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The International Comparative Legal Guide to: **Lending & Secured Finance 2016**

4th Edition

A practical cross-border insight into lending and secured finance

Published by Global Legal Group, with contributions from:

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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

Stephens & George
Print Group
April 2016

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ISBN 978-1-910083-90-1

ISSN 2050-9847

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Yankee Loans – “Lost in Translation” – a Look Back at Market Trends in 2015

White & Case LLP



Alan Rockwell



Martin Forbes

Introduction

This chapter takes a look at market trends for Yankee Loan issuance in 2015. “Yankee Loans” are US dollar denominated term loans that are syndicated in the US Term Loan B market to institutional investors and provided to European and Asian borrowers, based on New York law credit documentation.

Historically, European and Asian borrower groups sourced most of their financing needs through local European and Asian leveraged finance markets and would only seek to raise financing in the US leveraged finance market to match US dollar denominated financing against US dollar revenue streams or in certain more limited circumstances where there was insufficient liquidity in local markets to finance larger transactions.

Since the beginning of 2010, the depth and liquidity of the institutional investor base in the US Term Loan B market has proved at times to be an attractive alternative source of financing for some European and Asian borrower groups. It was a key source of financing liquidity to such borrowers in the early years following the 2008–2009 financial crisis, when financial conditions at the time in local markets affected availability of financing for borrowers in Europe and Asia. In more recent times, as local markets have continued to recover and the European Term Loan B market has started to develop, European and Asian borrowers have looked to tap US markets on a more opportunistic basis in a search for better pricing and terms (after factoring in currency hedging costs) in leveraged finance transactions, whether new acquisition financings, recapitalisations or repricings.

Market views on the outlook for Yankee Loans in 2016 continue to be varied but factors that will determine future issuance volume in 2016 and beyond will include supply/demand metrics in the US and European leveraged loan markets, the impact of regulatory oversight in both markets, whether US pricing rebounds to become more attractive again relative to pricing terms available from lenders in Europe and Asia, and whether the institutional investor base for European Term Loan B continues to increase in depth and liquidity, so that the European market gradually shifts away from the more traditional “buy and hold” approach from bank investors and moves towards a more liquid secondary trading market.

This chapter considers, firstly, some of the key structuring considerations for Yankee Loans. Secondly, it looks at how some differences get “lost in translation”, by comparing certain key provisions that differ between the US and European and Asian leveraged finance markets and exploring the differences that need to be taken into account for Yankee Loans, focusing on negative covenants, conditionality and transaction diligence.

A Look Back at 2015

The year 2015 was mixed for Yankee Loan issuance volume in the US loan markets. Overall, volume remained solid with 139 total Yankee Loans (including 42 Yankee Term B Loans and 6 Yankee Term A Loans). Of those deals, 32 Yankee Loans were done on a covenant-lite basis.¹ Yankee Loans were issued to borrowers in a broad number of non-US jurisdictions (including Australia, Austria, Belgium, the Czech Republic, France, Germany, Ireland, Luxembourg, the Netherlands, Switzerland and the United Kingdom).

However, as US loan market conditions started to deteriorate in the second half of 2015, the number of non-US issuers looking to tap capacity in the US loan markets dropped significantly, as those issuers looked to take advantage of better pricing and liquidity in their own local markets. Additionally, the convergence of terms on both sides of the Atlantic (as noted below in more detail) means that non-US borrowers (especially those based in Europe) are now increasingly able to negotiate for the inclusion of all or some of the more flexible US-style terms (in particular negative covenant flexibility) for European-based loan transactions.

Structuring Considerations

When looking at “Yankee Loan” deals, it is important to remember that there are a number of key structuring issues (driven primarily by location of the borrower(s) and guarantors) that need to be considered which may not apply in domestic US or in traditional European or Asian transactions.

(Re)structuring is key

The primary focus of senior secured 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 that senior secured lenders have the ability to control the restructuring process, which is achieved differently in the US and in Europe and Asia.

Due to these differences, the US and European and Asian leveraged finance markets start from very different places when it comes to structuring leveraged finance transactions.

In the US, a typical restructuring in a leveraged finance transaction is usually accomplished through a Chapter 11 case under the US Bankruptcy Code, where the position of senior secured lenders as secured creditors is protected by well-established rights and processes. Chapter 11 allows senior secured lenders to cram down “out of the

money” junior secured or unsecured creditors and release their debt claims, guarantee claims and security pursuant to a Bankruptcy Court-approved plan of reorganisation.

A Chapter 11 restructuring 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 its practical effect has global application, because any person violating the automatic stay may be held in contempt of court by 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). Senior secured 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 and Asia, it is more usual for a restructuring in a leveraged finance transaction to be accomplished through an out-of-court process;² this is typically achieved through enforcement of share pledge security to effect a transfer of equity interests of the top holding company of the borrower group and a sale of the business as a going concern, although in some situations restructurings can be achieved through a consensual out-of-court restructuring process without enforcing transaction security.

The reason for this is that placing a company into local insolvency proceedings in many European and Asian jurisdictions is often viewed very negatively as the option of last resort. Suppliers and customers typically view it as a precursor to the corporate collapse of the business and often there is no Chapter 11 equivalent restructuring process available in the applicable European or Asian jurisdiction(s). The result is that entering into local insolvency proceedings is usually value-destructive (in particular because of the lack of an automatic stay that binds trade creditors and, in some cases, because of a lack of clear procedures for cramming down junior creditors).

In order for senior secured lenders to retain control of a restructuring process in Europe or Asia, they traditionally rely on contractual tools contained in an intercreditor agreement (principally standstill and release provisions).

A standstill, which typically applies to junior creditors that are party to the intercreditor agreement, operates to limit or prohibit such junior creditors from enforcing their own security interests or forcing borrower groups into local insolvency proceedings. It allows senior secured lenders to control the reorganisation of the borrower group’s obligations by being able to prevent junior creditors from obtaining leverage through threatening to force a borrower group into a value-destroying local insolvency proceeding and allows them time to implement a controlled disposal of the borrower group through enforcement of security.

Release provisions applicable upon a “distressed” disposal of the borrower group, i.e. upon a trigger event such as the occurrence of a continuing Event of Default or following an acceleration event, operate to allow senior secured lenders to sell a borrower group free of the claims of material junior creditors that are party to the intercreditor agreement outside of formal insolvency proceedings.

Either or both of these intercreditor provisions are designed to enable a borrower group to be sold as a going concern and, in connection with this, for the guarantee and security claims (and in some cases, the primary debt claims) of junior creditors against the borrower group entities that are sold to be released once the proceeds from

such sale have been applied pursuant to the waterfall provisions of the intercreditor agreement. This practice has developed because, unlike the US Chapter 11 framework, there is no equivalent single insolvency regime that may be implemented across European or Asian jurisdictions. 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 there is no equivalent law in Asia) and most European and Asian insolvency regimes (with limited exceptions) do not provide for an automatic stay on enforcement applicable to all creditors.

The important distinction to note is that while a Chapter 11 proceeding binds all of a borrower group’s creditors, the provisions of the intercreditor agreement will only be binding on the creditors that are a party to it. Typically, these would be the primary creditors to the group (such as the providers of senior secured credit facilities, mezzanine or second lien facilities lenders and, in some instances, high-yield bondholders), but would not include trade and other non-finance creditors, nor would it include (unless execution of an intercreditor agreement is required as a condition to such debt being permitted) third party creditors of permitted debt (e.g. incremental equivalent debt or ratio debt). In view of that, consideration should be given to requiring the third party creditors of such debt to become bound by appropriate intercreditor arrangements for the benefit of senior secured lenders as a condition of incurrence.

Documentation

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, Asia 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 through Chapter 11 proceedings.

By contrast, historically, deals syndicated in the European or Asian leveraged loan market were those where the business or assets of the group were mainly in Europe or Asia, respectively, and these deals traditionally adopted a European or Asian approach to structuring: the loan documentation was typically English law governed, based on the LMA or APLMA 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 Term Loan B institutional investors are most familiar with, and typically expect, New York law and US market-style documentation. Therefore, most Yankee Loans are done using New York law 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 or Asian borrower group may be able to elect to reorganise itself pursuant to a US Bankruptcy proceeding (which would require only a minimum nexus with the US), most European and Asian borrower group restructurings have traditionally occurred outside of an insolvency process.

In light of this, to give senior secured lenders the ability to control the restructuring process in deals that involve European or Asian borrower groups, and protect their recoveries against competing creditors, a Yankee Loan done under New York law documentation should include the contractual “restructuring tools” typically found in a European or Asian-style intercreditor agreement, most

notably a release or transfer of claims upon a “distressed” disposal. Depending on the jurisdiction of the primary borrowers and material guarantors, consideration should also be given to inclusion of 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 or Asian borrower group’s junior creditors accelerating their debt and forcing the borrower group into local insolvency proceedings.

Location of borrower and 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 secured lenders. In Europe or Asia, however, there are a number of considerations which are of material importance to senior secured lenders when evaluating in which European or Asian jurisdiction a borrower should be organised and the credit support that can be provided by guarantors.

Borrower considerations

First, many European and Asian jurisdictions impose regulatory licensing requirements for lenders providing loans to borrowers organised in that jurisdiction. Second, withholding tax may be payable in respect of payments made by borrowers organised in many European or Asian jurisdictions to lenders located outside of the same jurisdiction (in particular, many “offshore” US Term Loan B investors are unable to lend directly to a borrower located in certain European and Asian jurisdictions without triggering withholding tax or interest deductibility issues). Finally, some European and Asian jurisdictions may impose limits on the number of creditors of a particular nature that a borrower organised in that jurisdiction may have.

Comparing guarantees and collateral

US: The value of collateral and guarantees from borrowers and guarantors located in the US in leveraged loan transactions is generally not a source of material concern for senior secured 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 taking security over real estate assets is, generally, relatively straightforward and inexpensive. Furthermore, save for well understood fraudulent conveyance risks, upstream, cross-stream and downstream guarantees from US entities do not give rise to material concerns for senior secured lenders.

Europe and Asia: In contrast, there are very few European and Asian 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 and taking security over real estate assets is generally less straightforward and can often be very expensive. Furthermore, the value of upstream and cross-stream guarantees given by companies in many European and Asian jurisdictions is frequently limited as a matter of law (and in some cases, may be prohibited altogether). This 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. Some other factors which do not apply to US borrowers or guarantors also need to be taken into account for European and Asian borrowers and guarantors. Examples include: (1) 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); (2) in some jurisdictions, it is not possible to take both first-ranking and second-ranking security over the same asset (an issue in second lien

financings); and (3) the US concept of excluding certain assets from the collateral package is not workable for certain types of “floating” security available in some European and Asian jurisdictions; instead, customary guaranty and security principles should operate in those jurisdictions to reflect local market requirements.

As a result, when structuring a Yankee Loan, significant consideration should be given to the jurisdiction of borrowers and guarantors to assess the quality and value of credit support and security that will be available.

In addition, to ensure that a European or Asian borrower group restructuring may be accomplished through the use of the relevant intercreditor provisions, it is important to determine an appropriate “single enforcement point” (SPE) in the group structure where a share pledge could be enforced quickly and efficiently, without interference by other creditors and stakeholders, in order to effect a sale of the whole group or business as a going concern. In this regard, the governing law of the share pledge and the jurisdiction of the relevant entity whose shares are to be sold should be considered to ensure that the distressed disposal provisions in a European or Asian intercreditor agreement may be fully taken advantage of (if needed). Particular attention should be paid to provisions which ensure that a senior secured lender can obtain financial information needed at the time of enforcement to produce any required market valuations.

Investor considerations

Many institutional investors in the US leveraged loan market (CLOs in particular) have investment criteria which govern what type of 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 Term Loan B institutional investors could participate in the financing. In deals where the US co-borrower will actually incur all or a portion of the relevant loans, careful consideration needs to be given to limitations that may affect joint and several liabilities between US co-borrowers and non-US co-borrowers. 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-stream guarantee or upstream 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.

“Lost in Translation” – a Comparison of Key Terms

In addition to the well-known (if not always fully understood or appreciated) difference in drafting styles between New York leveraged loan credit agreements and European and Asian LMA and APLMA facility agreements, the substantive terms of loan documentation in the US and European and Asian markets have traditionally differed as well, with certain concepts moving across the Atlantic in either direction over time.

Since 2010, Yankee Loan deals have been responsible for a lot of increased flexibility for borrowers in a variety of forms moving (initially slowly; since 2015, much more rapidly) from the US market to the European market (and to a lesser extent the Asian market). These new, more flexible terms are now starting to gain far more widespread acceptance in European deals due to a number of factors, including “cross-pollination” (based on European sponsors now having more experience in raising financing in US markets and US sponsors continuing to import terms “across the pond”) and the continued expansion of the European Term Loan B market.

US covenant-lite v. European covenant-lite

Covenant-lite (US and Europe): Since 2010, the US leveraged loan market has seen the re-emergence of “covenant-lite” facilities and these facilities have, since the beginning of 2015, also become much more commonplace in the European leveraged loan market, with the development of European Term Loan B facilities.

Covenant-lite facilities accounted for 29%³ market share of US leveraged loan issuance in 2015 (a significant drop from 2014) and 45%⁴ market share of European leveraged loan issuance in 2015 (a significant increase from 2014).

In covenant-lite deals, term loans do not benefit from any maintenance financial covenant. Only the revolving facility benefits from a single maintenance financial covenant, normally a leverage-based ratio (and this only applies on a “springing” basis, i.e. at the end of a fiscal quarter, on a rolling LTM-basis, if utilisation exceeds a certain trigger percentage; at the time of writing, typically ranging between 25–35%).

More importantly, the negative covenant package for “covenant-lite” facilities is either fully or partially incurrence-based in nature, similar to what would commonly be found in a high-yield unsecured bond covenant package, reflecting the growing convergence between the Term Loan B and high-yield bond markets in both the US and Europe.

Incurrence-based covenants typically provide permissions (for example, to incur additional debt) subject to compliance with a specific financial ratio which is tested at the time of the specific event, rather than a maintenance financial covenant which would require continual compliance at all times, which traditionally has been required in secured senior bank loans by testing compliance against a projected business plan or base case financial model.

European covenant-loose: Traditionally, European leveraged loans were structured as full maintenance financial covenant deals (i.e. with the benefit of four maintenance financial covenants (leverage, interest cover, cashflow cover and capex) but the market in Europe has now evolved to the point where nearly every deal is being done on a “covenant-loose” basis with a reduced maintenance financial covenant package for the benefit of both terms loans and revolving facilities (either one or two covenants (always leverage, and sometimes interest cover) instead of the usual four).

Both “covenant-loose” deals and traditional deals are now increasingly following the approach in US and European covenant-lite deals with respect to increased negative covenant flexibility, although they typically do not include full US-style covenant-lite incurred-based flexibility.

Outlook

There are differences between the US and European and Asian loan markets that mean that for at least some deals, loan terms may never fully converge. The key reasons for this are (1) banks remain an important source of liquidity in several European jurisdictions and banks generally have not been willing to buy significant amounts of covenant-lite debt on a take and hold basis, and (2) some European jurisdictions have withholding tax or regulatory barriers that make it more difficult for debt to be syndicated to institutional investors (particularly institutional investors structured on the assumption that they will lend to US borrowers). While deals can often be structured to mitigate the second issue, we expect that the former issue will mean that some European borrowers agree to include maintenance financial covenants in transactions that would, if marketed in the US, be much more likely to be done on a covenant-lite basis.

In spite of this, over time there will continue to be more convergence between the US and European markets, because borrower groups will continue to seek to maximise terms flexibility through adoption of “best in class” on both sides of the Atlantic, and cross-pollination (i.e. the same underwriting banks and borrowers, and sometimes the same investors will already be familiar with concepts from US or European deals) will make it easier to import new terms into the respective leveraged loan markets. It will take longer for convergence to occur to the same degree with Asian markets (because of the smaller volume of Yankee Loan deal flow).

Issues to watch out for

When agreeing to increased flexibility in negative covenant packages in the case of a Yankee Loan provided to a European or Asian borrower group, senior secured lenders need to consider very carefully the impact of this when compared to similar flexibility in negative covenant packages provided in the case of a loan provided to a US borrower group because the result may be very different in a restructuring scenario for European or Asian borrower groups.

In particular, the following issues are worth noting:

Debt incurrence (including incremental or accordion baskets and ratio debt baskets)

In US leveraged loan deals, there is usually no hard cap on debt incurrence, i.e. an unlimited amount of additional debt can be raised subject to compliance with one or more different incurrence ratio tests.

Such debt may be equal ranking secured debt incurred pursuant to the credit agreement (as incremental debt), typically by the existing borrower(s) only.

It may also be incremental “equivalent” debt (relying on incremental basket capacity), “ratio” debt or, in some deals, acquisition debt, and such debt may be either senior secured debt (which can be in the form of senior secured notes or in some cases in the form of sidecar loans (the latter is typically subject to the same “MFN” protection as incremental debt, although certain “strong” borrowers negotiate for exceptions to this)) or junior secured, subordinated or unsecured debt. In each case, such debt is incurred outside of the credit agreement, which usually can be incurred by any “restricted” group member subject to a non-guarantor cap. More recently, some deals in the US market have added a further restriction that senior secured debt incurred in the form of senior notes must not be on terms that are functionally the equivalent of a Term Loan B bank loan, to avoid backdoor circumvention of MFN protection.

Debt incurrence flexibility works well in deals that only involve US borrowers/guarantors, because there is generally no material concern about being able to deal with junior secured creditors or unsecured creditors in a restructuring or bankruptcy context.

However, in deals that involve non-US borrowers/guarantors, if comparable debt incurrence flexibility is allowed, issues can arise due to the fact that guarantees provided by non-US entities may be subject to material legal limitations and/or prohibitions and because the collateral provided by non-US entities may be subject to material legal and/or practical limitations resulting in security over much less than “all assets” of the relevant non-US entity, leading to some unexpected results for senior secured lenders in a Yankee Loan deal.

Specifically, the claims of the creditors of such incremental, incremental equivalent or ratio debt, even if junior secured or unsecured, may rank equally, or in some cases even effectively senior, to the guarantee claims of the senior secured lenders who provided the main senior secured credit facilities.

This may be because incremental, incremental equivalent or ratio debt is subject to less stringent guarantee limitations or prohibitions than the guarantee limitations or prohibitions applicable to the senior secured acquisition finance facilities incurred to pay for the acquisition of the applicable European or Asian borrower group or it may be because the transaction security provided by the applicable European or Asian borrower group is not fully comprehensive, resulting in a larger pool of unsecured assets, the value of which gets shared equally between senior secured creditors, junior secured creditors and unsecured creditors with equal ranking debt claims.

Additionally, for reasons detailed in the Structuring Considerations section above, in the event of a restructuring accomplished by means of a distressed disposal and release of claims, providers of incremental, incremental equivalent or ratio debt may not be subject to the contractual standstills or release provisions provided under a European or Asian intercreditor agreement.

This had led to an increasing number of European covenant-lite and covenant-loose transactions including provisions capping the amount of additional debt (especially unsecured debt) that can be incurred without the new creditors in respect of such additional debt entering into an intercreditor agreement with the agent for the senior secured lenders. Typically, borrowers will seek to agree the terms of such intercreditor agreement at the outset of the deal in order to avoid having to negotiate or obtain consent from senior secured lenders in order to incur junior secured debt or unsecured debt in the future. To an extent, this is continuation of a trend in the European market for transactions to include flexibility for several categories of potential future indebtedness in intercreditor agreements. The reason for doing this is to avoid senior secured lenders having a *de facto* consent right over future debt incurrence (if terms have not been agreed in advance, it is likely that obtaining such consent may be difficult in practice because of the detailed intercreditor provisions that are normally required in European loan transactions and the scope for resulting disagreement between different classes of creditors). In 2015, a small number of Yankee Loans started to follow the same approach. Given the general push back by US loan investors since the start of 2016 on more aggressive loan documentation terms, this may be one area where Yankee Loans start to follow the approach in European loan transactions more closely.

“Grower” baskets

It is now common to include “grower” baskets in both US and European deals (including Yankee Loans) set by reference to the greater of a fixed amount and either a percentage of Consolidated Total Assets (historically more common) or a percentage of Consolidated EBITDA (now becoming much more common in both US and European deals). These have tended to be more generous in US deals and are of particular relevance for intercompany transaction baskets – typically in US deals, unlimited intercompany transactions (investments and asset transfers) are permitted between borrowers/guarantors, but depending on the location of certain borrowers/guarantors (especially where either guarantee or security coverage may be weak), this may give rise to credit support value leakage concerns in Yankee Loan deals for European or Asian borrower groups.

The lack of any intercompany basket protection may also be of concern in Yankee Loan deals specifically in relation to “unrestricted” subsidiaries (a concept imported originally from high-yield bond deals and now routinely included in Term Loan B deals). The ability to designate “unrestricted” subsidiaries allows a borrower group to operate a portion of its business outside of

the credit-support “ring-fence”. The result is that such entities are not subject to any of the covenants or other provisions of the loan documentation and, correspondingly, their net income is not factored into any of the financial covenants or incurrence-condition testing of the “restricted” borrower group. This is problematic because third party creditors who lend money to such entities could potentially disrupt an out-of-court restructuring by senior secured creditors through security enforcement, by blocking a distressed disposal of the borrower group as a going concern through foreclosure or share pledge enforcement.

Finally, it is worth noting that historically, a “grower” did not apply to the “fixed” or “free and clear” components for Incremental debt baskets or Available Amount baskets but “strong” borrowers have successfully negotiated for this in some deals in both the US and Europe.

Investments and acquisitions

US deals now usually do not include a fixed cap (although some deals retain requirement for *pro forma* compliance with a financial ratio condition). However, it is still typical to include a non-guarantor cap (or in some deals a guarantor coverage test requirement, more similar to European or Asian deals, or a combination of the two concepts). In Yankee Loan deals with little or no US credit support, and weak guarantee/security credit support packages in non-US locations, this normally is the subject of far more detailed negotiation between lenders and borrowers, with tighter baskets and sometimes fixed caps in place of incurrence ratio conditions.

To enable borrower groups to undertake additional acquisitions on a “Sungard” or “certain funds” conditionality basis, while keeping in place their existing capital structure, the market is now seeing:

- Limited Conditionality Acquisitions (i.e. acquisitions that are not conditioned on obtaining financing) – satisfaction of conditions to acquisitions and other events occurring now tested at time of acquisition (including *pro forma* debt incurrence) – what happens in relation to additional *pro forma* incurrence testing with respect to other transactions in the time between the Limited Conditionality Acquisition test (if tested at signing) and the consummation of that acquisition remains subject to negotiation.
- Limits on requirements with respect to Event of Default blocker conditions or bring down of representation conditions.

This flexibility is now increasingly also being included in European and Asian deals.

“Available Amount” (or “Builder”) basket for investments and acquisitions, restricted payments and restricted junior debt repayments

This basket builds with Consolidated Net Income (typically 50% CNI minus 100% losses) or a percentage of Retained Excess Cash Flow, plus certain equity contributions and returns on investments made using the Available Amount basket – this basket may be applied subject to certain Event of Default blocker conditions and subject to *pro forma* compliance with a leverage-based incurrence ratio condition (although leverage-based incurrence ratio condition protection may be limited, or even excluded, in some deals). Use of the basket is typically subject to an incurrence ratio condition for restricted payments (in some deals, restricted debt payments and investments benefit from the same condition) while the extent of Event of Default blocker conditions varies. However, market conditions in the US tightened significantly in Q1, 2016, with investors calling for more stringent restrictions and controls on

restricted payments to equity (prior to meaningful reduction of debt leverage). Historically, Available Amount/builder baskets were not common in European deals but they are now being included more frequently in European Term Loan B deals, with smaller fixed baskets and tighter financial ratio conditions.

Additional unlimited baskets for permitted investments and acquisitions, restricted payments and restricted debt repayments

These baskets allow for the application of unlimited amounts towards permitted acquisitions and investments, restricted payments and restricted debt payments subject to (in some cases) an Event of Default blocker condition and (in some cases) *pro forma* compliance with an incurrence ratio condition (the level typically varies in range from at least 0.5x inside to at least 2.0x inside closing date total net leverage, depending on the intended application/usage) rather than a fixed cap amount. These baskets have become fairly common in US covenant-lite deals (including Yankee Loan deals) but have yet to be seen with any frequency in European covenant-lite or covenant-loose deals or Asian syndicated deals.

Asset disposals

In US deals (including Yankee Loan deals), this is now commonly an unlimited basket, subject to no Event of Default blocker condition (although even this protection is excluded in some deals), and provided that 75% of consideration is cash (or designated non-cash consideration), sale is for fair market value and net sale proceeds are applied and/or reinvested in accordance with mandatory prepayment asset sale sweep provisions. By contrast, it is still more common in European and Asian deals to include some form of fixed cap, although European and Asian deals do tend to include more extensive basket carve-outs for certain identified assets (such as the sale of “non-core” assets following the acquisition of new businesses).

Conditionality

Documentation Principles v. 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 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 and Asian deals, documentation risk is generally a much greater concern for sellers. 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 and Asian leveraged financings (and under English law, an agreement to agree is unenforceable). Therefore, to address seller concerns about documentation risk in European and Asian 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 borrower 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 (or in some more recent cases, actually executed at the time of bid submission).

Over time, it will be interesting to see if European sellers (and their advisors) become more comfortable with addressing documentation risk by relying on documentation principles, and follow the US practice for commitment documentation, 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 this point becomes more settled, consideration will need to be given to the appropriate form of financing documentation and the potential timing and cost implications that may arise as a result.

SunGard v. Certain Funds

Certainty of funding for leveraged acquisitions is a familiar topic in the US, Europe and Asia. It is customary for financing of private companies in Europe and Asia 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 an 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 that which is 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 and Asian private “certain funds” deals, it is more customary for the lenders not to have material adverse effect condition protection (in contrast to US deals which still typically have such protection). However, lenders usually benefit from a consent right to any material changes or waivers with respect to the acquisition agreement, so if a European or Asian 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 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 “acquisition agreement representations” and certain key “specified representations”, in each case made with respect to the target, must be true and correct (usually in all material respects), although in the case of such “acquisition agreement representations” 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 “acquisition agreement representations” would give the buyer the ability to walk

away from the transaction. By contrast, in the European and Asian markets, 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 and Asian 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, or not complete, the transaction, waiver of this condition would likely require the consent of the lenders under a European or Asian “certain funds” deal.

Much like the comparison between documentation principles *v.* full documents (or an interim facility), a comparison between *SunGard v. European* “certain funds” reveals that despite technical differences, the substantive outcomes are similar. Yankee Loans continue to approach these issues on a case-by-case basis, with a roughly even split between the US and European approaches.

Diligence – reliance or non-reliance

Lenders in US leveraged finance transactions normally expect to perform their own commercial diligence with respect to a target group and expect their counsel to perform legal diligence with respect to the target group, based on a combination of a review of primary review of information available in a data room or a data site and, sometimes, a review of diligence reports prepared by the bidder’s advisors and/or the seller’s advisors, which are provided on a non-reliance basis only.

Lenders in European or Asian leveraged finance transactions normally expect to perform their own commercial diligence with respect to a target group but also typically perform their own legal diligence as well (sometimes, but less frequently, with the assistance of their counsel), and such review is normally limited to a review of diligence reports prepared by advisors to the bidder and/or the seller (with no separate review of data room or data site materials). However, European and Asian lenders typically do benefit from express reliance on these reports, which is also extended to lenders which become party to the financing in syndication. Borrowers familiar with the US market will often seek to provide reports on a non-reliance basis only, particularly in covenant-lite transactions. This is something that lenders need to consider carefully, because the underlying practice of lenders and their counsel undertaking detailed diligence rather than simply relying on reports is typically not duplicated outside the US.

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 to be provided by European or Asian banks (likely relationship banks to the borrower or target group) as opposed to the US banks that initially arrange and underwrite the term loan facilities.

Conclusion

Ultimately, Yankee Loans can be viewed simply as US Term Loan B facilities provided by institutional investors to European or Asian borrower groups (as opposed to US borrower groups). However, because of the fundamental differences between the manner in which restructuring of a US borrower group and restructuring of a European or Asian borrower group would occur in a default situation and because of the “lost in translation” issues that have arisen and will continue to arise in the future (caused by differing market practices and the use of different terminology in New York law and English law transactions), greater care must be taken when structuring a Yankee Loan.

Endnotes

1. Source: Thompson Reuters Loan Connector, 2016.
2. While it is possible in certain European and Asian jurisdictions to restructure through court-controlled processes that achieve a result similar to a Chapter 11 case, this will depend entirely on the jurisdiction of the borrower(s) and material guarantors.
3. Source: Thompson Reuters Loan Connector, 2016.
4. Source: S&P Capital IQ, 2016.

Acknowledgment

The authors would like to thank Samantha Richardson, White & Case London, and Han Rhee and Christopher Cameron, White & Case New York, who helped with the research for this chapter.

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