds Ruby, Shearman & Sterling LLP	20
6	**Recent Trends in U.S. Term Loan B** – Meyer C. Dworkin & Monica Holland, Davis Polk & Wardwell LLP	26
7	**Yankee Loans – Structural Considerations and Familiar Differences from Across the Pond to Consider** – R. Jake Mincemoyer, White & Case LLP	31
8	**Issues and Challenges in Structuring Asian Cross-Border Transactions – An Introduction** – Roger Lui & Elizabeth Leckie, Allen & Overy LLP	36
9	**Acquisition Financing in the United States: Outlook and Overview –** Geoffrey Peck & Mark Wojciechowski, Morrison & Foerster LLP	41
10	**A Comparative Overview of Transatlantic Intercreditor Agreements –** Lauren Hanrahan & Suhrud Mehta, Milbank, Tweed, Hadley & McCloy LLP	46
11	**Oil and Gas Reserve-Based Lending** – Robert Rabalais & Matthew Einbinder, Simpson Thacher & Bartlett LLP	52
12	**Lending to Health Care Providers in the United States: Key Collateral and Legal Issues** – Art Gambill & Kent Walker, McGuireWoods LLP	56
13	**A Comparison of Key Provisions in U.S. and European Leveraged Loan Agreements** – Sarah M. Ward & Mark L. Darley, Skadden, Arps, Slate, Meagher & Flom LLP	61
14	**Financing in Africa: A New Era** – Nicholas George & Pascal Agboyibor, Orrick, Herrington & Sutcliffe LLP	67
15	**LSTA v. LMA: Comparing and Contrasting Loan Secondary Trading Documentation Used Across the Pond** – Kenneth L. Rothenberg & Angelina M. Yearick, Andrews Kurth LLP	72
16	**The Global Subscription Credit Facility Market – Key Trends and Emerging Developments** – Michael C. Mascia & Kiel Bowen, Mayer Brown LLP	79
17	**Majority Rules: Credit Bidding Under a Syndicated Facility** – Douglas H. Mannal & Thomas T. Janover, Kramer Levin Naftalis & Frankel LLP	83

Country Question and Answer Chapters:

18	**Albania**	KALO & ASSOCIATES: Nives Shtylla	87
19	**Angola**	SRS Advogados in cooperation with Adjuris: Carla Vieira Mesquita & Gustavo Ordonhas Oliveira	94
20	**Argentina**	Marval, O'Farrell & Mairal: Juan M. Diehl Moreno & Diego A. Chighizola	101
21	**Australia**	Clayton Utz: David Fagan	109
22	**Bermuda**	MJM Limited: Jeremy Leese & Timothy Frith	117
23	**Bolivia**	Criales, Urcullo & Antezana - Abogados: Carlos Raúl Molina Antezana & Andrea Mariah Urcullo Pereira	127
24	**Botswana**	Khan Corporate Law: Shakila Khan	134
25	**Brazil**	TozziniFreire Advogados: Antonio Felix de Araujo Cintra	141
26	**British Virgin Islands**	Maples and Calder: Michael Gagie & Matthew Gilbert	147
27	**Canada**	McMillan LLP: Jeff Rogers & Don Waters	154
28	**Cayman Islands**	Maples and Calder: Alasdair Robertson & Tina Meigh	162
29	**China**	DLA Piper: Robert Caldwell & Peter Li	169
30	**Costa Rica**	Cordero & Cordero Abogados: Hernán Cordero Maduro & Ricardo Cordero Baltodano	177
31	**Cyprus**	Andreas Neocleous & Co LLC: Elias Neocleous & George Chrysaphinis	184

Continued Overleaf

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Country Question and Answer Chapters:

32	**Czech Republic**	JŠK, advokátní kancelář, s.r.o.: Roman Šťastný & Patrik Müller	192
33	**Denmark**	Bruun & Hjejle: Jakob Echwald Sevel & Peter-Andreas Bodilsen	198
34	**England**	Skadden, Arps, Slate, Meagher & Flom LLP: Clive Wells & Paul Donnelly	205
35	**France**	Freshfields Bruckhaus Deringer LLP: Emmanuel Ringeval & Cristina Radu	215
36	**Germany**	Cleary Gottlieb Steen & Hamilton LLP: Dr. Werner Meier & Daniel Ludwig	224
37	**Greece**	KPP Law Offices: George N. Kerameus & Panagiotis Moschonas	235
38	**Hong Kong**	Bingham McCutchen LLP in association with Roome Puhar: Vincent Sum & Naomi Moore	242
39	**India**	Dave & Girish & Co.: Mona Bhide	253
40	**Indonesia**	Ali Budiardjo, Nugroho, Reksodiputro: Theodoor Bakker & Ayik Candrawulan Gunadi	259
41	**Italy**	Chiomenti Studio Legale: Francesco Ago & Gregorio Consoli	266
42	**Japan**	Bingham Sakai Mimura Aizawa: Taro Awataguchi & Toshikazu Sakai	274
43	**Korea**	Lee & Ko: Woo Young Jung & Yong Jae Chang	282
44	**Kosovo**	KALO & ASSOCIATES: Vegim Kraja	289
45	**Luxembourg**	Bonn & Schmitt: Alex Schmitt & Philipp Mössner	297
46	**Mexico**	Cornejo Méndez Gonzalez y Duarte S.C.: José Luis Duarte Cabeza & Ana Laura Méndez Burkart	303
47	**Morocco**	Hajji & Associés: Amin Hajji	310
48	**Mozambique**	SRS Advogados in association with Bhikha & Popat Advogados: Momede Popat & Gonçalo dos Reis Martins	317
49	**Netherlands**	Loyens & Loeff N.V.: Gianluca Kreuze & Sietske van 't Hooft	322
50	**Nigeria**	Ikeyi & Arifayan: Nduka Ikeyi & Kenechi Ezezika	330
51	**Peru**	Miranda & Amado Abogados: Juan Luis Avendaño C. & Jose Miguel Puiggros O.	337
52	**Portugal**	SRS Advogados: William Smithson & Gonçalo dos Reis Martins	346
53	**Russia**	White & Case LLP: Maxim Kobzev & Natalia Nikitina	352
54	**Singapore**	Drew & Napier LLC: Valerie Kwok & Blossom Hing	359
55	**South Africa**	Brian Kahn Inc. Attorneys: Brian Kahn & Michelle Steffenini	367
56	**Spain**	Cuatrecasas, Gonçalves Pereira: Manuel Follía & Héctor Bros	373
57	**Switzerland**	Pestalozzi Attorneys at Law Ltd: Oliver Widmer & Urs Klöti	381
58	**Taiwan**	Lee and Li, Attorneys-at-Law: Abe Sung & Hsin-Lan Hsu	390
59	**Thailand**	LawPlus Ltd.: Kowit Somwaiya & Naddaporn Suwanvajukkasikij	398
60	**Trinidad & Tobago**	J.D. Sellier + Co.: William David Clarke & Donna-Marie Johnson	405
61	**USA**	Bingham McCutchen LLP: Thomas Mellor & Rick Eisenbiegler	414
62	**Venezuela**	Rodner, Martínez & Asociados: Jaime Martínez Estévez	425
63	**Zambia**	Nchito & Nchito: Nchima Nchito SC & Ngosa Mulenga Simachela	430

Yankee Loans – Structural Considerations and Familiar Differences from Across the Pond to Consider

White & Case LLP

R. Jake Mincemoyer

Introduction

The depth and liquidity of the investor base in the US institutional term loan market provides an attractive alternative for European borrowers in the leveraged finance market and has been a key source of financing liquidity, particularly in the last few years as European markets have suffered from macroeconomic uncertainty and regulatory constraints. The comparatively lower pricing of US dollar leveraged loans available in the US compared to that of leveraged loans in the European market has also been an attraction for European borrowers, even once the cost of currency hedging has been factored in.

There are, however, a number of issues to consider in structuring so called "Yankee Loans" (US institutional term loans provided to European borrower groups governed by New York law credit documentation). These are driven primarily by differences in restructuring regimes in the US and Europe, and also by the needs (and expectations) of US institutional term loan investors.

There are also a number of features typical for the European leveraged loan market which, while familiar in the US leveraged loan market, are treated in very different ways in New York law governed deals. In the context of Yankee Loans, many of these differing features or familiar differences need to be considered more carefully and amount to much more than e.g. a mere difference between English and American spelling. This article considers firstly some of the key structuring considerations for Yankee Loans and then goes on to discuss some key familiar differences between the US and European leveraged finance markets, to be considered more carefully in the context of Yankee Loans.

Structuring Considerations

(Re)structuring is key

The primary focus of senior lenders in any leveraged finance transaction is the ability to recover their investment in a default or restructuring scenario. The optimal capital structure minimises enforcement risk by ensuring the senior lenders have the ability to control the restructuring process, which is achieved differently in the US and Europe. In the US, a typical restructuring is a creature of statute and is usually accomplished through a Chapter 11 case under the US Bankruptcy code, where senior lenders' status as such is protected by well-established rights and processes. By contrast, in Europe, an effective restructuring for senior lenders in a leveraged finance transaction is typically a creature of contract – typically the intercreditor agreement – this is because placing a company into formal European insolvency proceedings is often seen as the option of last resort as it limits the restructuring options (and likely value recovery) available to the senior lenders. Due to this difference in expectation around how a restructuring is expected to take place, the US and European leveraged finance markets start from very different places when it comes to structuring leveraged finance transactions. In the US, structures typically assume a US Bankruptcy process, and in Europe structures typically assume a restructuring outside of a formal insolvency process, relying on contractual rights in an intercreditor agreement.

In the US, a restructuring implemented under Chapter 11 of the US Bankruptcy Code is a uniform, typically group-wide, court-led process where the aim is to obtain the greatest return by delivering the restructured business out of bankruptcy as a going concern. Bankruptcy petitions filed under Chapter 11 invoke an automatic stay prohibiting any creditor (importantly this includes trade creditors) from taking enforcement action which in terms of practical effect has global application, as a violation of the stay may lead to an order of contempt from the applicable US Bankruptcy Court. The automatic stay protects the reorganisation process by preventing any creditor from taking enforcement action that could lead to a diminution in the value of the business. It is important to note that a Chapter 11 case binds all creditors of the given debtor (or group of debtors). US lenders retain control through this process as a result of their status as senior secured creditors holding senior secured claims on all (or substantially all) of the assets of a US borrower group.

By contrast, in Europe senior lenders traditionally rely on contractual tools contained in an intercreditor agreement to retain control of a restructuring process. These contractual tools found in a European intercreditor agreement include standstills applicable to junior creditors party to the intercreditor agreement and release provisions applicable upon a distressed disposal of the borrower group. These allow for the group to be sold as a going concern (typically following the enforcement of a share pledge at a holding company level) and released from the claims of the creditors party to the intercreditor agreement following the application of the proceeds from such sale pursuant to an agreed waterfall. This practice has developed because, unlike the US Chapter 11 framework, there is no equivalent single insolvency regime that may be implemented across Europe. While the EC Regulation on Insolvency Proceedings provides a set of laws that promote the orderly administration of a European debtor with assets and operations in multiple EU jurisdictions, such laws do not include a concept of a "group" insolvency filing and most European insolvency regimes (with limited exceptions) do not provide for a

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stay on enforcement applicable to all creditors. Worth noting, however, is that while a Chapter 11 proceeding binds all of the borrower's creditors, the provisions of the intercreditor agreement are only binding on the parties thereto. Typically these would be the primary creditors to the group (such as senior bank lenders, mezzanine lenders and/or high yield bondholders), but would not include trade and other non-finance creditors, nor (unless execution of an intercreditor agreement is required as a condition to such debt being permitted) third party creditors of permitted debt.

In addition to the challenges arising as a result of multiple different European restructuring and insolvency laws, placing a company into formal insolvency proceedings in many European jurisdictions is largely seen as the last option, as it will often impact the lenders' ability to sell the business as a going concern and therefore will in most instances reduce the value recovered (attitudes in Europe towards filing for formal insolvency proceedings are generally negative, with vendors and customers typically viewing it as a precursor to the corporate collapse of the business).

Therefore, in order to obtain strategic control in an out-of-court restructuring of a European borrower, it is important that senior lenders are able to use their contractual rights to not only control the reorganisation of the borrower's obligations (either by taking enforcement action, typically pursuant to a share pledge over the equity interests in a holding company of the borrower group, or by leveraging those rights to renegotiate the terms of the financing) but also to prevent other creditors from pushing the borrower into a formal insolvency process.

Historically, deals syndicated in the US leveraged loan market were those where the business or assets of the borrower's group were mainly in the US, albeit that some of the group may have been located in Europe or elsewhere, and these deals traditionally adopted the US approach to structuring: the loan documentation was typically New York law governed and assumed any restructuring would be effected in the US. Similarly, deals syndicated in the European leveraged loan market were historically those where the business or assets of the group were mainly in Europe, and these deals traditionally adopted a European approach to structuring: the loan documentation was typically English law governed, based on the LMA form of senior facilities agreement, and provided contractual tools for an out-of-court restructuring in an intercreditor agreement (typically based on an LMA form).

US institutional term loan investors are most familiar with, and typically expect, NY law and market-style documentation. Therefore, most Yankee Loans are done using NY documentation, which includes provisions in contemplation of a US Bankruptcy in the event of a reorganisation (including, for example, an automatic acceleration of loans and cancellation of commitments upon a US Bankruptcy filing due to the automatic stay applicable upon a US Bankruptcy filing). However, while a European borrower group could elect to reorganise itself pursuant to a US Bankruptcy proceeding (which would require only a minimum nexus with the US), most European borrower group restructurings have traditionally occurred outside of a formal insolvency process, as described above.

It is therefore important that US lenders ensure that the structure and documentation of the financing for a European borrower group provide the contractual tools necessary to allow the senior lenders to have control of the restructuring process before the borrower may be required to initiate a local insolvency filing (which in some jurisdictions is an obligation binding on directors) or other creditors take enforcement actions which may trigger a formal insolvency.

To ensure senior lenders' ability to drive the process in Europe and protect their recoveries against competing creditors, a Yankee Loan done under NY documentation should include the contractual "restructuring tools" typically found in a European-style intercreditor agreement, most notably a release or transfer of claims upon a distressed disposal, and consideration should be given as to whether to include a standstill on enforcement actions applicable to junior creditors (which in many ways can be seen as a parallel to the automatic stay under the US Bankruptcy Code) to protect against a European borrower's junior creditors accelerating their loans and forcing the borrower into insolvency. If that were to occur, the likelihood of an effective restructuring of the business would be reduced as, not only would the senior creditors lose the ability to effectively control enforcement of their security (for example, arranging a pre-packaged sale of the business), but also, the equity holders would lose the ability to negotiate exclusively with the senior creditors for a period of time.

Who/Where is your borrower and your guarantors?

Legal/structuring considerations

In US leveraged loan transactions, the most common US state of organisation of the borrower is Delaware, but the borrower could be organised in any state in the US without giving rise to material concerns to senior lenders. In Europe, however, there are a number of considerations which are of material importance to senior lenders when evaluating in which European jurisdiction a borrower should be organised. First, many European jurisdictions have regulatory licensing requirements for lenders to borrowers organised in that jurisdiction. Second, withholding tax is payable in respect of payments made by borrowers organised in many European jurisdictions to lenders located outside of the same jurisdiction. Finally, some European jurisdictions may impose limits on the number of creditors of a particular nature a borrower organised in that jurisdiction may have.

Similarly, the value of collateral and guarantees from US borrower group members in US leveraged loan transactions is generally not a source of material concern for senior lenders. The UCC provides for a relatively simple and inexpensive means of taking security over substantially all of the non-real property assets of a US entity and, save for well understood fraudulent conveyance risks, upstream, cross stream and downstream guaranties from US entities do not give rise to material concerns for senior lenders.

However, the value of upstream and cross stream guarantees given by companies in many European jurisdictions is frequently limited as a matter of law. These limits can often mean that lenders do not get the benefit of a guarantee for either the full amount of their debt or the full value of the assets of the relevant guarantor. There are also very few European jurisdictions in which fully perfected security interests can be taken over substantially all of a company's non-real property assets with the ease or relative lack of expense afforded by the UCC. In many jurisdictions it is not practically possible to take security over certain types of assets, especially in favour of a syndicate of lenders which may change from time to time (if not from day-to-day).

As a result, in structuring a Yankee Loan, significant consideration should be given to the jurisdiction of the borrower, and guarantors within the group, in light of a number of issues that are not typically relevant for a US leveraged loan transaction. In addition, as discussed in more detail below, consideration should be given to the fact that due to the limitations on upstream and cross stream guarantees and the ability to include substantially all of an entity's assets as collateral, third party debt incurred at a subsidiary guarantor level may have claims that are *pari passu* with, or senior to, the claims of the senior secured lenders who have lent to a

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holding company of the guarantor, even if such third party debt is unsecured.

In addition, to ensure that a European restructuring may be accomplished through the use of the relevant intercreditor provisions, consideration should be given to determine an appropriate "enforcement point" in the group structure where a share pledge could be enforced to effect a sale of the group. The ease with which such share pledge may be enforced (given the governing law of the share pledge and the jurisdiction of the relevant entity whose shares are to be sold) should also be considered to ensure that the distressed disposal provisions in a European intercreditor agreement may be fully taken advantage of if needed.

Investor considerations

Many institutional investors in the US leveraged loan market (CLOs in particular) have investment criteria which governs the loans that they may participate in. These criteria usually include the jurisdiction of the borrower of the relevant loans, with larger availability or "baskets" for US borrower loans, and smaller "baskets" for non-US borrower loans. As a result, many recent Yankee Loans have included US co-borrowers in an effort to ensure that a maximum number of US institutional leveraged term loan investors could participate in the financing. The addition of a US co-borrower in any financing structure merits careful consideration of many of the issues noted above if the other co-borrower is European. For example, the non US co-borrower may not legally be able to be fully liable for its US co-borrower's obligations due to cross-guarantee limitations. In addition, a US co-borrower may raise a number of tax structuring considerations, including a potential impact on the deductibility of interest, which should be carefully considered.

Familiar Differences

Covenant flexibility

In addition to the well-known (if not fully understood or appreciated) difference in drafting style between NY leveraged loan credit agreements and European LMA facility agreements, the substantive terms of loan documentation in the US and European markets have traditionally differed as well, with certain concepts moving across the Atlantic in either direction over time. Most recently, we have seen increased flexibility for borrowers in a variety of forms moving slowly from the US market to Europe, but many common US provisions have yet to gain broad market acceptance in the current European market, which adds to the attractiveness of Yankee Loans for European borrowers.

One aspect of the terms for US leveraged loan transactions which has not readily emerged on the European side of the Atlantic has been the trend in the US for "covenant-lite" facilities, in which typically only the revolving facility benefits from a financial covenant (but not the term facilities). Financial covenants in US leveraged deals (whether or not "covenant-lite") also routinely include "equity cure" provisions which allow for an "EBITDA cure", pursuant to which an equity contribution may be made to "cure" a financial covenant breach, with the cure amount being deemed to be contributed to the EBITDA side of the leverage ratio (i.e. the ratio of debt to EBITDA), rather than reducing debt (either through a deemed reduction or an actual repayment), as is typically seen in European "equity cure" provisions.

The negative covenant package for "covenant-lite" facilities in the US also typically contains incurrence ratio baskets similar to what would commonly be found in a high yield bond covenant package, which provide permissions (for example to incur additional debt) subject to compliance with a specific financial covenant ratio which is tested at the time of the specific event, rather than a maintenance covenant which would require continual compliance at all times, which traditionally has been required in bank loan covenants.

All of these features of the current US institutional term loan market provide attractive flexibility for European borrowers, and are frequently included in Yankee Loans, which adds to their appeal for European borrowers. Senior lenders should however consider these features carefully, as they may have different impacts in a Yankee Loan provided to a European group compared to a loan made to a US group.

Debt incurrence covenants in particular should be carefully considered in the context of a Yankee Loan. As noted above, guarantees provided by European group members may be subject to material legal limitations and the collateral provided by European guarantors may be subject to material legal and/or practical limitations resulting in security over much less than "all assets" of the relevant guarantor. This may lead to an unexpected result for senior lenders accustomed to guarantees and collateral provided by US entities in the event of a restructuring consummated by means of a Chapter 11 process. If permitted incremental or ratio debt is incurred by a borrower that is also a guarantor of the main credit facilities and such guarantee or collateral is subject to material limitations, the claims of the creditors of such incremental or ratio debt, even if unsecured, may be *pari passu*, or even effectively senior to the guarantee claims of the senior secured lenders of the main credit facilities at that guarantor. In a Chapter 11 proceeding involving such a guarantor, the senior lenders will only have a senior secured claim against that guarantor to the extent of their guarantee claim and the value of any collateral provided by that guarantor.

In addition, in the event of a restructuring accomplished by means of a distressed disposal and release of claims utilising the contractual provisions from a European intercreditor agreement, the providers of incremental or ratio debt may not be subject to the terms of the intercreditor agreement if they are not a party thereto. As a result, they will not be subject to any standstills on enforcement actions, or subject to any release provisions upon a distressed disposal, even if such debt is junior secured or unsecured in nature. This again may be an unexpected result for senior lenders. While the contractual provisions in a European intercreditor agreement in many ways emulate two of the key features of a Chapter 11 proceeding – a standstill on enforcement applicable to junior creditors, which is comparable to the Chapter 11 automatic stay and the release of claims upon a distressed disposal, which is comparable to the release of claims which may be effected upon a US Bankruptcy Court confirming a plan of reorganisation, these features only apply to creditors that are party to the intercreditor agreement (as opposed to a Chapter 11 proceeding, which generally binds all creditors to a given debtor). It should be noted that these concerns apply to all third party debt incurred by guarantors with limited guarantees and/or collateral pursuant to general baskets or in respect of trade credit, but the risk is heightened in relation to incremental or ratio debt that may be incurred pursuant to incurrence ratio baskets.

Conditionality

Documentation Principles vs. Interim Facilities and "Full Docs"

In acquisition financing, the risk that the purchaser in a leveraged buyout will not reach agreement with its lenders prior to the closing of the acquisition (sometimes referred to as "documentation risk") is generally not a material concern (or at least is a well understood and seen to be manageable concern) of sellers in private US

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transactions. Under New York law, there is a general duty to negotiate the terms of definitive documentation in good faith and US leveraged finance commitment documents also typically provide that the documents from an identified precedent transaction will be used as the basis for documenting the definitive credit documentation, with changes specified in the agreed term sheet, together with other specified parameters. These agreed criteria are generally referred to as "documentation principles" and give additional comfort to sellers in US transactions that the documentation risk is minimal.

In European deals, there is generally a much greater concern of sellers relating to documentation risk. This can be explained in part by the fact that there is no similar duty imposed to negotiate in good faith under English law, the typical governing law for European leveraged financings (and under English law, an agreement to agree is unenforceable). Therefore, to address seller concerns about documentation risk in European deals, lenders typically agree with purchasers to enter into fully negotiated definitive credit documentation prior to the submission of bids, or to execute a short-form interim facility agreement under which funding is guaranteed to take place in the event that the lenders and the sponsor are unable to agree on definitive credit documentation in time for closing, with the form of the interim facility pre-agreed and attached as an appendix to the commitment documents.

In some recent Yankee Loans, sellers (or buyers sensitive to European sellers' concerns) have been pressing that the European approach to solving documentation risk be followed, notwithstanding that the finance documentation will be governed by New York law provided by US market investors.

Putting aside the difference in drafting style between NY leveraged loan agreements and European LMA facility agreements, and the resultant impact on transaction costs and timing, which itself would tend to support following US practice of commitment documents containing documentation principles, the need to carefully consider the structuring considerations discussed above would seem to support the use of commitment documents containing documentation principles *in lieu* of full credit documentation or interim facility agreements in connection with bids where Yankee Loans provided under NY law will finance the acquisition.

With time, we would expect European sellers (and their advisors) to become comfortable with the use of documentation principles for New York law financings (as is customary for US sellers), given that the governing law of the finance documents, not the jurisdiction of the seller, is the key factor in evaluating documentation risk. However, until then consideration will need to be given to the appropriate form of financing documentation and the potential timing and cost implications resulting therefrom.

SunGard vs. Certain Funds

Certainty of funding for leveraged acquisitions is a familiar topic on both sides of the Atlantic. It is customary for financing of private companies in Europe to be provided on a private "certain funds" basis, which limits the conditions to funding or "draw stops" that lenders may benefit from as conditions to the initial funding for the acquisition. Bidders and sellers alike want to ensure that, aside from documentation risk, there are minimal (and manageable) conditions precedent to funding at closing (with varying degrees of focus by the bidder or seller dependent on whether the acquisition agreement provides a "financing out" for the bidder – an ability to terminate the acquisition if the financing is not provided to the bidder).

Similar concerns exist in the US market, which has developed a comparable, although slightly different approach to "certain funds". In the US market, these provisions are frequently referred to as "SunGard" provisions, named after the deal in which they first appeared. In both cases, the guiding principle is that the conditions to the initial funding should be limited to those which are in the control of the bidder/borrower, but as expected there are some familiar differences which are relevant to consider in the context of a Yankee Loan.

The first key difference is that in the US, market lenders typically benefit from a condition that no material adverse effect with respect to the target group has occurred. However, the test for whether a material adverse effect has occurred must match exactly to that contained in the acquisition agreement. With this construct, the lenders' condition is the same as that of the buyer, however if the buyer did want to waive a breach of this condition the lenders would typically need to consent to this. In European certain funds, the lenders typically have no material adverse effect condition protection, although they usually would benefit from a consent right to any material changes or waivers with respect to the acquisition agreement (as would also be present in SunGard conditionality). Therefore, if a European buyer wished to waive a material adverse effect condition that it had the benefit of in an acquisition agreement, it is likely that this would be an action that European "certain funds" lenders would need to consent to.

The second key difference is that in the US, market lenders typically benefit from a condition that certain key "specified representations" made with respect to the target are true and correct (usually in all material respects). However, these must be consistent with the representations made by the target in the acquisition agreement and this condition is only violated if a breach of such specified representations would give the buyer the ability to walk away from the transaction. In the European market, no representations with respect to the target group generally need to be true and correct as a condition to the lenders' initial funding. The only representations which may provide a draw stop to the initial funding are typically core representations with respect to the bidder. Similar to the material adverse effect condition, while these appear different on their surface, in most European transactions if a representation made with respect to the target group in the acquisition agreement was not correct, and as a result the buyer had the ability to walk away from the transaction, this would likely trigger a consent right for the lenders under a European certain funds deal.

Much like documentation principles compared to full documents (or an interim facility), SunGard conditionality compared to European "certain funds" show differing approaches to an issue taken on each side of the Atlantic which result in similar substantive outcomes. Thus far, Yankee Loans have approached these issues on a case-by-case basis, although with at least a slight majority favouring the US approach to these issues.

Diligence – reliance or non-reliance

Lenders in US leveraged finance transactions will be accustomed to performing their own primary diligence with respect to a target group, and their counsel will perform primary legal diligence with respect to the target group. Frequently this may include the review of diligence reports prepared by the bidder's advisors and/or the seller's advisors, which will be provided on a non-reliance basis and primary review of information available in a data room or a data site.

Lenders in European leveraged finance transactions will also be accustomed to performing their own diligence with respect to a target group with the assistance of their counsel, which will also frequently include the review of diligence reports prepared by advisors to the bidder and/or the seller. However, European lenders typically are provided with explicit reliance on these reports, which is also extended to lenders which become party to the financing in syndication.

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In the context of a Yankee Loan, while the advisors to the bidder and/or seller may be willing to provide reliance on their reports for lenders, consideration will need to be given as to whether this is needed and/or desired. Lenders' expectations may also diverge in the context of a Yankee Loan which includes a revolving credit facility provided by European banks (likely relationship banks to the borrower or target group) as opposed to the US banks initially providing the term loan facilities.

Conclusion

We expect Yankee Loans to be of continuing importance, at least in the near term. Ultimately, Yankee Loans can be seen as simply US institutional term loan tranches provided to European groups. However, while one may reasonably expect that many of the "familiar differences" between the US and European leveraged loan markets would (and perhaps should) follow a US approach for what is ultimately a US product with US market investors, there are fundamental differences to restructurings of US and European leveraged groups, as outlined above, which should be considered during the structuring of a Yankee Loan.

Acknowledgment

The author would like to thank Associates Shanan Dunstan and Ben Wilkinson, who contributed to this chapter.

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