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Shearman & Sterling LLP's finance group regularly advises on many of the largest and most complex financing transactions worldwide and is consistently ranked at the top of syndicated lending league tables. The group represents a broad range of clients, including commercial banks, investment banks, private equity sponsors, hedge funds and corporate borrowers, and is widely acknowledged for its skill in structuring a wide variety of transactions, including leveraged buyouts, first and second lien loan structures, leveraged recapitalisation financings, investment grade financings, complex debt restructurings, senior and subordinated bridge financings, asset-based loan financings, mezzanine financings and secured lending.

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1. Loan Market Panorama

1.1 Impact of Economic Cycle and Regulatory Environment

Non-Project Finance

As a result of the 2008 credit crunch, regulators in the United States have increased their oversight of the leveraged lending practices of the financial institutions that they regulate. New leveraged lending guidelines were released in 2013, which replaced guidelines that had been in effect since 2001. The regulators (the Federal Reserve, the Office of the Comptroller of the Currency (or the "OCC") and the Federal Deposit Insurance Corporation (or the "FDIC")) have stated that their goal is to strengthen lending standards.

The guidelines specify that a debt level greater than six times earnings (typically measured as EBITDA or earnings before interest, taxes, depreciation and amortisation) raises regulators' concerns. The regulators are also primarily focused on debt paydown and covenants (or rather a lack thereof). If any lending transaction breaches the guidelines, that transaction will be marked as substandard by the regulators and therefore will attract a higher capital weighting. As a result, issuance has declined in the broadly syndicated leveraged loan market where the financing is underwritten by regulated banks and distributed to institutional investors.

Due to the increased regulatory oversight and the resulting slowing of loan issuance arranged and/or underwritten by the regulated financial institutions, alternative financing providers are becoming more significant participants in the syndicated loan market. Particularly in the area of middle-market credit space, the emergence of alternative financing services providing significant capital can be seen. Regulators are not currently focusing on these credit providers as the volumes of alternative financings are small compared to the total volumes of the largest banks. The alternative financing sources will provide financing to borrowers at higher leverage levels as well as provide covenant–like loans as described below.

Project Finance

Following the 2008 credit crisis, there was a significant contraction in the availability of funding for project finance transactions in the US market. With regard to the power space:

(i) the United States Department of Energy became a significant lending source between 2008 and 2011 as a result of its Loan Guarantee Programme, and
(ii) particularly since 2012, which saw a significant increase in its budget authority, the United States Department of Transportation has significantly increased its lending under the Transportation Infrastructure Finance and Innovation Act ("TIFIA") to support infrastructure transactions in the area of transportation.

As credit markets stabilised, commercial banks returned to the project finance lending market and the private placement market led by the insurance companies also ramped up lending to projects benefiting from long-term off-take contracts. Since the credit crisis, the commercial banks have generally participated in project finance transactions on a "club" basis rather than in a full underwriting capacity, although since 2014 there has been greater willingness on the part of the commercial banks to underwrite project finance transactions and take some syndication risk. The Term Loan B and project bond market have also returned with a vengeance, providing capital for a wide range of projects, though generally focusing on the power space. For commercial banks, the trend is still to provide mini-permanent financing structures rather than amortising loans over the full life of the project asset.

The big news in 2014 was the growth of the yieldco structure for renewable energy transactions. These types of transactions are generally structured as a master limited partnership, real estate investment trust or a "C" corporation. NRG and NextEra Energy, amongst others, successfully launched yieldcos in 2013-2014.

Another significant development of financing sources in the United States during the 2013-2015 timeframe was the provision of capital by export credit agencies such as the Japan Bank for International Co-operation and The Export-Import Bank of Korea; these export credit agencies provided financing for investors from their home countries who were investing in projects in the United States, including projects in the mining and LNG sectors where the Japanese and Koreans were significant investors during this period.

Whilst the majority of project finance transactions in the United States still occur in the power space, LNG projects and transportation infrastructure projects also received significant financing during the 2014 to first half of 2015 timeframe. For projects in the LNG and transportation sectors it is not uncommon to see a mixture of financing sources combining one or more commercial bank tranches or a TIFIA loan with a private placement or bond issuance.

Mining projects also can attract financing by means of streaming transactions which monetise a portion of proposed mineral production through a forward sale transaction. There are several companies (such as Franco Nevada and Silver Wheaton) which focus on providing financing to operating or developing mining companies through streaming transactions.

At the time of the writing of this chapter, there is a wide range of sources of capital available for well-structured project finance transactions across all sectors.

1.2 The High Yield Market

Over the last ten years or so, the US loan market has seen investors who historically bought high-yield bonds cross over into the syndicated loan space. During periods of low interest rates (such as have been prevalent over the last several years), these investors have wanted floating rate paper to take advantage of any increases in LIBOR. The influx of such investors into the leveraged bank loan space has created what is known as the Term Loan B market. Term Loan A facilities (also referred to as part of the pro-rata tranches) are typically held by commercial banks and investment banks. The tenure for Term Loan A facilities is typically five to six years with significant amortisation over the term of the deal. In contrast, Term Loan B facilities typically have a tenure of seven years and have annual amortisation of only 1% per annum. Term Loan B investors (similar to high-yield investors) rely in large part on the credit ratings for the debt. As a result, the terms of these Term Loan B facilities have become more similar to the covenants contained in high-yield bonds. The biggest change resulting from this convergence is that many Term Loan B facilities are "covenant-lite" which in essence means that there are no financial maintenance covenants.

Historically, syndicated bank loans contained covenants that tested a borrower's performance against the business model that was delivered to the lenders prior to closing. Such tests included a total debt ratio (total debt to earnings), secured debt ratio (total secured debt to earnings) and interest coverage ratio (earnings to total interest expense). Typically, a syndicated bank loan agreement would include one or two such tests. The ratio levels which the borrower had to meet were measured on a quarterly basis and were set at a certain cushion to the levels shown in the model. Therefore, the leverage ratio levels would decrease over the term of a deal and interest coverage ratio levels would increase over the term of a deal.

In addition to a lack of financial maintenance covenants, aggressive Term Loan B facilities use incurrence tests to permit unlimited debt incurrences, investments and restricted payments. Traditionally, syndicated bank credit facilities would have dollar baskets for debt incurrences, investments and restricted payments, regardless of the strength of the company. Incurrence-style exceptions allow a borrower to carry out restricted activities as long as, on a pro forma basis, the borrower is in compliance with an agreed leverage ratio level.

1.3 Recent Developments

A significant portion of leveraged loans have been held by collateralised loan obligations ("CLOs"). In October 2014 the FDIC and the Federal Reserve (amongst other regulators) issued final rules for implementing certain requirements of the Dodd–Frank Wall Street Reform and Consumer Protection Act. Part of these final rules require that the "sponsor" of a CLO retain, and refrain from transferring or selling or hedging, an economic interest in the credit risk of the securitised assets in an amount equal to at least 5% of the fair value of the CLO securities issued in the transaction. These rules become effective two years following the date on which they were published. CLOs existing prior to the effective date of these rules will be "grandfathered" (that is, exempted) unless they enter into transactions, after the effective date, which are characterised as the issuance of CLO securities. Such risk-retention requirements may prevent small and medium-sized managers from either entering into or remaining in the CLO market which could reduce the supply of CLO financing and thereby reduce the demand for leveraged loans. If this happens, there may be a tightening of the terms of leveraged lending. However, the two-year effective date provides the CLO market with an opportunity to analyse, and adapt to, these new risk-retention rules.

2. Authorisation

2.1 Requirements and Procedures

In the United States, a commercial bank can operate under either a national bank charter or a state bank charter. The OCC (a bureau of the Treasury Department) has the power to grant national bank charters and serve as the primary regulator and supervisor of such national banks. Each state has the power to grant state banking authority; these state banks are supervised and regulated by the applicable state banking commission as well as by the FDIC and the Federal Reserve. A foreign bank may establish a presence in the United States in a number of ways. A foreign bank could acquire or establish a separate bank or bank holding company in the United States which would be treated for regulatory purposes as a domestic financial institution. Alternatively, a foreign bank could establish a branch or agency in the United States which would be licensed by the applicable state government and the OCC. In addition, the Federal Reserve would regulate state-licensed foreign bank branches and agencies.

Another entity that makes loans in the United States is a business development company ("BDC"). BDCs generally make loans to smaller and medium-sized businesses. These entities are formed under the Investment Company Act and are therefore regulated by the Securities and Exchange Commission.

3. Structuring and Documentation Considerations

3.1 Foreign Lender Restrictions: Granting Loans

In general, foreign banks that operate in the United States have great flexibility to engage in any financial activity (including making loans) in the United States but they will be subject to regulation by the Federal Reserve, amongst others. The guiding principle of the International Banking Act of 1978 is to treat foreign and domestic banks in a similar fashion in like circumstances.

3.2 Foreign Lender Restrictions: Granting of Security

In general, US law does not create any restriction or impediment on the giving of a guarantee by, or the grant of a security interest in the assets of, a US entity to a foreign lender. Certain regulated entities (such as investment companies or entities which hold certain types of licences) may have restrictions on providing credit support (to both domestic and foreign lenders).

3.3 Foreign Currency Exchange Restrictions
Currently, the United States does not impose any controls on foreign currency exchange.

3.4 Agent and Trust Concepts
Typically, in bank lending transactions where there is more than one lender, a collateral agent is appointed for the lenders and the grant of security is given to that collateral agent for the benefit of all the lenders. In transactions where public debt bonds or notes are secured, the security interest is typically granted to a collateral trustee on behalf of the holders of the secured debt.

3.5 Loan Transfer Mechanisms
In the US bank market, loans are transferred between lenders through either an assignment or a participation. An assignment is a sale of all or part of a lender's rights and obligations under the applicable loan agreement to another lender. Pursuant to an assignment, the assignee is replacing the assigner with respect to the portion of the loan being assigned. The assignee has a direct contractual relationship with the borrower under the terms of the loan agreement and thus an assignee has available to it all of the remedies that the assigning lender had.

A loan agreement will establish any conditions that are necessary for an assignment to occur. Typical requirements include:

(i) minimum amounts for the assignment (generally USD1 million in the case of term loans and USD5 million in the case of revolving loans) and
(ii) consent of the borrower as well as the administrative agent for the lenders. Borrower consent will not be required (x) if an event of default has occurred and is continuing (or, in certain transactions, if a payment or bankruptcy event of default has occurred and is continuing) or (y) if the assignment is to another lender or to an affiliate or related fund of a lender. Over the last several years, it has become market practice to include "borrower deemed consent" language in credit agreements. Such language provides that if a borrower has not objected to an assignment within a certain period (typically five to ten business days) after having received notice of that assignment, it will be deemed to have consented. Often, administrative agents will charge a fee per assignment (typically USD3,500) to offset the costs of processing that assignment.

Under a participation, a lender will sell an interest in a loan to another institution (that institution being the "Participant") but the Participant is not a party to the loan agreement and therefore does not have any contractual relationship with the borrower. As a result, a participant does not have the ability directly to exercise any remedies against the borrower.

A participant has only a contractual relationship with the participating lender. Therefore, the participating lender:

(i) retains a partial interest in the loan,
(ii) retains title of record to the loan,
(iii) retains all liability for future obligations in respect of the loan and
(iv) retains privity with the borrower (including the right to enforce remedies against the borrower). A participation is not a novation of the loan and therefore it does not require borrower consent.

Generally, participation agreements describe the participation arrangement as a sale and purchase of an undivided interest in the loan and in any collateral and other credit support for the loan. Participants typically have limited rights to vote in respect of amendments, waivers and other modifications of the loan. The limited rights include a vote on decreases in interest rate, extension of final maturity, decreases in principal amount owing to lenders and other significant economic terms.

3.6 Debt Buy-back
Debt buy-backs by borrowers and their affiliates are generally permitted in the leveraged loan market, in each case subject to certain restrictions. Debt buy-backs that are consummated by the borrower or any of the other loan parties typically are required to be offered to all of the lenders on a pro-rata basis. This typically would occur through a dutch auction or some other mechanism by which the borrower solicits discounted prepayment offers from each of the term lenders. The borrower buy-backs will either take the form of a prepayment (on a non-pro rata basis if not all of the lenders participate) or an assignment. If the borrower actually takes by assignment, the loan agreement will require that the borrower cancel all of the assigned loans immediately upon the effectiveness of the assignment.

In the leveraged loan market for portfolio companies of private equity sponsors (including in the acquisition financing consummated in connection with the private equity sponsor acquiring such a company), there is generally not a requirement that buy-backs by the sponsor or its affiliates (other than the borrower and the guarantors) be done on a pro-rata basis (or that an offer be made to all the lenders). This is because the funds for such buy-backs are either from funds that the loan documentation permits to be sent out of the system through a restricted payment or from other funds that the sponsor has (and not from cash of the borrower). In other words, a sponsor buy-back is not a disguised prepayment. Sponsors can carry out buy-backs through open market purchases and are not required to cancel the loans.

However, loan documentation does impose restrictions on sponsors who hold loans. In general, sponsors are not permitted to attend lender-only meetings or receive lender information. A cap on the aggregate amount of loans held by sponsors is imposed (generally between 20% and 30%). A debt fund affiliate (ie bona fide debt funds or affiliates who primarily invest in loans and other long-term indebtedness in the ordinary course of business) are usually excluded from such restrictions.

3.7 Public Acquisition Finance

At the time that an acquisition agreement is entered into, the buyer will have committed financing which is evidenced by a commitment letter, a detailed term sheet and a fee letter. The commitment papers are not typically publicly filed. The definitive loan documentation will be entered into substantially concurrently with the consummation of the acquisition. Prior to the execution of the commitment papers, the lenders will have completed their due diligence on the target and the buyer (if other than an entity established by a private equity sponsor solely for purposes of consummating the transaction). Therefore, there is no diligence once the commitment papers have been delivered.

The typical conditions for an acquisition financing include the following:

(i) the acquisition is consummated pursuant to the terms of an acquisition agreement that the lenders have approved prior to the execution of the commitment papers and there has been no amendment, waiver or modification of that acquisition agreement which is materially adverse to the lenders without the consent of the lead arrangers;
(ii) the accuracy of only (x) those representations contained in the acquisition agreement pertaining to the target which are material to the lenders' interests and that, if they cannot be satisfied prior to the closing date, would permit the buyer to terminate their obligations and (y) certain "specified representations" which relate to corporate authority and governing enforceability of the loan documentation, compliance with certain laws and perfection of certain security interests;
(iii) with respect to collateral, only the delivery of stock certificates and the filing of Uniform Commercial Code financing statements (and sometimes intellectual property);
(iv) no material adverse change in the target which is identical to the no "MAC" condition in the acquisition agreement;
(v) receipt of audited financial statements (typically for the last three years) and unaudited financials for any quarters occurring after the last audited financials;
(vi) the refinancing of certain outstanding indebtedness of the target;
(vii) payment of fees and expenses of lenders;
(viii) receipt of customary closing certificates, legal opinions and solvency certificates and execution and delivery of definitive loan documentation;
(ix) receipt of information required under the USA Patriot Act and other 'know your customer' regulations; and
(x) completion of a bank marketing period (typically 15 business days).

4. Tax

4.1 Withholding Tax

In general, gross-basis 30% US withholding tax is imposed on payments of interest by US obligors. For this purpose, when a debt instrument is issued at a discount ("original issue discount"), the amount of that discount may be treated as interest that is subject to US withholding tax when paid or when the debt instrument is sold. Gain from the sale of a debt instrument by a non-US lender is generally considered to be non-US source income, unless the gain is attributable to a US trade or business conducted by the lender. Principal payments (and gross proceeds from the sale of a debt instrument) are generally not subject to US withholding tax (except with respect to Foreign Account Tax Compliance Act (FATCA) withholding taxes, which are discussed briefly below). Other types of income paid to lenders (eg fee income) may also be treated as US-source payments that are subject to US withholding tax.

Notwithstanding the general rule described above, no withholding is required with respect to:

(i) interest eligible for exemption under an applicable US tax treaty and
(ii) portfolio interest, as discussed below.

Treaty exemptions: Many US tax treaties provide a complete exemption from US withholding tax with respect to interest. Other US tax treaties provide for a reduced rate (eg 5% or 10%) of US withholding tax with respect to interest.

Portfolio interest exemption: "Portfolio interest" is exempt from US withholding tax (without regard to the residency of the lender or whether a US tax treaty applies). To qualify for the portfolio interest exemption:

(i) the non-US lender must not own (directly or by attribution) 10% or more of the voting equity of the borrower,
(ii) the non-US lender must not be a controlled foreign corporation related to the borrower,
(iii) the non-US lender must not be a bank extending credit pursuant to a loan agreement entered into in the ordinary course of its trade or business and

(iv) the interest must not be subject to certain contingencies (eg interest based on the income or profits of the borrower).

Other exemptions, such as an exemption for bank deposit interest and an exemption for interest paid on short-term original issue discount obligations, may also apply in certain circumstances. In general, non-US lenders are required to provide US tax certifications to the borrower (generally on US Internal Revenue Service Form W–8BEN-E or another applicable Form W-8) in order to claim an exemption from US withholding tax.

US tax legislation enacted in 2010 and commonly known as the "Foreign Account Tax Compliance Act" or "FATCA" imposes a 30% US withholding tax on non-US banks and other financial institutions that fail to comply with certain due diligence, reporting and withholding requirements. FATCA withholding tax applies to payments of US source interest and, starting in 2017, to gross proceeds from the sale or other disposition (including a repayment or a redemption) of debt instruments of US obligors, and the exemptions described above (eg treaty exemptions and the portfolio interest exemption) do not apply with respect to a FATCA withholding. Many countries have entered into agreements with the United States to implement FATCA, which may result in modified requirements that apply to financial institutions organised or resident in such countries. As of August 2015, more than 173,000 financial institutions have registered with the US Internal Revenue Service and have agreed to comply with FATCA due diligence, withholding and reporting requirements.

4.2 Other Taxes, Duties and Charges

Non-US lenders need to take care that their activities within the United States do not give rise to a US trade or business or a permanent establishment within the United States, in which case those non-US lenders may be subject to net-basis taxation. Whether a non-US lender is engaged in the conduct of a US trade or business or has a permanent establishment depends on all the facts and circumstances, including the activities undertaken from within the United States and whether the non-US lender has an office or other fixed place of business within the United States (taking into account, in certain circumstances, certain activities of agents who are present in the United States).

4.3 Limits to the Amount of Interest

Federal and state-chartered banking institutions are subject to laws and regulations on the amount of interest that can be charged on loans. In general, a national bank may charge interest on any loan that is the higher of (x) the rate that is allowed by the laws of the state in which such bank is located and (y) 1% above the discount rate on 90-day commercial paper which is in effect in that bank's Federal Reserve district. If the laws of the state in which a bank is located do not provide for a maximum interest rate, that bank may charge the higher of (x) 7% per annum or (y) 1% above the discount rate on 90-day commercial paper which is in effect in that bank's Federal Reserve district. This rule has been interpreted to allow national banks to charge the maximum rate of interest permitted for any state-licensed lending institution. Operating subsidiaries of national banks are regulated in the same manner as other non-bank lenders under relevant state law.

Since the majority of major commercial transactions are governed by New York law, it should be noted that New York has both civil and criminal statutes relating to charging usurious interest rates. Under the civil statute, the limits on maximum interest charged do not apply to loans in excess of USD250,000. Under the criminal usury statute, the maximum interest rate limits do not apply to loans in excess of USD2.5 million.

5. Guarantees and Security

5.1 Assets Available and Forms of Security

Generally speaking, all assets of a borrower or guarantor organised under the laws of the United States are available to lenders as collateral. It is customary for there to be negotiated exceptions to the collateral package. Such exceptions typically include immaterial owned real property, equity interests in joint ventures, assets of entities that are restricted from granting liens on their assets and assets that are subject to certificates of title. In addition, immaterial subsidiaries may also be excluded from the requirements of granting a lien on their assets or providing a guarantee.

In general, a security interest in respect of personal property, such as goods, equipment, accounts receivable, inventory and intellectual property, is governed by Article 9 of the Uniform Commercial Code (or "UCC"). Under Article 9, in order to have an enforceable security interest in the collateral the security interest must attach to the collateral and then the security interest must be perfected. In order to have attachment, three elements must be satisfied:

(1) Value must be given by the lender to the grantor;
(2) The grantor of the security interest must have rights in the collateral; and
(3) The grantor of the security interest must sign or "authenticate" a security agreement.

A security agreement serves as the primary document that evidences the granting of a security interest. Article 9 of the UCC does not require a specific form for the document creating the security interest. However, the security agreement must "create or provide" for a security interest (such a provision is commonly called the granting clause). In addition, the security agreement must contain a description of the collateral that reasonably identifies the applicable assets. This is generally done by listing by collateral type all of the borrower's assets that are intended to be covered by the security arrangements. Description by type of collateral is not sufficient if the lender wishes to take a security interest in commercial tort claims or co-operative interests, as their descriptions need to include more specific details.

If a lender has control of the relevant collateral (such as investment property, deposit accounts, electronic chattel paper or letter-of-credit rights) or if a lender is in possession of certain collateral, then the security agreement may be made orally. However, due to potential evidentiary issues, oral security agreements are not relied upon in syndicated secured financings.

Once a security interest has attached, the lender must perfect the security interest in order for that security interest to be effective against third parties. Perfection of a security interest in personal property collateral is governed by Article 9 of the UCC and the rules will vary depending on the type of collateral that is involved. The four principal methods of perfection are:

(i) filing a UCC financing statement,
(ii) possession of the collateral,
(iii) control of the collateral and
(iv) automatic perfection.

In addition, a security interest in proceeds is automatically perfected for 20 days if the lender had a perfected security interest in the collateral that was sold which gave rise to the proceeds.

Security interests in most types of personal property can be perfected by filing a properly completed UCC-1 financing statement in the appropriate office. Common exceptions to the filing rule are deposit accounts and letter-of-credit rights. The general rule for where to file for a grantor that is a registered entity is to file at the Secretary of State's office in the grantor's jurisdiction of organisation.

Security interests in investment property, electronic chattel paper and letter-of-credit rights can be perfected by control, whilst perfection by control is the only method of perfection for deposit accounts. Control can be established in different ways, depending on the nature of the collateral. With respect to investment property, the method of perfection by control will depend on whether the asset is a certificated security, an uncertified security or a securities entitlement. In general, perfection by control will take the form of possession or entering into a security account control agreement. With respect to deposit accounts, control is achieved if:

(i) the account is in the name of the lender or
(ii) a deposit account control agreement is entered into by the lender, the grantor and the depository bank.

Security interests in real estate are generally evidenced by mortgages or deeds of trust. Such documentation is filed locally in the jurisdiction where the property is located.

5.2 Floating Charges and Other Security Interests

Floating liens, which are the US equivalent of a floating charge, are permitted under Article 9 of the UCC. Both the granting clause in the security agreement and the financing statement files should refer to all present and future assets of the type enumerated. The concept of a floating lien only applies to collateral that falls within the scope of Article 9 and does not apply to real estate or insurance.

Although floating liens are permissible under the UCC, such interests may be subject to attack in the case of insolvency or bankruptcy. Section 552(a) of the US Bankruptcy Code invalidates all pre-petition liens resulting from a security agreement on post-petition property acquired by the debtor or the debtor's estate. The primary purpose of this section is to facilitate the debtor's reorganisation. However, Section 552(b) of the US Bankruptcy Code generally allows a secured lender to retain its liens in the post-petition proceeds and products from its pre-petition collateral to the extent provided by the applicable security agreement and non-bankruptcy law.

5.3 Downstream, Upstream and Cross-stream Guarantees

In the United States, downstream, upstream and cross-stream guarantees are all permitted. However, guarantees may be voided as fraudulent conveyances under the US Bankruptcy Code and applicable state fraudulent transfer laws. A fraudulent conveyance occurs if:

(i) the guarantee was made with an actual intent to delay, hinder or defraud creditors or
(ii) the guarantor (x) was insolvent at the time of the making of such a guarantee or was rendered insolvent by the making of that guarantee and (y) did not receive reasonably equivalent value for that guarantee (or transfer).

Generally, fraudulent conveyances issues in connection with a downstream guarantee are not a matter for concern. It is assumed that the parent entity providing the guarantee has received reasonably equivalent value as the equity owner of the borrower. The same analysis is not true for upstream or cross-stream guarantees, since the subsidiaries or sister entities of the borrower may not receive reasonably equivalent value. In determining reasonably equivalent value, courts may consider indirect benefits received or a shared identity of interest. However, the indirect benefit must be fairly concrete and should clearly strengthen the overall viability of the corporate group.

In order to prevent an upstream or cross-stream guarantee from being voided in a bankruptcy proceeding, the amount of the guarantee is typically limited to the maximum amount that the guarantor could pay without causing it to become insolvent. This type of limit is generally called the "savings clause".

Upstream guarantees from controlled foreign subsidiaries (generally defined as entities that are more than majority-owned by certain US entities) can cause the US borrower to be treated (from a tax perspective) as annually receiving a deemed dividend from the foreign subsidiary; that deemed dividend would be subject to US federal income taxes. Such taxes could be a significant cost for the US borrower and, therefore, lenders do not generally require a guarantee from a controlled foreign subsidiary.

5.4 Restrictions on the Target

In the United States, targets being acquired are not prohibited from granting liens on their assets or from giving guarantees. Likewise, there is no prohibition on a target providing financial assistance in the acquisition of their own shares. However, lenders need to consider that if the target is providing the credit support for the financing for the acquisition, disgruntled creditors of the target existing prior to the acquisition could argue that the financing transaction is a fraudulent conveyance. The disgruntled creditors would argue that the steps in the overall transaction should be collapsed and, therefore, since the proceeds are being used to pay consideration to the sellers of the target (ie its stockholders) the target entities providing the credit support are not receiving reasonably equivalent value. Therefore, it is important for lenders to ascertain by diligence whether or not the target is solvent at the time of the acquisition. Typically, lenders require a representation from the borrower as to its solvency at the funding of the loan as well as a solvency certificate as a condition to closing.

Lenders are also to consider preferential transfers in bankruptcy whenever they take additional guarantees or collateral for an existing obligation. Under Section 547(b) of the US Bankruptcy Code, a preferential transfer or "preference" occurs when a transfer of an interest in property of the debtor:

(i) is made for the benefit of a creditor,
(ii) is made on account of an antecedent debt (ie a debt that existed before the time of the transfer),
(iii) is made while the debtor was insolvent,
(iv) is made within 90 days prior to the filing of a bankruptcy petition (or within one year if the transfer is made to an insider) and
(v) enabled the lender to receive more than it would have received in a liquidation under Chapter 7 of the US Bankruptcy Code.

Section 547 of the Bankruptcy Code has special rules for determining when a transfer occurred. If a transfer is perfected within 30 days after the transfer occurs, the transfer is deemed to have been made on the date the transfer occurred. However, if a transfer is perfected more than 30 days after the transfer occurred, the transfer is considered as made on the date of perfection. If the transfer is not perfected by the later of the filing of the bankruptcy petition and the 30th day after the date the transfer occurred, the transfer is considered to have been made immediately before the bankruptcy petition was filed (and therefore the transaction occurs during the preference period).

Preferences are voidable in bankruptcy and a debtor or a bankruptcy trustee may bring an action against a creditor to bring the applicable transferred property back into the debtor's estate. In that event, the debtor may distribute such property to all creditors in accordance with the rules provided by the Bankruptcy Code.

5.5 Release of Security

Loan documents typically provide for the automatic release of the lender's security interest upon payment in full of the loan or upon a permitted disposition of assets. Upon an automatic release, additional steps are typically taken to provide evidence of that release of a security interest. If the applicable collateral has been perfected by the filing of a UCC financing statement, the lender will file a termination statement in the same filing office in the event of a full release of collateral or will file an amendment to the applicable UCC financing statement in the event of a partial release. With respect to collateral perfected through possession, the lender must deliver the possessory collateral back to the borrower. If the collateral has been perfected through control, the lender must take action to undo the control it obtained in the collateral. For other forms of collateral such as real estate or intellectual property, a release or termination would be filed in the appropriate filing office.

5.6 Rules Governing the Priority of Competing Security Interests

The general rules of priority of security interests are as follows:

(1) a perfected security interest has priority over an unperfected security interest;
(2) if two security interests are unperfected, then the first security interest to attach has priority; and
(3) if two security interests are perfected in an equal manner, then the first to perfect has priority.

However, with respect to certain types of collateral, there may be more than one way to perfect. In such a case, the lender with the better form of perfection will have priority regardless of which was perfected first.

Some common methods of perfection which give better priority are the following:

(1) Perfection by possession of certificated securities gives better priority than the perfection by filing.
(2) Perfection by control in a letter-of-credit right gives better priority than a security of interest perfected automatically as a supporting obligation.
(3) Perfection by control in investment property and securities accounts gives better priority than a security interest perfected by filing.

In the United States there is both structural subordination and contractual subordination. Structural subordination results from the structure of the transaction rather than by agreement between the creditors and the borrower.

Contractual subordination is a written contractual arrangement that generally only affects the rights of senior and junior creditors with respect to one another; it does not affect the rights of the junior creditors against the issuer of the debt. Contractual subordination provisions can apply to payment obligations, lien priorities or both. Under the laws in the United States, if a provision says only that one debt is subordinated to another and does not have any other provision relating to subordination, then that provision would not be given any meaning. The terms of subordination must be explicitly set forth in the subordination provision in detail.

Lien subordination is typically documented in an intercreditor agreement. Generally, there can be lien subordination without payment subordination. Without any sort of contractual agreement, second lien lenders are secured creditors with rights under the US Bankruptcy Code that can interfere with the rights of first lien lenders in a workout or bankruptcy of the borrower.

Most intercreditor agreements provide that the first lien claims will be considered as first lien, regardless of the timing of perfection and that the second lien will not challenge the first lien nature of such obligations. Intercreditor agreements also provide that the first lien lenders can keep the proceeds of the collateral until they have been paid in full before the second lien is entitled to receive any of those proceeds. Generally, the second lien will agree that it will not attempt to exercise any rights against the collateral for a specified period. After that specified period, the second lien may exercise remedies but must agree to turn over to the first lien any amounts that it receives from the collateral.

Subordination agreements and intercreditor agreements will generally survive the bankruptcy of a US borrower or guarantor. Section 510 of the Bankruptcy Code provides that subordination agreements are enforceable in bankruptcy proceedings to the extent that such agreements are enforceable under non-bankruptcy law.

6. Enforcement

6.1 Enforcing Collateral

In general, a security document will provide when a lender can exercise its rights and remedies in respect of the collateral. Typically, security documents will state that upon the occurrence and during the continuance of an event of default a lender may commence enforcing its rights in respect of collateral. Occasionally, the triggering event may be an unmatured event of default (ie the cure period has not yet run).

Although events of default are highly negotiated, typical events of default include:

(i) payment default,
(ii) inaccuracy of representations and warranties included in the loan documentation,
(iii) breach of covenants (with negotiated cure periods for some covenants),
(iv) cross-default and/or cross-acceleration to other material debt,
(v) change of control,
(vi) insolvency or bankruptcy of the borrower and the guarantors and
(vii) certain issues with respect to collateral and guarantees.

In general, if the event of default (or default) is not continuing (either because the borrower has cured that breach or the lender has waived the breach), the lender is not entitled to exercise its remedies.

Remedies available to a lender upon the occurrence of an event of default include terminating any commitments to extend future credit, accelerating the outstanding loans, charging higher interest rates, calling upon guarantees and enforcing the collateral. With respect to collateral, a lender can enforce its rights against the collateral using either judicial or non-judicial enforcement. A lender can obtain a judgment on the debt or foreclose on the collateral. Judicial foreclosure (which is foreclosure conducted as a court proceeding) on the collateral requires compliance with the applicable state foreclosure laws. The Uniform Commercial Code provides for non-judicial enforcement.

Another remedy under the Uniform Commercial Code is for the lender to take possession of the collateral. A secured party may also retain the collateral in full or partial satisfaction of the secured obligations. This remedy is also known as strict foreclosure. The Uniform Commercial Code sets out notice requirements and other steps that must be taken before the secured party can exercise this remedy.

Another remedy is that the secured party may collect payments directly from parties who owe amounts to the borrower. There are several ways this remedy can be accomplished: by notifying account debtors to make payment directly to the secured party or by enforcing the borrower's/guarantor's rights with respect thereto.

The secured party can also elect to dispose of the property itself in a commercially reasonable manner. The secured party may dispose of the collateral in a private or public sale. If a good-faith buyer purchases the collateral, the sale discharges the secured party's security interest, as well as any junior security interests. There is a minimum ten-day notice period for any sale of the collateral.

6.2 Governing Law, Submission to Foreign Jurisdiction and Waiver of Immunity

Forum selection clauses are generally enforceable in the United States and will be considered non-exclusive unless the documents expressly state that such a choice is exclusive. Unless a case falls under federal jurisdiction (such as the Foreign Sovereign Immunities Act of 1976 or matters relating to international or foreign banking), state law governs the enforceability of a forum selection clause.

New York's conflict of laws rules uphold foreign forum selection clauses when the jurisdiction chosen has a reasonable relationship to the transaction. Note that New York courts will apply the substantive law of the foreign jurisdiction but not that foreign jurisdiction's conflicts of law rules. Generally, there will be a reasonable relationship to a jurisdiction if a significant portion of the negotiating or performance of the contract is to occur or occurs in that jurisdiction. However, the parties' freedom to choose a governing law does not extend to issues involving the interests of third parties (such as the perfection of security interests).

6.3 Judgments and Arbitral Awards by Foreign Courts

US law is generally liberal in recognising and enforcing foreign judgments. Most federal and state court decisions on recognition of foreign judgments follow the comity analysis set forth in the Hilton v Guyot decision by the US Supreme Court. However, this area of law is considered to be a state law issue. Substantive state law rules are fairly uniform; nevertheless, in some states they are found in statutes whilst in other states they are a matter of common law.

In general, most courts require that a separate action be brought for recognition of the foreign judgment. If this action is successful, the judgment becomes a local judgment that is enforceable under local law in addition to becoming entitled to the full faith and credit in other courts within the United States.

7. Bankruptcy and Insolvency

7.1 Company Rescue or Reorganisation Procedures

An out-of-court restructuring can be achieved in many ways, including by means of negotiated amendments to the company's loan agreements, debt-for-equity exchanges, exchange offers, or recapitalisations through capital contributions or a sale process. Lenders might agree, for example, to extend a loan's maturity date in exchange for economic incentives such as the payment of one-time fees or an increased interest rate. In cases of serious financial distress, lenders may agree to cancel some or all of the outstanding principal amount of their loans in exchange for an equity interest in the company.

The ability of a company to achieve a successful out-of-court restructuring is dependent upon the willingness of its stakeholders to participate in the restructuring process, as well as any contractual limitations that may prevent consummation of a restructuring without a court process. A common difficulty in restructuring credit agreements and indentures out of court is that many amendments, such as an extension of the maturity date or a reduction in principal amount, typically require 100% consent of the lenders or noteholders pursuant to the terms of the relevant agreement. Large corporate loans and bonds commonly are syndicated and may trade on the open market. As a result, several lenders or holders with divergent interests may hold portions of the same loan, and obtaining 100% consent to a restructuring transaction may be difficult or impossible.

If 100% consent cannot be achieved, it is still possible to restructure by soliciting consent from a company's debtholders and agreeing to move forward with the out-of-court restructuring if a threshold of debtholders acceptable to the company and consenting debtholders consents. Non-consenting debtholders still maintain their monetary claims under the original debt instruments (though creditor rights, other than payment rights that did not require consent of all debtholders, may be stripped from the governing documents), but do not receive any of the benefits of the restructuring.

Public securities typically are restructured out of court through some form of exchange offer or consent solicitation. An exchange offer is the acquisition by an existing debtholder of a newly issued security of an issuer using the existing security as the purchase consideration through an exchange. In a consent solicitation, an issuer seeks the agreement of debtholders to modifications of material terms of the indenture or other debt instrument in accordance with applicable securities laws and regulations. All exchange offers must be registered, unless an exemption is available under the securities laws.

7.2 Impact of Insolvency Processes on Lender's Rights to Enforce

The filing of a petition for Chapter 11 relief automatically triggers an injunction known as the "automatic stay", which prohibits attempts to enforce or collect pre-petition claims against the debtor. The automatic stay provides one of the Bankruptcy Code's most fundamental protections, by both giving the debtor a temporary reprieve against enforcement of its obligations whilst the debtor attempts to reorganise under Chapter 11, and preserving the bankruptcy estate for distribution according to the Bankruptcy Code's priorities.

A creditor may obtain relief from the automatic stay by requesting an order from the court approving the termination, modification or conditioning of the automatic stay. The court may grant relief from the automatic stay for cause upon notice and a hearing, which cause includes lack of "adequate protection" of an interest in property of the requesting creditor. The absence of adequate protection in general is found where the value of property securing a claim is likely to diminish in value, or already is valued at an amount less than the secured claim. Although cause exists to lift the automatic stay where there is a lack of adequate protection, the Bankruptcy Code allows debtors to satisfy the adequate protection requirement by offsetting the decline in the value of the property by making cash payments or by granting additional liens on the property or other assets of the debtor.

7.3 Payment of Creditors

The Bankruptcy Code establishes a hierarchy for distribution of a debtor's assets, which is known as the "absolute priority rule". The absolute priority rule provides a basic framework for ensuring fair distribution by mandating that claims of higher priority are paid in full before claims and interests of lower priority may realise any recovery.

Under the absolute priority rule, secured claims are paid first to the extent of the value of the collateral, followed by super-priority administrative claims, then administrative claims, then priority unsecured claims, then unsecured claims, and lastly equity interests. For a plan of reorganisation to be confirmed under Chapter 11, it must provide for the payment in full in cash of administrative (and super-priority administrative) claims.

7.4 Risk Areas for Lenders

The general rule is that a bankruptcy filing by a borrower does not affect the validity of a security interest in collateral. In many cases, however, the unsecured creditors' committee will investigate whether a lien held by a creditor has been property perfected under applicable state law, and seek to challenge the lien if it is appropriate to do so.

Unless a claim is over-secured, post-petition payments of interest, fees and charges arising from a secured claim typically are not allowed. Post-petition interest generally is not paid in the ordinary course of business even though it is part of a secured claim, but sometimes it is paid to a secured creditor as adequate protection for the use of its collateral by the debtor.

Bankruptcy courts have broad discretion to subordinate claims in appropriate circumstances. Such circumstances include if the claimholder has contractually agreed to the subordination of their claim, if the claim is related to rescission of or damages from the purchase or sale of a security of the debtor, or if subordination is appropriate based on the equities of the case.

Prior to a bankruptcy filing, a creditor may, consistent with their rights and remedies contained in the contract, attempt to exert influence over a financially distressed company to prevent it from acting in ways that could reduce the creditor's ability to be repaid. However, any actions that may be viewed as taking undue control of the company's management or business may raise "lender liability" issues if the creditor's actions are viewed as being detrimental to the financially distressed company or other creditors of the company.

A Chapter 11 debtor has the right, with court approval, to obtain new financing to fund operations during the Chapter 11 case (known as "debtor-in-possession" or "DIP" financing). A "priming" DIP is DIP financing pursuant to which liens granted to the DIP lender take priority over existing liens. The debtor may grant senior or equal liens on property that already is encumbered if credit is otherwise unavailable and the debtor's existing lenders are adequately protected. Priming liens may be granted on a consensual or contested basis.

Cash collateral is defined in the bankruptcy code as "cash, negotiable instruments, document of title, securities, deposit accounts or other cash equivalents" that secure a lien. A bankruptcy court may authorise a debtor's use of cash collateral over a secured party's objection if the debtor can establish that the secured party's collateral is adequately protected.

8. Project Finance

8.1 Introduction to Project Finance

In the United States, there is no specific legal framework for project finance transactions. Whilst the commercial bank market, capital markets and insurance companies (through private placements) have traditionally been the principal source of financing for projects in the energy (including power and oil and gas projects) and mining sectors (both in the form of corporate and project financings structures), the financing of infrastructure assets such as roads, bridges, tunnels, rail facilities, airports, water treatment plants, schools and other social infrastructure has largely been the purview of government agencies at the federal, state and municipal levels, with such funding consisting of government expenditures appropriated from tax revenues, user fees or the issuance of state or municipal bonds or notes, the spreads of which are typically are low because the interest payments on such bonds or notes are generally exempt from federal income tax.

8.2 Public-Private Partnership Transactions

Whilst much of the rest of the world, in particular Canada and several countries in Europe and Latin America, have for decades frequently developed and financed infrastructure assets through the use of a "public-private partnership" (or "PPP") model, this model has faced significant challenges in the United States due to the lack of clear support (either institutionally or financially) for such a model at the federal level, the lack of an accepted statutory model at the state and local levels and political considerations at the state and local levels, due in part to the poor performance of certain early projects that were procured using the PPP model during the 1990s and 2000s. However, since the financial crisis, due in large part to an increasing national awareness of the poor condition of transportation infrastructure in the United States and significant fiscal constraints at the state and local levels, there has been a renewed focus by certain states on the efficiencies that can be gained through the use of the PPP model and several projects have been successfully procured as PPPs. As a result, PPPs have begun to gain more traction, as an increasing number of states have passed PPP legislation (33 states have passed this legislation as the time of writing). Whilst there still is no comprehensive federal legislation supporting PPP development, the federal government has provided support for PPPs through the TIFIA loan programme and permitting the expansion of the scope of tax-exempt bonds (so-called Private Activity Bonds, because they are issued to fund PPPs) to surface transportation projects. There has also been much discussion of, and several legislative proposals made in respect of, the creation of a national infrastructure bank that would focus on supporting the public-private partnership development of infrastructure assets, including in sectors other than transportation.

The enabling legislation at the state level and, as applicable, municipal level for PPPs is not uniform and varies in scope widely. Whilst several statutes permit PPPs in sectors other than transportation, the principal use of PPP legislation in practice has been in the transportation sector, partly due to the federal support that is available for financing projects in this sector. PPP enabling legislation in the United States generally relies on either a "user" fee model or "availability payment" model. Under the "user" fee model, the revenue risk associated with the relevant project largely lies with the private sector developer whilst under the "availability payment" model, this risk is generally borne by the government agency, which is obliged to make payments to the private sector developer regardless of actual usage of the relevant project, as long as the project remains available for use. The current trend in PPPs in the United States is towards availability payment structures.

8.3 Government Approvals, Taxes, Fees and Charges

In the US market, applicable regulation and governmental approvals are largely dependent on the nature of the project. There are no federal government rules or approvals that are generally applicable to a project finance transaction. However, a project will need to comply with any applicable federal environmental laws and if the project is receiving federal funding or is located on federal lands, it will need to comply with the National Environmental Policy Act. In addition, sector-specific regulation may apply to a project – for instance, a power project needs to comply with federal regulation under the Federal Power Act and may require certain federal approvals for its operation (ie approvals of interconnection arrangements or power purchase agreements). In developing and financing a project, local and regulatory counsel will need to be consulted and involved in the due diligence process to ensure that a project is in compliance with applicable federal, state and local laws and permitting requirements. At the federal level, either the Federal Energy Regulatory Commission or, in the case of a transportation project, the Federal Highway Administration is likely to have jurisdiction over the operation of the project. At the state level, depending on the nature of the project, there may be both state and local laws and permits which must be addressed.

As a general rule, transaction documents are not required to be registered or filed with any governmental body and the governing law of most project finance documents is New York law, although real estate collateral documents are generally governed by the laws of the state of the jurisdiction in which the real estate collateral is located.

8.4 Structuring the Project Company

Project companies in the United States are generally formed as a Delaware limited liability company or a limited partnership. However, the last few years have seen a development of the use of master limited partnerships (MLPs) and "yieldcos" in the project space. The use of these types of corporate structures enable the projects to access greater liquidity through corporate issuances to the retail investor market. As noted above, there is a wide range of capital sources available to finance projects in the US market, depending on the nature and structure of the project – projects in construction are often financed through commercial bank loans and, in certain instances, private placement issuances. Construction financing of projects is often financed either through long-term commercial bank financing which amortises over the life of the off-take agreements applicable to the relevant project or by the issuance of bonds or notes either in the 144A or private placement market. Due to the long-term payment stream associated with project assets, the institutional investor market is willing to provide long-tenor financing that amortises over the life of the relevant off-take contract on a fixed income basis.

The tax equity markets have also provided a fair amount of liquidity for the financing of assets in the renewable energy sector over the last decade. However, there is significant uncertainty as to the future of renewable energy tax credits in the United States. The Tax Increase Prevention Act of 2014 which was signed into law in late December 2014 extends to certain tax credits, including the production tax credit to projects if they started construction on or before 31 December 2014. Notwithstanding, there has been heavy resistance in Congress to any long-term tax credit programme to support renewable energy and this does not appear likely to change any time soon.

The principal limitation on foreign investment into the United States is the Exon-Florio Provision, as amended by the Foreign Investment and National Security Act of 2007 (FINSA). Under FINSA, a foreign investor must receive approval from the Committee on Foreign Investment in the United States (CFIUS). Whilst historically CFIUS has not raised much concern in project finance transactions, the actions by CFIUS in issuing a divestment order to Ralls Corporation (a Chinese-owned company that had invested in wind projects) have highlighted that project finance transactions may face obstacles in obtaining the necessary approvals. The actions by the US Court of Appeals for the District of Columbia in finding that the divestment order issued to Ralls violated due process has led to some uncertainty as to the criteria that apply to receipt of a CFIUS approval or disapproval of investment in project finance transactions.

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8.5 Acquisition and Export of Natural Resources

For LNG export projects being developed in the United States, the principal regulatory hurdle has been issuance of a licence from the US Department of Energy approving the export of LNG to countries that are not party to a free trade agreement with the United States. The process of receiving these licences has been time-consuming but during 2013 and 2014 a number of projects received the necessary licence which enabled them to move to a financial close.

Another regulation which is subject to a high degree of focus in the area of project finance is the EPA's issuance of a proposal to regulate carbon pollution from new power plants. This regulation has received a number of challenges and is currently in a state of uncertainty following the United States Supreme Court's decision in Michigan v Environmental Protection Agency.

Finally, gas and petroleum projects taking advantage of hydraulic fracturing technology have been the subject of a great deal of federal and state regulatory focus with the laws adopted by several states effectively deterring the development of fracking projects, including in New York where hydraulic fracturing has been banned completely.

8.6 Environmental, Health and Safety Issues

The project finance market in the United States is hard to categorise in a simple fashion from a legal regulation perspective, given that many projects are subject to regulation at both a federal and state and/or local level. The nature of the regulation is largely dependent on the industry of the asset. The intention is to highlight at a high level some of the regulatory challenges applicable to a project finance transaction.

9. Islamic Finance

9.1 Overview

In general, some entities require Shariah-compliant financing for their US transactions but it is not a significant part of the US banking market. The Federal Reserve permits US financial institutions to offer Shariah-compliant products in countries where such institutions are mandated or where it is necessary that they are competitive.