England & Wales

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General structuring of financing

1 What territory's law typically governs the transaction agreements? Will courts in your jurisdiction recognise a choice of foreign law or a judgment from a foreign jurisdiction?

Loan and intercreditor agreements are typically governed by English law. However, there has been a recent increase in New York law governed term loan debt provided by US lenders. High yield bond documents are governed by New York law in nearly all cases. Security documents are generally governed by the law of the jurisdiction where the assets are located, save in the case of security over claims which is often governed by the law of the place of the debtor.

Subject to certain exceptions, the English courts will apply the Rome I Regulation ((EC) 593/2008) on the law applicable to contractual obligations to determine the governing law of a contract made on or after 17 December 2009, whether the countries involved are EU member states or not. The general rule under Rome I is that the contract is governed by the law chosen by the parties. Subject to certain exceptions, an English court would also uphold an agreement made in advance to submit non-contractual obligations (eg, a claim in respect of a misrepresentation made in the course of contractual negotiations) to the law of a particular country, in accordance with the terms of the Rome II Regulation ((EC) 864/2007).

Enforceability in England of judgments from the courts of other EU member states is usually governed by either the Brussels Regulation ((EC) 44/2001) or the European Enforcement Order Regulation ((EC) 805/2004) (which, in summary, only applies to uncontested judgments). The UK is subject to the Brussels Regulation. This will be amended with effect from 10 January 2015. In the case of judgments from the courts of Iceland, Switzerland and Norway, the 2007 Lugano Convention applies (which mostly mirrors the Brussels Regulation). Judgments from the courts of Commonwealth (and some other) countries are enforceable in England pursuant to either the Administration of Justice Act 1920 or the Foreign Judgments (Reciprocal Enforcement) Act 1933. If none of the above apply and there is no bilateral treaty for reciprocity with a country, under the English common law fresh proceedings will be required to determine the matter and obtain a judgment enforceable in England. This covers a large category of countries, including the USA.

2 Does the legal and regulatory regime in your jurisdiction restrict acquisitions by foreign entities? Are there any restrictions on cross-border lending?

Except as below, the acquisition of domestic companies by foreign entities is not restricted.

Entities which are subject to financial markets supervision are usually subject to change of control restrictions. For example, acquisitions of qualifying holdings (broadly speaking, acquiring a holding of 10 per cent or more of shares or voting power and each subsequent increase above 20 per cent, 30 per cent and 50 per cent thresholds) in banks, regulated financial services and insurance undertakings and certain regulated investment funds require prior regulatory approval pursuant to section 178 of the Financial Services and Markets Act 2000 (FSMA). Similar restrictions exist for other financial sector businesses including investment exchanges and e-money institutions. A prior notification requirement applies to the acquisition of a qualifying holding in a payment service provider authorised pursuant to the Payment Services Regulations 2009.

The Disclosure and Transparency Rules also require any acquisitions or disposals of shares in listed companies which cause the percentage of those voting rights to reach, exceed or fall below 3 per cent (and each 1 per cent thereafter) in the case of UK companies, or in the case of non-UK companies to reach, exceed or fall below 5, 10, 15, 20, 25, 30, 50 and 75 per cent to be notified to the issuer. Further disclosure requirements are set out in the City Code on Takeovers and Mergers (the Code), which may require shareholders of a listed company subject to a takeover offer to make public disclosures when they are interested in 1 per cent or more of any class of relevant securities.

The Alternative Investment Fund Managers Directive (2011/61/EU) entered into force in the UK on 22 July 2013 and imposes disclosure obligations on certain private equity funds which acquire major stakes in certain EU-based non-listed companies. The starting threshold for such obligations is the acquisition of 10 per cent of the voting rights in the relevant non-listed company. More onerous reporting obligations are imposed on funds which acquire 'control' of EU-based non-listed companies and issuers whose securities are admitted to trading on a regulated market. Some industries, such as utility companies, also require some form of regulatory approval in instances of changes of control. Government procurement contracts often also include change of control provisions. Additional merger control rules may apply under the EC Merger Regulation and the Enterprise Act 2002.

There are no specific restrictions on cross-border lending into the UK. For further detail on the regulatory restrictions applicable to certain types of lending in the UK, see question 6. Nevertheless, any cross-border payments may become subject to restrictions imposed by United Nations, European Union or UK sanctions or other similar measures, including exchange control restrictions (pursuant to the International Monetary Fund Act 1979 and the Bretton Woods Agreement Order in Council (SI 1946/36)). Sanctions have been imposed as a result of the Ukraine crisis.

3 What are the typical debt components of acquisition financing in your jurisdiction? Does acquisition financing typically include subordinated debt or just senior debt?

The component parts of debt financing vary depending on the size of the deal. It is common for larger financings to comprise a combination of senior and mezzanine debt or senior debt and high yield bonds. Financing can include senior term and revolving debt, second lien debt in the form of loans or notes, mezzanine term debt, payment-in-kind (or PIK) loans or notes, vendor financing, 'unitranche' facilities or high yield bonds.

Market conditions have made it more difficult to fund acquisitions solely with bank debt.

Mezzanine debt, to the extent legally possible, is usually guaranteed by and secured on the same assets as senior debt. Intercreditor arrangements are put in place, pursuant to which in certain circumstances payment on the mezzanine debt is subordinated to the senior debt and the ability of the mezzanine lenders to enforce their guarantee and security package is subject to a standstill. Mezzanine debt is not structurally senior to the senior debt and will be applied to fund the purchase price and acquisition costs of the transaction. While a significant amount of the senior debt will be borrowed by the same holding company as the mezzanine debt, some senior debt may be borrowed at a structurally senior level to refinance existing debt within the target group at closing. In cross-border financings, senior debt that is borrowed at operating company level and which is used to refinance existing debt may benefit from an enhanced guarantee and security package due to corporate benefit and other legal considerations.

The mezzanine facility matures one year after the latest dated senior debt. Financing structures including second lien debt are similar to mezzanine debt, save that the second lien debt is typically an additional tranche in the same credit agreement as the senior debt but with a maturity date six months later than the other senior loans. Under the intercreditor agreement, second lien debt is contractually subordinated to the other senior bank debt in a similar manner to mezzanine debt, save that the second lien lenders may not have an independent right to enforce in some cases.

PIK debt and vendor financing are the most junior pieces of debt finance in the capital structure. They tend to be lent to or issued by holding companies of the borrowers of the senior and mezzanine debt and tend to have limited, if any, recourse in the form of security and guarantees. They mature after the other debt in the structure. The interest on PIK facilities generally capitalises, or there may be an option for the borrower to pay part in cash, if permitted under the terms of the other debt in the structure.

Acquisitions have been increasingly financed with the proceeds of issue of secured bonds combined with a revolving credit facility with priority over the realisations of security enforcement, or term debt ranking pari passu. Bond issues are generally only suitable for larger transactions where the debt will not be repaid quickly due to the cost and non-call features.

For mid-market transactions involving companies which are too small (or whose debt would be too illiquid) to issue on the bond market, borrowers have sometimes been able to finance acquisitions with bilateral 'unitranche' facilities. This tranche is priced with an interest rate that is a blend of the rate that would have applied to a senior term loan and a mezzanine loan. The lender will often enter into a participation agreement with a pool of investors which will have interests in the facility carrying a rate of interest and ranking applicable to the facility as if it were comprised of both a senior and junior element. The borrower is often not a party to this arrangement and so only deals with the lender under the unitranche facility. The advantages of a unitranche facility may be simplicity of documentation and execution. The disadvantages may be that the borrower has no relationship with investors who may be critical to pass certain consents and waivers. The borrower may also need to find a separate provider of revolving credit facilities and hedging arrangements.

4 Are there rules requiring certainty of financing for acquisitions of public companies? Have 'certain funds' provisions become market practice in other transactions where not required?

In relation to an offer for the acquisition of a public company, the Code states that, before a press announcement formally announcing an offer under the Code is made, the bidder must be satisfied that all necessary due diligence has been carried out, that it will be able to implement the offer and, in particular, that it has sufficient cash available to it to do so. These principles have also become market practice for the acquisitions of private companies. A lender will only be entitled to withhold funding at closing in respect of events of default relating to the actions or omissions of the acquiring group companies and not the target group. In the lead up to the final bid date, the borrower will also try to satisfy as many conditions precedent to closing as possible (or obtain confirmation from the arrangers that if delivered in the pre-agreed form at closing, such conditions precedent will be satisfied). The borrower will indicate the status of these conditions precedent to the seller to further support the certainty of the funding for its bid.

5 Are there any restrictions on the borrower's use of proceeds from loans or debt securities?

Loan agreements usually include a purpose clause specifying how the loan proceeds are to be used. One reason for this is to attempt to create a trust over any monies advanced but not used for the specified purpose, particularly if the borrower becomes insolvent. See also question 15 regarding financial assistance.

6 What are the licensing requirements for financial institutions to provide financing to a company organised in your jurisdiction?

Lending, 'including…financing of commercial transactions (including forfeiting)', is an ancillary banking activity under the Capital Requirements Directive 2013/36/EU (CRD), which was effective as of 1 January 2014 as part of the Capital Requirements IV Directive package, which also included the Capital Requirements Regulation No 575/2013 (CRR) (together CRD IV). EU member states have discretion as to whether various types of lending may be carried out by entities that are not regulated as banks (credit institutions) or otherwise. Subject to exemptions, lending is generally not regulated in the UK but deposit taking is. The EEA passporting regime set out in the CRD permits a bank regulated in one member state to carry out all banking activities recognised under the CRD in other EEA member states. The EEA passporting regime does not offer passporting rights for unregulated lenders, nor for investment firms which wish to engage in lending activity on a cross-border basis. As part of its responsibility to 'flesh out' the rules set out in CRD IV, the European Banking Authority is responsible for developing regulatory and implementing technical standards to promote a harmonised European approach in certain important areas, such as in relation to passporting.

CRD IV also substantially increases the regulatory capital that financial institutions will be required to allocate against their lending transactions. However, current practice in respect of requirements to procure legal opinions for secured lending has not been materially altered as a result of the implementation of CRD IV. In situations where the collateral is located in another jurisdiction, parties may, following previous practice or requests

from home country competent authorities, wish to obtain a local law legal opinion on the enforceability of such collateral in that jurisdiction.

Various activities in connection with regulated residential mortgages are regulated, however, and consumer lending is subject to a separate regulatory regime under the Financial Services and Markets Act 2000. Consumer lending broadly includes lending to individuals, unincorporated associations or partnerships of no more than three persons. From 1 April 2014, to grant consumer credit or conduct credit brokerage a consumer credit licence from the UK Financial Conduct Authority (FCA) is required. Where the provision of financing does not involve any regulated activities such as arranging transactions in investments or advising on investments and does not include any involvement in regulated mortgages or consumer credit business, no licence is generally required.

In addition, the European Commission and various national and international bodies are currently looking at tightening regulation for the 'shadow banking' sector. The Financial Stability Board defines shadow banking as 'the system of credit intermediation involving entities and activities outside the regular banking system'. The European Commission published a draft regulation on 29 January 2014 which aims to improve the transparency of shadow banking activities by requiring all securities financing transactions to be reported. The regulation will also require management companies of UCITS, UCITS investment companies and AIFMs to inform their investors on the use they make of securities financing transactions. Similarly, in September 2013, the European Commission published a proposal for a regulation concerning money market funds (MMFs). The proposed regulation aims to enhance the liquidity and stability of MMFs and will apply to all MMFs that invest in money market instruments. It is also possible that lending may become more tightly regulated in the UK and other jurisdictions.

US rules designed to reduce systemic risk in the OTC derivatives market have impacted on English law transactions. This arises because swap and loan obligations are usually secured as part of the same security package. In such a scenario, subsidiaries of the borrower will be required to guarantee not just the loans, but the swaps as well. However, the US Dodd-Frank regulations purport to render unenforceable the whole of any guarantee covering swap obligations which is given by an entity which is not an 'eligible contract participant'. This means that if a subsidiary is not an ECP, its guarantee would be unenforceable. This is likely to be problematic where several subsidiaries do not qualify as ECPs (usually because they have less than $10 million in assets) and where such obligors are either US incorporated or have a US presence or significant US assets. As a consequence, hedging on some deals may be more difficult or expensive to implement.

7 Are principal or interest payments or other fees related to indebtedness subject to withholding tax? Is the borrower responsible for withholding tax? Must the borrower indemnify the lenders for such taxes?

Repayments of principal are generally not subject to UK withholding tax. Prima facie, payments of interest by a UK borrower (or by a non-UK borrower where the payments are of UK source interest) are subject to withholding tax at the rate of 20 per cent. However this general position is subject to various exemptions, such as interest paid on an advance from a UK bank or a non-UK bank or other financial institutions benefiting from an exemption provided by an applicable double tax treaty. The borrower is responsible for accounting to the UK tax authorities for any applicable UK withholding tax. The facility agreement will normally allocate day one and change of fact withholding tax risk to lenders, while borrowers are generally only required to gross-up if the withholding arises as a result of a change in law. Lenders will generally expect to be indemnified for any taxes that arise in connection with the loan other than by way of withholding (excluding any taxes on net income imposed by the jurisdiction in which the lender is incorporated/resident or (if different) lends from).

It is increasingly common for facility agreements to deal with FATCA. Broadly, FATCA refers to US rules under which US source payments to non-US financial institutions and, potentially, payments between non-US financial institutions can become subject to US withholding tax unless, among other things, certain information has been provided by the relevant financial institution to the IRS (or provided to the local tax authorities, for a financial institution operating in a jurisdiction such as the United Kingdom which has made an appropriate intergovernmental agreement with the United States). FATCA clauses in a facility agreement would typically allocate the risk of US withholding tax under FATCA and cover the provision of information relevant to FATCA between the parties.

8 Are there usury laws or other rules limiting the amount of interest that can be charged?

There is no general prohibition on usury rates in the context of commercial lending. However an English court will not enforce a contractual provision for the payment of additional amounts in excess of the loss reasonably expected to be suffered by a party as a result of a breach of the contract. As a result, excessive rates of default interest could be construed as a penalty (rather than a genuine pre-estimate of loss suffered by a lender) and would be unenforceable.

Either an administrator or a liquidator can apply to the court to set aside an extortionate credit transaction entered into by a company up to three years before the day on which the company entered into administration or went into liquidation. A transaction is 'extortionate' if, having regard to the risk accepted by the person providing the credit, either: its terms require grossly exorbitant payments to be made (whether unconditionally or in certain contingencies) in respect of the provision of the credit; or it otherwise grossly contravenes ordinary principles of fair dealing.

In the context of consumer lending (see question 6), the Consumer Credit Act 1974 confers on the courts a broad power to re-open a credit agreement if the agreement creates an unfair relationship between the creditor and debtor. This includes the power to change the terms of the agreement or a related agreement, including the amounts payable.

9 What kind of indemnities would customarily be provided by the borrower to lenders in connection with a financing?

There are numerous indemnity provisions contained in a credit agreement covering various matters, including: tax, stamp duty, loss arising from participating in the transaction or providing funding, the costs of translation of a payment from one currency into the currency that was due under the finance documents, increased costs protection resulting from a change in law and costs and expenses arising from the transaction, amendments to the documentation and enforcement and preservation of security. Floating interest rates traditionally included a 'mandatory cost' element, intended to compensate banks for the cost of paying supervisory fees to the financial regulator and to place non-interest bearing deposits with the Bank of England. However the methodology for calculating these costs was complex, leading to operational difficulties. As a result, in 2013 the Loan Market Association (LMA) withdrew its published template for mandatory costs and many lead agent banks have asked for

the related provisions to be removed from their term sheets and facility documentation.

10 Can interests in debt be freely assigned among lenders?

Typically following syndication, lenders can transfer or assign participations after consultation with the borrower unless a default has occurred or the transfer or assignment is to another existing lender or affiliate or a related fund, when no consultation is needed. Usually no restriction applies to sub-participations. Borrowers usually want to impose some controls over syndicate members and may require that (at least prior to completion of syndication) transfers or assignments are only to lenders on an agreed 'white list' or with the consent of the borrower and not to 'competitors'.

11 Do rules in your jurisdiction govern whether an entity can act as an administrative agent, trustee or collateral agent?

If the agreed role of the relevant trustee or agent (taking into account all actions which could conceivably be required during the life cycle of the transaction) includes activities which are regulated in the UK, it is likely to require prior regulatory authorisation. Relevant regulated activities include accepting deposits (for which a banking licence is required), arranging deals in investments, advising on investments, dealing in investments as a principal or agent, safeguarding and administering investments and managing investments. Entities carrying on regulated activities in the UK must generally be authorised by the FCA or, in the case of banks, building societies, credit unions, insurers and major investment firms, the Prudential Regulation Authority. See also question 6 regarding licensing requirements.

Where the same entity acts as a security trustee and as a creditor, there is a risk of a conflict of interest. As a result, there will need to be clear distinctions between information received by the bank as creditor and that received by the bank in its capacity as a security trustee. In addition, to mitigate against any potential conflict, the security trust provisions may expressly allow the security trustee to engage in other kinds of banking, trust or other business as if it were not the security trustee (and not seek the approval of beneficiaries or account to them for any benefit or income in their doing so). It may nevertheless encounter significant conflicts when there is an event of default (when divided loyalties may arise, even if it is following apparently valid instructions).

12 May a borrower or financial sponsor conduct a debt buy-back?

For a long time bond buy-backs by issuers have been considered possible under New York law in the bond market, either under the terms of the relevant bond indenture or in line with market practice with bondholder consent.

Under English law it is uncertain whether a borrower can buy back its own debt, particularly if the documentation does not expressly provide for this. As a result, a buy-back may be structured as a purchase of the debt by a holding company of the borrower. Whether such purchaser can receive interest on the debt depends on the terms of the intercreditor agreement. A loan buy-back may also be effected by a synthetic route such as a fund sub-participation, total return swap (where the borrower receives the total return on the asset in return for paying the lender a periodic cash flow) or a trust.

In 2008, the LMA published optional buy-back provisions which are now often included in loan agreements. One option prohibits debt buy-backs by a borrower and any member of the group of which such borrower is a member. The second option permits debt purchases by a borrower subject to certain conditions (eg, notification of the facility agent, disenfranchisement of sponsor affiliates and borrowers).

13 Is it permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements?

English law has developed in this area and following the recent decision of the Court of Appeal in *Sergio Barreiros Azevedo v Imcopa*, the position can be summarised as follows: essentially, any proposal whereby those voting in favour obtain one result and those voting against obtain a different (and prejudicial) result will be struck down. This is the process, commonly called 'exit consents', which is a typical (and legally valid) feature of US restructurings. Conversely, offering an incentive payment (known as 'consent payments') to those voting in favour but not to those who do not has been upheld as valid provided that the offer of payment is made to all creditors openly. Exit consents are viewed as a 'stick', consent payments as a 'carrot'. The case law has developed in the context of bond issues, but is likely to be applied in the context of bank financings.

Guarantees and collateral

14 Are there restrictions on the provision of related company guarantees? Are there any limitations on the ability of foreign-registered related companies to provide guarantees?

Guarantees must be documented in writing and are usually executed as deeds. The availability of guarantees is restricted by financial assistance rules (see question 15) and corporate benefit. Directors of an English company are under a duty to promote the success of the company for the benefit of its members. If the directors misuse their powers in entering into a transaction, and the lenders are aware of this, the lenders may be required to disgorge guarantee payments.

It is more difficult to establish that a company obtains a corporate benefit from providing an upstream or cross-stream guarantee or security. As a result, lenders usually require that the giving of the guarantee is authorised by an appropriate shareholders' resolution, to avoid the possibility of the transaction being challenged by a shareholder on the basis that the directors have breached their duties. However, this will not cure a lack of corporate benefit if the company is in the zone of insolvency when the directors' primary duty is deemed to be owed to the company's creditors.

An upstream guarantee may result in an unlawful reduction of capital unless the company has distributable reserves sufficient to cover the amount of the reduction and the statutory requirements for effecting such a reduction are complied with. The effect on net assets should be determined according to normal accounting principles. As a result, lenders may wish to see board minutes which address the issue of net assets. Where the borrower group is in financial distress, lenders may require a net assets letter from the company's auditors.

Guarantees are also vulnerable to challenge when the guaranteed debt is amended, rescheduled or otherwise extended without the consent of the guarantor. Provisions are usually inserted into guarantees to provide advance consent to such amendments, but the effect of such provisions is limited and a prudent approach is to obtain guarantee confirmations whenever material amendments are made to the guaranteed debt.

There are no particular English law limitations on the ability of foreign-registered related companies to provide guarantees in an English law document.

See also question 31 as to situations where guaranteed claims would be voidable.

15 Are there specific restrictions on the target's provision of guarantees or collateral or financial assistance in an acquisition of its shares? What steps may be taken to permit such actions?

The Companies Act 2006 prohibits:

- financial assistance given by a public company (or any of its UK subsidiaries, whether public or private) directly or indirectly for the purpose of the acquisition of shares in that company (or reducing or discharging a liability incurred for such purpose) while it remains a public company; or
- financial assistance given by a public company subsidiary of a private company, directly or indirectly for the purpose of the acquisition of shares in that private company (or reducing or discharging a liability incurred for such purpose).

Outside the above scenarios, there is no longer a statutory prohibition on a private company giving financial assistance. Nevertheless, the provision of guarantees and security raises related issues (see question 14).

16 What kinds of security are available? Are floating and fixed charges permitted? Can a blanket lien be granted on all assets of a company? What are the typical exceptions to an all-assets grant?

A debenture containing a fixed and floating charge can be used to create security over all of the assets of a company. Lenders will usually take fixed charges over assets that do not fluctuate in the business (such as shares, real estate, intellectual property and certain contracts), the remainder of the assets being subject to a floating charge. The position of a fixed charge holder is stronger in an insolvency (see question 35). If a fixed charge is taken over assets but the chargor is permitted to deal with the assets in the ordinary course of its business (such as book debts or inventory), the charge may be deemed by a court in an enforcement situation as constituting a floating charge, despite being labelled in the charging document as a fixed charge.

Fixed security may take the form of a mortgage, a charge or a pledge. A 'pledge' requires delivery of possession of an asset to the creditor by way of security and is rare in commercial lending, where a charge is more common.

Security over real estate assets is usually granted by way of a legal mortgage. Security over registered securities (eg, shares) is usually taken by way of a charge. Security over claims and contractual rights can be created by a charge or legal or equitable assignment. A legal assignment requires notice to be given to the debtor and is not possible if the contract prohibits assignment.

17 What kinds of notification or other steps must be taken to perfect a security interest against collateral?

Almost all mortgages and charges created by companies incorporated in the United Kingdom are registrable with Companies House within 21 days of creation (the most significant exception being for security financial collateral arrangements). Registration is necessary even when the assets charged are located outside the jurisdiction (so long as the charge is created by a UK-registered company) and also in cases where the security is governed by foreign law. The rules regarding registration changed on 6 April 2013, when criminal sanctions for not submitting charges for registration were abolished. Failure to register a registrable charge at Companies House will render the charge void against a liquidator, administrator or other creditor of the company. Online registration is now also possible. Once registered (subject to minor permitted redactions), the charging document becomes a public document, accessible via the online register. Since October 2011, mortgages and charges created by overseas companies are not registrable at Companies House.

In addition there are asset-specific registers for land, intellectual property, ships and aircraft, and separate registration requirements apply.

To perfect security over monetary claims, notice should be served on the counterparty to the claim or receivable, as priority of security over such claims is generally determined by the timing of the giving of such notice.

Security created by individuals or other non-corporate security providers needs to be registered with the High Court pursuant to the Bills of Sale Acts, which govern the ability of an individual or non-corporate debtor to leverage property (typically, personal chattels) as security.

18 Once a security interest is perfected, are there are renewal procedures to keep the lien valid and recorded?

Once security created by a UK-registered company has been registered at Companies House, there is no need to renew the registration in order to preserve the validity of the security. However, certain events arising post registration will require further actions to be taken. For instance, the charging company is required to keep certain related documents (including instruments amending the charge) available for inspection. Amendments to existing charging documents which effectively create a new charge would be registrable. It is also possible to register at Companies House security existing on property acquired. Lastly, when a receiver or manager of the charging company is appointed, the appointee has to notify Companies House within seven days of appointment.

Bills of Sale Act registrations (see question 17) are renewable every five years.

19 Are there 'works council' or other similar consents required to approve the provision of guarantees or security by a company?

In the absence of any express agreements with unions or other employee representative bodies which may oblige the employer to obtain consent or consult on this subject (which in practice are likely to be rare), there is no obligation to obtain consents from or consult with a works council, trade union or other employee representative body for the provision of guarantees or security by an English company. However, the Transfer of Undertakings (Protection of Employment) Regulations 2006 (SI 2006/246) contain information and consultation obligations which are likely to be triggered by the sale of the underlying business.

If the company has a defined benefit pension scheme, it may be necessary to obtain the consent of pension trustees before encumbering assets if this weakens the company's ability to meet its pension obligations.

20 Can security be granted to an agent for the benefit of all lenders or must collateral be granted to lenders individually and then amendments executed upon any assignment?

Where there are several lenders, security is typically granted to a security trustee who holds the security on trust for the finance parties from time to time. As a result, assignments and transfers can be effected by lenders under a facility agreement without, in general, the need for any steps to be taken in relation to the underlying English law security documents.

21 What protection is typically afforded to creditors before collateral can be released? Are there ways to structure around such protection?

There are few specific legal protections for creditors in relation to the release of security. However, the security trustee (or receiver) will owe a number of common law duties to secured creditors

in the context of the sale of a secured asset under a charge or mortgage (eg, to act in good faith, to take reasonable steps to obtain a proper price for the asset, to obtain the best price reasonably obtainable and to act with reasonable care and skill). In addition, the intercreditor agreement may include further conditions for any release of security. Further protections apply in the case of asset-specific registers. For instance, in the case of registered land, the Land Registry would require a signed deed (in a form prescribed by the Land Registry known as a DS1) from the mortgagee authorising the release.

22 Describe the fraudulent transfer laws in your jurisdiction.

See question 31 regarding voidable transactions.

Debt commitment letters and acquisition agreements

23 What documentation is typically used in your jurisdiction for acquisition financing? Are short form or long form debt commitment letters used and when is full documentation required?

Credit agreements and intercreditor agreements will generally follow the format of the latest LMA form for leveraged finance transactions. The credit agreement will be heavily negotiated. The LMA has published two forms of intercreditor. The first is structured for a senior and mezzanine bank loan financing. The second (published in November 2013) is for a super senior revolving credit facility and senior secured high yield notes.

For acquisitions of private companies, a commitment letter attaching a detailed long-form term sheet is generally used. On some transactions the arrangers will also commit to enter into an 'interim facility' agreement attached to the commitment letter. The interim facility agreement includes provisions for a facility that matures within a short period of time after closing and which is available to fund the acquisition at closing. For transactions involving private equity houses, commitment papers will often follow papers for past transactions completed by that house.

For acquisitions of public companies, a fully negotiated and executed credit agreement and other ancillary financing documentation would be required to be in place at the time the offer is made in order to satisfy the certain funds requirements of the Code (see question 29).

24 What levels of commitment are given by parties in debt commitment letters and acquisition agreements in your jurisdiction? Fully underwritten, best efforts or other types of commitments?

Commitment letters usually provide for underwritten debt or for a club of lenders to provide financing. Best efforts commitments are sometimes provided for bond transactions or refinancings.

25 What are the typical conditions precedent to funding contained in the commitment letter in your jurisdiction?

Conditions precedent contained in the commitment letter will generally depend on the strength of the certain fund basis of the offer and of the underlying business as well as the duration of the commitment. They may include material adverse change clauses and/or specific financing conditions. Conditions precedent to funding generally include:

- corporate formalities for all borrowers and guarantors (eg, board and shareholder resolutions, constitutional documents, specimen signatures and certificates certifying no breach of limitations relating to borrowing, the grant of guarantees or security);
- executed finance documents (eg, the facility agreements, security documentation, intercreditor agreement and fee letters);
- notices and any other relevant documentation under the security documentation;
- an executed acquisition agreement;
- details of insurance;
- copies of due diligence reports, including a tax structure memorandum and reliance letters in respect thereof;
- financial projections;
- financial statements;
- a closing funds flow statement;
- proof that an agent for service of process has been appointed (if there is no English company in the group);
- a group structure chart;
- 'know your customer' requirements;
- evidence that fees and expenses have been paid;
- evidence that existing debt will be refinanced and security released on closing; and
- legal opinions.

26 Are flex provisions used in commitment letters in your jurisdiction? Which provisions are usually subject to such flex?

Market flex provisions are usually included for financing to be syndicated to other lenders in the market. Such provisions may permit arrangers to increase the margin and fees, move debt between tranches under the same agreement or create or increase the amount of a subordinated facility, remove borrower-friendly provisions or tighten others if this appears necessary or desirable to ensure that the original lenders can sell down to their targeted hold levels in the facilities. Market flex is often documented in the fee letter, for confidentiality reasons.

27 Are securities demands a key feature in acquisition financing in your jurisdiction? Give details of the notable features of securities demands in your jurisdiction.

Securities demands are typically included in commitment letters or fee letters where lenders are providing a bridge facility which is designed to be refinanced as soon as possible thereafter with the proceeds of a bond offering. The terms of the securities demand will provide that the lenders may force the borrower to issue securities, subject to certain agreed criteria. The negotiation may centre around how often the demand may be made, whether the issuance must be for a minimum principal amount of notes (to ensure some level of efficiency for the issuer in terms of transaction costs and management time), the maximum interest rate at which the issuer can be forced to issue the notes and the terms of the notes (eg, currencies and maturity).

28 What are the key elements in the acquisition agreement that are relevant to the lenders in your jurisdiction? What liability protections are typically afforded to lenders in the acquisition agreement?

For acquisitions of private companies, lenders will wish to benefit from any business material adverse change clause that a buyer negotiates in the acquisition agreement for the target, but generally will not require these provisions to be replicated in the commitment letter or the credit agreement, which will provide instead that the conditions to the acquisition are satisfied and not waived. The lenders will require controls on the ability of the purchaser to amend or waive certain provisions of the acquisition agreement, such as the long stop date, price and the conditions to closing or termination rights.

The lenders will require security over the contractual rights contained in the acquisition agreement that enable the purchaser to seek recourse against the vendor and also that the acquisition agreement can be disclosed to the lenders. The 'drop dead

date' for completing the acquisition should match the availability period for the financing.

29 Are commitment letters and acquisition agreements publicly filed in your jurisdiction? At what point in the process are the commitment papers made public?

There is generally no requirement to do so in respect of acquisitions of private companies. For acquisitions of public companies, the Code (Rule 24.3(f)) requires the offer document to describe how the offer will be financed.

In particular, the following must be covered:

- the amount of each facility or instrument;
- the repayment terms;
- interest rates, including any 'step up' or other variation provided for (which may, subject to any grace periods granted by the Panel, require market flex provisions contained in syndication letters to be disclosed);
- any security provided;
- a summary of the key covenants;
- the names of the principal financing banks; and
- if applicable, details of the time by which the offeror will be required to refinance the acquisition facilities and of the consequences of its not doing so by that time.

In addition, unless the Panel have granted a dispensation from doing so, under Rule 26.1(b) copies of any documents relating to the financing of the offer must be published on a website by no later than 12pm on the business day following a bidder's announcement of a firm intention to make an offer (or, if later, the date of the relevant document) until the end of the offer (including any related competition reference period). Subsequent amendments or updates to these documents must also be published during this period, with specific processes outlined in Rule 27 for announcing material changes and subsequent documents.

However there are aspects of the financing where the Code Committee has indicated that the above disclosure rules are waived. These include: (i) headroom elements (where the bidder has agreed a potential increase in its facility with its financing bank); and (ii) detail of the structures for providing equity to private equity vehicles (meaning that the leverage within such funds does not need to be disclosed). There have also been cases where the Executive has lifted the obligation to promptly publish market flex arrangements, allowing the lead arranger time to arrange syndication.

Enforcement of claims and insolvency

30 What restrictions are there on the ability of lenders to enforce against collateral?

When an application for the appointment of an administrator is made or a notice of intention to appoint an administrator is filed an interim moratorium begins, which becomes final when an administrator is appointed. Once the moratorium has commenced lenders cannot enforce security (other than certain financial collateral arrangements) or institute or commence other legal proceedings. When a winding-up order has been made in a compulsory winding-up of a company no action or proceeding can be started or continued against the company but the moratorium will not prevent lenders enforcing their collateral. When a creditors' voluntary liquidation of a company commences, no automatic stay on legal proceedings applies but a liquidator, creditor or shareholder can apply to court for a stay.

No automatic stay applies in a restructuring implemented by way of a scheme of arrangement. However, if a majority of creditors support the restructuring the court has discretion to grant a temporary stay of legal proceedings to allow a company to carry on trading. This should not prevent secured lenders enforcing collateral, however.

A company that does not exceed certain size thresholds can apply for a 28-day stay while it attempts to implement a company voluntary arrangement (CVA) and can, with creditors' consent, extend this by a further two months. A CVA does not bind secured creditors, however.

31 Discuss any preference periods in which secured claims could be voidable.

The vulnerable period for a transaction at an undervalue or a preference given to a connected party is two years prior to the commencement of administration or liquidation or six months for a preference given to an unconnected party. The vulnerable period for a floating charge (which is not a financial collateral arrangement) granted to an unconnected party is 12 months prior to the commencement of administration or liquidation or two years for a floating charge granted to a connected party. A transaction at an undervalue, preference or floating charge can only be challenged by an administrator or liquidator and (save where a floating charge is granted to a connected party) only if the company was unable to pay its debts (or became unable to pay its debts) as a consequence of the transaction.

Security could also be challenged without time limit by a liquidator or administrator (or, with the consent of the court, the victim) on the grounds it was a transaction to defraud creditors (a transaction at an undervalue where the purpose was to put assets beyond the reach of persons who may make a claim against the company) or otherwise prejudicing the interests of such a person in relation to such a claim. This is generally not a risk in a normal commercial lending.

A transaction at an undervalue, such as the grant of security, is a transaction entered into for no consideration or consideration in money or money's worth which is significantly less than the consideration provided by the company. It is a defence to such a challenge to show that the company entered into the transaction in good faith for the purpose of carrying on the business of the company and at the time there were reasonable grounds for believing the transaction would benefit the company. This is more difficult to show where a company provides a guarantee or security for the obligations of its sister or parent company, rather than for the obligations of its subsidiary. It is typical in an acquisition financing for a bidco to borrow debt and for the target subsidiaries to guarantee and secure the debt and the lenders usually require detailed board minutes for each obligor setting out the benefit of the transaction to that obligor. In addition a shareholders' resolution is usually required which will, unless the obligor is in the zone of insolvency, protect against a challenge by the shareholder for breach by directors of their fiduciary and statutory duties if there is a lack of corporate benefit.

A company grants a preference when it prefers a creditor, surety or guarantor by putting that entity into a better position than it would otherwise have been in without the preference if the company went into insolvent liquidation. This could be the case of a company granted security for an existing debt. A court will only make an order to unwind the transaction if the company was influenced by a desire to prefer the entity. The desire to prefer is assumed when the parties are 'connected' (eg, where the company gives security to another group company). Typically in an acquisition financing, an obligor grants security as a condition precedent to funding or to avoid a breach of undertaking which will lead to an event of default and likely insolvency rather than from a desire to prefer.

A floating charge is hardened during the vulnerable period to the extent of money paid or goods or services supplied to or a discharge or reduction of any debt of a chargor at the same time

as or after and in consideration of the creation of the charge, together with interest. As a result it is common to require companies granting floating charges to borrow directly rather than through a holding company and to grant security on or before the loan is made.

Following the Financial Collateral Arrangements (No. 2) Regulations 2003, certain insolvency challenge risks and the moratorium on enforcement of security in administration do not apply to security over financial instruments, credit claims (including claims for repayment of money to and loans made by credit institutions) and cash.

32 Does your jurisdiction allow for debtor-in-possession (DIP) financing?

No. However, an administrator or liquidator has the power to borrow and such borrowings will be an expense of administration ranking ahead of the claims of floating charge holders. Such new security will not trump fixed charges and new security cannot trump any existing security if this breaches negative pledges. Most restructurings take the form of an out of court restructuring scheme or CVA and, in such a case, the priority of new money is contractually agreed.

An administrator can sell assets subject to a floating charge without the consent of the floating charge holder and the floating charge holder will have the same priority over property acquired with the proceeds as it had in respect of the assets disposed of. The administrator can only sell assets subject to a fixed charge with the consent of the fixed charge holder or the court and must account to the fixed charge holder for the net amount realised on a sale at the market value of the assets sold.

33 During an insolvency proceeding, is there a general stay enforceable against creditors? Is there a concept of adequate protection for existing lien holders who become subject to superior claims?

See question 30. Note that creditors are entitled to rely on insolvency termination clauses in contracts to terminate subject to exceptions for landlords and utility providers.

34 In the course of an insolvency, can previous payments to lenders be clawed back by a court or other authority? What are the rules for such clawbacks and what period is covered?

Such payments can be clawed back if made in the context of transactions at an undervalue or preferences (see question 31 for applicable time periods) or extortionate credit transactions or transactions defrauding creditors. A payment could be clawed back, for example, if a company made a voluntary prepayment of a loan when it was unable to pay its debts.

35 In an insolvency, are creditors ranked? What votes are required to approve a plan of reorganisation?

Other than the costs of preserving and realising fixed charge assets, no creditor has a prior right to the proceeds of fixed charge security ahead of the fixed charge holder.

The proceeds of floating charge assets are applied as follows:

- costs of preserving and realising the floating charge assets;
- the administrator's or liquidator's remuneration and costs (although litigation costs need the consent of creditors);
- preferential debts (unpaid contributions to occupational pension schemes, unpaid employees' wages (subject to a cap) and holiday pay);
- a ring-fenced amount of up to £600,000 (unless the charge was created prior to 15 September 2003), payable to unsecured creditors (the 'prescribed part');
- sums owed to the floating charge holder;
- unsecured creditors.

The proceeds of uncharged assets after payment of administration and liquidation costs and expenses and any surplus from the enforcement of security are used to pay unsecured creditors pari passu. If the realisations of security are insufficient to fully repay the secured debt the secured creditor will rank as an unsecured creditor for the balance but cannot participate in the prescribed part.

The treatment of administrators' and liquidators' expenses has been the subject of several recent cases. In 2013 the Supreme Court ruled that, if the UK Pensions Regulator orders an administrator or liquidator to provide financial support or make a financial contribution to a defined benefit (ie, final salary) pension scheme in deficit, the amount claimed would rank alongside unsecured provable debts (and not, as was previously thought, as an expense of administration or liquidation). In 2014 the Court of Appeal ruled that, where an administrator or liquidator makes use of leasehold property for the purposes of the administration or winding up, then the reserved rent is payable as an expense for the period during which the property is so used, and will be treated as accruing from day to day for that purpose. This is true whether the rent is payable in arrears or in advance.

In an administration, the administrator will make proposals for the rescue or sale of the company's business or realisation of its assets. The plan cannot override the rights of secured creditors. Creditors vote on the plan and the level for approval is 50 per cent of unsecured creditors by value of claims although the administrator can carry out a pre-pack sale without approval of creditors. If the creditors do not approve the plan the administrator will apply to court and the court can make such order as it sees fit.

A scheme of arrangement enables a company to enter into a compromise or arrangement with its creditors or any class under a court-based statutory procedure. A scheme can be used to cram down creditors within a class of creditors, such as a class of secured creditors. This requires the approval of a majority in number and 75 per cent in value of the creditors in each class present and voting and the approval of a majority of the shareholders. A court sanction is also required. A scheme of arrangement may be approved even if the shareholders vote against it if the company is insolvent. A scheme can only be used to cram down creditors in a class and creditors in one class cannot cram down an impaired class through a scheme.

A CVA is an agreement between a company and its unsecured creditors reached pursuant to a statutory procedure without the need for court approval. It requires the approval of a majority of 75 per cent or more in value of unsecured creditors present and voting and a simple majority of shareholders (although the creditors' vote will prevail unless the shareholders apply to court to challenge the decision). If the creditors approve the CVA then the CVA will bind all creditors who were entitled to vote but not secured and preferential creditors unless they consent. A resolution of creditors approving a CVA will be invalid if the creditors voting against it include more than half in value of unsecured unconnected creditors to whom notice of the meeting was given. Where a distribution is made under a CVA or scheme of arrangement the terms of the CVA or scheme will provide for the order of distribution although CVAs cannot affect the rights of secured or preferential creditors without their consent.

36 Will courts recognise contractual agreements between creditors providing for lien subordination or otherwise addressing lien priorities?

Courts will generally give effect to contractual subordination arrangements so long as they do not override mandatory insolvency laws such as the requirement that unsecured

Update and trends

The UK has opted into an amended version of the Brussels Regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, which is due to come into effect on 10 January 2015 (see question 1).

The Alternative Investment Fund Managers Directive entered into force in the UK on 22 July 2013 and imposes disclosure obligations on certain private equity funds which acquire major stakes in certain EU-based non-listed companies (see question 2).

There have been a number of regulatory responses to the credit crunch which include substantial increases in the collateral that will be required for lending transactions (see question 6).

In November 2013 the Loan Market Association published new template loan and intercreditor agreements to cater for the current trend of 'super senior' revolving credit facilities being made available alongside the issue of senior secured high-yield notes (see question 23).

The Insolvency Service recently consulted on the modernisation of rules relating to English insolvency law. It proposes to simplify and reorder existing Insolvency Rules and replace them with a single set of rules which will bring together 23 Statutory Instruments and make common provision for processes, such as meetings of creditors, that apply across different insolvency procedures. In addition, the treatment of administrators' and liquidators' expenses has been the subject of several recent high-profile cases (see question 35). New rules on pre-packaged sales in administrations came into force from 1 November 2013, providing for increased disclosure in relation to the transaction and of pre-appointment considerations, marketing and valuation.

Proposals are currently being developed to amend the European Insolvency Regulation, which could change the way that debt restructurings are carried out in the UK and across the EU. If implemented, it is likely that pre-insolvency procedures will come under the scope of the Regulation and that there will be changes to the rules for opening secondary insolvency proceedings. The notion of a company's 'centre of main interests' (COMI) is also under focus and the proposals include new rules on 'COMI shifting' and challenging COMI (if creditors believe that COMI was wrongly identified). The proposals aim to improve coordination of cross-border insolvencies involving groups of companies and also better publicity of insolvency proceedings across member states.

creditors (which are not preferential creditors) are paid *pari passu*. Therefore, different groups of lenders can agree priority between themselves but the lenders cannot agree with the borrower that the lenders will rank ahead of unsecured creditors other than through holding security. Structural subordination can be used to give one category of unsecured creditor priority over another.

In addition, the parties cannot contract out of the statutory rules for the realisation and distribution of assets in insolvency under the anti-deprivation rule. In the *Belmont Park/Perpetual Trustee* case the Supreme Court held that the anti-deprivation rule would unwind a transfer of assets from a company if the transfer is triggered by insolvency but if the transfer occurs before insolvency the court will not unwind the transfer.

37 How is the claim of an original issue discount (OID) or discount debt instrument treated in an insolvency proceeding in your jurisdiction?

In a liquidation or administration a creditor will not be paid interest accruing after the commencement of the liquidation or administration until after all other claims have been paid in full. It is possible that the courts may refuse to allow a part of a claim if it is attributable to the amount of interest which would have accrued between the commencement of liquidation or administration and the date of payment.

38 Discuss potential liabilities for a secured creditor that enforces against collateral.

If a secured creditor forecloses on mortgaged land it can incur the liabilities of an owner such as liabilities to clean up environmental contamination. In addition, if a lender becomes involved in the chain of management leading to a breach of environmental law (whether as a result of involvement in a restructuring or enforcing security or otherwise) then it may incur liability because it has caused or knowingly permitted the breach. If a lender appoints a receiver to enforce and gives the receiver an indemnity against environmental liabilities then the lender may be liable under the indemnity.

An administrator or liquidator who runs a business will have all the liabilities associated with it and will be required to obtain all necessary licences and approvals (eg, alcohol and entertainment licences). As a result administrators and liquidators will generally ask secured creditors for indemnities.

If a company is an employer with an occupational defined benefit scheme the Pension Regulator can in certain circumstances by notice require persons who are connected or associated with the company (including other members of a corporate group, directors and shareholders with one third or more voting control) requiring them to provide financial support or a contribution to the deficit. If a lender becomes such a person (such as a shareholder of the company or another company in the same group), there is a risk the Pensions Regulator could in theory

require the lender to provide financial support or a contribution. The Pensions Regulator has rarely exercised such powers.

A secured creditor also has a duty to take reasonable care to sell at the best price reasonably available in the market and it is usually necessary, at a minimum, to obtain a valuation.

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