LOANS & SECURED FINANCING

USA

Consulting editor

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Loans & Secured Financing

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Quick reference guide enabling side-by-side comparison of local insights into general issues (bank loans versus debt securities; common forms of bank loan facility; bridge facilities; role of agents, trustees and lenders; governing laws); regulation (capital, liquidity and disclosure requirements; use of loan proceeds; cross-border lending; interest rate and currency restrictions); security interests and guarantees; the impact of fraudulent conveyance and similar doctrines on the structure of bank loan financings; intercreditor matters; loan terms and structures; and recent trends.

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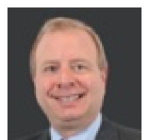

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GENERAL FRAMEWORK

Jurisdictional pros and cons

What are the primary advantages and disadvantages in your jurisdiction of incurring indebtedness in the form of bank loans versus debt securities?

Unlike the incurrence of bank loans, the offering of debt securities is subject to the requirements of the US federal and state securities laws – in particular, the US Securities Act of 1933, as amended, which sets forth the registration requirements for the offering of debt securities. Even where a particular issuance of debt securities is exempt from the registration requirements of such securities laws (eg, if the issuance is conducted through a private placement rather than a public offering), investors in debt securities expect that the securities will be offered under an offering document that contains substantially all the same types of information that would be included in a registration statement for a registered offering. In addition, regardless of whether a particular series of debt securities is required to be registered under such laws, the debtor is still subject to the anti-fraud provisions of the US federal securities laws. By contrast, bank loans are not subject to the securities laws' anti-fraud provisions but are instead subject to common law fraud provisions. As a result, it generally is more expensive and time-consuming to incur indebtedness as debt securities rather than bank loans.

In addition to the foregoing, bank loans have some favourable features compared to debt securities. In particular, bank loans are generally callable at par or for a lower premium and have shorter duration call protection than debt securities that generally are not callable for several years after issuance at higher call prices. In addition, bank loans are easier to amend as a practical matter compared to debt securities, because they tend to be held by fewer investors and amendments to debt securities must comply with any applicable securities laws.

Law stated - 27 April 2023

Forms

What are the most common forms of bank loan facilities (eg, revolving credit facilities, term loan facilities)? Discuss any other types of facilities (eg, letter of credit, banker's acceptance and swingline facilities and competitive bid revolving credit facilities) commonly made available to the debtor in addition to, or as part of, the bank loan facilities.

The most common forms of bank loan facilities are term loan facilities. These are typically used to provide financing for specific transactions, such as acquisitions and revolving credit facilities, which are usually used to finance the debtor's working capital needs.

Term loan facilities are typically structured to permit one borrowing either upon the closing of the bank loan facility or multiple drawings on a delayed draw basis. Once a term loan has been repaid, it cannot be reborrowed. Term loans amortise over the life of the term loan facility and are often subject to mandatory prepayment requirements upon the occurrence of certain events, such as the sale of assets outside the ordinary course of business, the incurrence of debt that is not otherwise permitted and from a portion of the 'excess cash flow' of the business.

Unlike term loan facilities, revolving credit facilities permit the debtor to reborrow amounts that have been prepaid. In addition, revolving credit loans do not amortise over the life of the revolving credit facility – the loans become due on the specified maturity date for the revolving credit facility.

Revolving credit facilities often include sub-facilities for the issuance of letters of credit and, in some cases, the borrowing of swingline loans. Letters of credit are issued, upon request from the debtor, to specified beneficiaries by one or more issuing banks that are also lenders under the facility. Each lender participating in the revolving credit

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facility agrees to purchase a participation in any letter of credit so issued such that if the debtor fails to reimburse any disbursement by the issuing bank under a letter of credit, each lender is obliged to pay to the issuing bank its pro rata share of the disbursement.

Swingline loans are revolving credit loans that are funded on a same-day basis by the swingline lender (which is usually the administrative agent for the revolving credit facility) rather than by the lenders participating in the revolving credit facility. As with the letter of credit sub-facility, the lenders participating in the revolving credit facility agree to reimburse the swingline lender on a pro rata basis in the event that the debtor fails to repay an outstanding swingline loan on its scheduled prepayment date, which is typically within a short period after the funding of the swingline loan.

Law stated - 27 April 2023

Investors

Describe the types of investors (eg, traditional banks, hedge funds, pension funds) that participate in bank loan financings and the overlap with the investors that participate in debt securities financings. (Is there a tendency toward certain groups of bank loan investors participating in a particular type of bank loan facility (eg, revolving credit facilities versus term loan facilities)?)

The lenders that provide revolving credit facilities and tranche A term loan facilities typically consist of traditional banks that provide other financial services (eg, treasury management services or hedging services) to the debtor.

The lender syndicates for tranche B term loan facilities are more varied and include prime rate funds, insurance companies, hedge funds, pension funds and collateralised loan obligation funds. These types of institutions also commonly invest in debt securities financings, including high-yield notes.

Law stated - 27 April 2023

How are the terms of a bank loan facility affected by the type of investors participating in such facility?

Tranche B term loan facilities (which are typically funded by institutional investors) and tranche A term loan facilities (which are typically funded by traditional banks) differ in several material respects, owing mainly to the institutional lenders' desire to remain fully invested in the loans, as follows.

- Amortisation: for tranche B term loan facilities, amortisation is nominal – typically, 1 per cent per year, payable quarterly, with a bullet payment at maturity. Tranche A term loan facilities typically have significantly higher amortisation than tranche B term loan facilities, with amortisation normally ranging from 2.5 per cent to 20 per cent per year, with the rate of amortisation increasing as the facility moves closer to maturity.
- Call protection: Tranche B term loan facilities usually have some form of call protection for a limited period of time. Typically, the call protection applies solely in the case where the tranche B term loans are repaid within the first six to 12 months after funding with the proceeds of similar debt that has a lower yield. This is commonly referred to as a 'soft call'. Second lien loans will often contain more stringent call protection (known as a 'hard call') that is paid during the first several years in the event of any voluntary prepayment of the loans. Tranche A term loans rarely have call protection.
- Mandatory prepayments: lenders holding tranche B term loans are often permitted to reject mandatory prepayments that are triggered by asset sales, casualty events or excess cash flow.
- Pricing: Unlike revolving credit facilities and tranche A term loan facilities, where the interest margin is often

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determined by reference to a pricing grid that adjusts based on the debtor's debt-to-EBITDA (earnings before interest, taxes, depreciation, and amortisation) ratio or public debt ratings, tranche B term loan facilities typically have a fixed interest margin, although there are certain facilities that will have a pricing grid that adjusts based on the debtor's debt-EBITDA ratio.

Law stated - 27 April 2023

Bridge facilities

Are bank loan facilities used as 'bridges' to permanent debt security financings? How do the structure and terms of bridge facilities deviate from those of a typical bank loan facility?

To ensure the availability of funds for certain transactions, and given the uncertainties and timing issues inherent in accessing the debt capital markets, debtors under certain circumstances will rely on bank loan facilities as bridges to permanent debt security financings. This practice is especially common in committed acquisition financings, where the debtor anticipates financing the acquisition with debt securities but requests a bridge loan commitment from the banks to secure financing for the acquisition in the event that a debt securities offering cannot be completed by the time that the acquisition closes.

Bridge loan facilities are similar to standard term loan facilities, with the following exceptions:

- the bridge loan typically has a short tenor (usually one year), at which time the bridge loan will either mature or will be converted into permanent loan financing (typically subject to limited conditions), which may include the right of the lenders to exchange the bridge loans for extended term loans and/or notes;
- the interest rate for the bridge loan increases at the end of each quarter after funding, up to an agreed upon cap;
- the bridge loan must be repaid with any subsequent issuance of debt, subject to certain limited exceptions;
- the covenants applicable to a bridge loan are often customary for high-yield debt securities, although the exceptions for incurrences of debt and liens and for restricted payments may be made tighter; and
- for bridge facilities that extend after their one year maturity, the lenders usually would have a 'securities demand' option, which requires the debtor, after completion of a customary marketing period and subject to certain terms and conditions agreed to by the debtor and the banks, to issue permanent debt securities to refinance the bridge loans at the request of the banks.

Law stated - 27 April 2023

Role of agents and trustees

What role do agents or trustees play in administering bank loan facilities with multiple investors? (Do administrative agents, collateral agents, trustees or similar entities owe a fiduciary responsibility to the investor group or the debtor? Discuss any rights to indemnification or reimbursement that typically accrue to such entities.)

In syndicated bank loan facilities, an administrative agent (which is in many cases one of the lenders in the revolving credit facility or an affiliate thereof) will be appointed by the lenders to provide administrative services under the facility. These services include receiving and processing borrowing requests, distributing to the lenders any principal, interest and fee payments paid by the debtor, processing assignments and distributing to the lenders any notices and financial information delivered by the debtor pursuant to the bank loan documentation. The administrative agent is often granted additional rights by the debtor and the lenders, including the right to inspect the books, records and property of the debtor and, the right to consent to assignees of the loans and commitments. The bank loan documentation expressly

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provides that the administrative agent is a non-fiduciary agent of the lenders. Furthermore, the bank loan documentation provides that the lenders will rateably indemnify the administrative agent for any losses realised by the administrative agent in performing its administrative functions on behalf of the lenders. The debtor agrees to pay to the administrative agent an annual fee (sometimes paid quarterly).

Many bank loan facilities also provide for the appointment of a collateral agent. For administrative ease, the debtor will typically grant a security interest in the collateral to the collateral agent, on behalf of the lenders and the other secured parties, and the secured parties will agree that the collateral agent has the sole right to exercise collateral remedies under the bank loan documentation should the debtor default. Often, the administrative agent and the collateral agent will be the same financial institution and, as a result, both roles will be combined into one agency position (ie, the administrative agent).

Law stated - 27 April 2023

Role of lenders

Describe the primary roles and typical fees of the financial institutions that arrange and syndicate bank loan facilities.

Bank loan facilities are structured and arranged for the debtor by one or more 'arrangers' or 'bookrunners', which are commonly a subset of the lending institutions that ultimately commit to providing the bank loans (or affiliates thereof). One or more of those entities will be designated as 'left lead arranger' for the bank loan facilities and will negotiate the terms of the bank loan facilities with the debtor, arrange potential lenders that comprise the lending syndicate and, prepare the marketing documentation for the bank loan facilities. The lending affiliate of the left lead arranger is typically designated as the administrative agent and collateral agent for the bank loan facilities.

The debtor will pay to the arrangers, upon the closing of the bank loan facilities, an arrangement fee that is most often equal to a percentage of the total commitments in respect of the bank loan facilities as of the closing date; or, if the financing is committed, a percentage of the total commitments in respect of the bank loan facilities at the time that the commitment is first executed.

Law stated - 27 April 2023

Governing law

In cross-border transactions or secured transactions involving guarantees or collateral from entities organised in multiple jurisdictions, which jurisdiction's laws govern the bank loan documentation?

If US law governs the bank loan agreement, then the guarantee agreement will also be governed by law of the same jurisdiction.

The law governing the collateral documentation is a matter of negotiation. For collateral pledged by the US entities, a US law security agreement will be executed. For collateral pledged by non-US entities, the lenders may agree to rely on the pledge created under the US law security agreement. However, if the collateral of the non-US entities is material, the lenders may require the debtor to execute local law security documents where the non-US entities are organised to ensure enforceability of the pledge in the event that remedies are exercised by the administrative agent or the collateral agent.

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REGULATION

Capital and liquidity requirements

Describe how capital and liquidity requirements (eg, Basel III) impact the structure of bank loan facilities, including the availability of related facilities (such as letter of credit, banker's acceptance and swingline facilities).

As a result of the capital requirements imposed on US banks by the Basel III guidelines with respect to confirming letters of credit and maintaining swingline loan commitments, US banks face internal pressures to provide only a portion of the total letter of credit fronting commitment and swingline commitment, in particular where the commitment levels are sizeable.

One approach is to provide in the bank loan documentation that each of the lenders under the revolving credit facility (or, at least, those lenders that are joint lead arrangers for the revolving credit facility) accept a pro rata share of the letter of credit fronting commitment and swingline commitment, based on their respective shares of the aggregate commitments under the revolving credit facility.

Another approach is to cap the aggregate exposure of the financial institution serving as the letter of credit issuing bank and the swingline lender such that the outstanding face amount of the letters of credit issued by the financial institution, when taken together with the aggregate principal amount of swingline loans and revolving credit loans held by such financial institutions, cannot exceed the financial institution's commitment under the revolving credit facility.

Law stated - 27 April 2023

Disclosure requirements

For public company debtors, are there disclosure requirements applicable to bank loan facilities?

Under the US Securities Exchange Act of 1934, as amended, public company debtors must disclose on a current report on Form 8-K, within four business days, the entry into a material definitive agreement or the creation of a direct financial obligation. The entry by the debtor into a bank loan facility triggers a public disclosure requirement under both of these current report categories. Public debtors will generally also be required to disclose amendments to material financing facilities.

Law stated - 27 April 2023

Use of loan proceeds

How is the use of bank loan proceeds by the debtor regulated? (For example, is the use of bank loan proceeds subject to anti-corruption or anti-money laundering regulations or anti-terrorism sanctions? Are there limitations on the use of bank loan proceeds for certain forms of acquisition transactions, such as public tenders?) What liability could investors be exposed to if the debtor uses the proceeds contrary to regulations? Can investors mitigate their liability?

Debtors are prohibited by the terms of the bank loan documentation from using bank loan proceeds in violation of US and foreign anti-corruption laws (such as the Foreign Corrupt Practices Act), anti-money laundering laws (such as the Bank Secrecy Act) and anti-terrorism laws (such as the USA PATRIOT Act, as restored by the USA FREEDOM Act, and the regulations administered by the Office of Foreign Assets Control of the US Department of the Treasury (OFAC)). In addition to the reputational harm to the lenders, a violation of these regulations by the debtor could expose the lenders

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to sanctions, disgorgement of profits, challenges to the priority of the lenders' security interests in the debtor's collateral, monetary fines and criminal penalties, depending on the regulation violated and the scope of the violation. In certain circumstances, the lenders may be able to mitigate their liability by showing that they have performed adequate diligence on the debtor's operations and that the bank loan documentation contains certain safeguards, such as requirements that the debtor maintain and enforce internal policies concerning compliance with such regulations.

In addition, the bank loan documentation prohibits the debtor from using the bank loan proceeds in violation of the margin regulations promulgated by the Board of Governors of the Federal Reserve System. In particular, Regulation U prohibits banks from extending any credit for the purpose of financing the purchase or carrying of publicly traded equity securities (margin stock) in an amount that exceeds the 'maximum loan value' of the collateral securing such credit. The maximum loan value of margin stock is 50 per cent of its market value, meaning that a bank can only lend up to US $50 to a debtor to purchase margin stock having a market value of US$100 if such margin stock secures the loan, unless other non-margin stock collateral also secures the loan. Violations of Regulation U can result in criminal liability to the lenders as well as a rescission of the bank loan. To provide the lenders with an argument in defence of a rescission claim, the bank loan documentation includes a representation by the debtor that it will not use the bank loan proceeds in violation of Regulation U. Furthermore, certain bank loan documentation will place additional restrictions on the debtor's use of proceeds such as limiting the use of proceeds of the revolving facility to repurchase term loans.

A violation of the use of proceeds provisions of the bank loan documentation almost always results in an automatic event of default, allowing the lenders to accelerate any outstanding loans, terminate unused commitments and exercise remedies against the debtor and the collateral.

Law stated - 27 April 2023

Cross-border lending

Are there regulations that limit an investor's ability to extend credit to debtors organised or operating in particular jurisdictions (including jurisdictions that are subject to sanctions)? What liability are investors exposed to if they lend to such debtors? Can the investors mitigate their liability?

Sanctions administered by OFAC prohibit US persons (including financial institutions) from engaging in transactions in certain targeted foreign countries or involving persons or entities listed on OFAC's Specially Designated Nationals List. The blocked transactions include the making of loans to OFAC sanctions targets and raising money for OFAC sanctions targets. OFAC regulations provide that a US person that enters into a transaction with an OFAC sanctions target may be unable to enforce their rights under the applicable agreement, may be unable to enforce their rights on any collateral, and may be subject to fines and other sanctions by OFAC. However, OFAC sanctions do not impose strict liability on US persons. A US person can mitigate their liability in respect of OFAC infractions by:

- showing that they did not wilfully violate OFAC regulations;
- showing that they had no reasonable cause to know or suspect that the transaction violated the OFAC regulations; and
- upon discovery of the infraction, promptly reporting the infraction to OFAC.

For this reason, the bank loan documentation will include a representation by the debtor that neither it nor its subsidiaries nor any of its respective directors, officers or employees are on OFAC's Specially Designated Nationals List nor are operating, organised or residents in any targeted foreign country. Depending on the debtor, this representation may extend to economic or financial sanctions or trade embargoes administered under foreign law, including the laws

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of the European Union and Her Majesty's Treasury of the United Kingdom.

Law stated - 27 April 2023

Debtor's leverage profile

Are there limitations (eg, laws, regulations, rules or guidelines) on an investor's ability to extend credit to a debtor based on the debtor's leverage profile?

Guidance released in March 2013 (and supplemented in November 2014 and further clarified in February 2015) by certain US financial institution regulators (the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency) described expectations for the sound risk management of leveraged lending activities. Among other items, the guidance called for regulated financial institutions engaged in leveraged lending to adopt a risk management framework that implements 'an intensive and frequent review and monitoring process' with respect to loans to leveraged debtors. In particular, the guidance indicated that leveraged financing resulting in a debtor having a ratio of total indebtedness to EBITDA (earnings before interest, taxes, depreciation, and amortisation) in excess of six times raises supervisory concerns and that those transactions are far more likely to be criticised by the regulators. More recent pronouncements (in particular, those from September 2018) from the aforementioned US financial institution regulators have clarified that such supervisory guidance does not have the force and effect of law and, further, that the regulators do not take enforcement actions based on supervisory guidance. In particular, the regulators indicated that they would limit the use of 'bright-line' tests and would not criticise an institution for a 'violation' of supervisory guidance.

Law stated - 27 April 2023

Interest rates

Do regulations limit the rate of interest that can be charged on bank loans?

State usury laws limit the amount of interest that can be charged for money loans. Failure to comply with the usury laws could result in both civil and criminal penalties for the lending institution. While the usury laws in each state differ, it is generally the case that the maximum rate of interest that can be charged by a lending institution to an individual differs from the maximum rate of interest that can be charged to a business institution. Furthermore, the maximum rate of interest will often depend on the size of the loan in question. For example, in the state of New York, the laws of which govern many corporate loans, the maximum rate of interest that can be charged for a money loan having a principal amount below US$2.5 million is 25 per cent; however, if the loan has a principal amount of US$2.5 million or more, then the usury laws do not apply to the loan.

Law stated - 27 April 2023

Currency restrictions

What limitations are there on investors funding bank loans in a currency other than the local currency?

US law does not impose any limitations on US banks funding bank loans in a currency other than US dollars.

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Other regulations

(Briefly) Describe any other regulatory requirements that have an impact on the structuring or the availability of bank loan facilities.

Certain additional regulatory requirements that impact the structuring and availability of bank loan facilities include the following:

- The Investment Company Act of 1940 (the 1940 Act): an entity that is an investment company as defined in the 1940 Act is prohibited from engaging in a variety of business activities, including borrowing on bank loans, unless that entity registers under the 1940 Act. If a lender makes a loan to an unregistered investment company, then the bank loan documentation may be unenforceable.
- Anti-tying regulations: the anti-tying regulations promulgated under the Bank Holding Company Act Amendments of 1970 prohibit US banks from conditioning the availability or price of a bank product (eg, an extension of credit) on the requirement that the customer also purchase a non-bank product (eg, capital markets underwriting services) from the bank or one of its affiliates. These regulations do not apply in cases where the US bank's customer is not a US person.

Law stated - 27 April 2023

SECURITY INTERESTS AND GUARANTEES

Collateral and guarantee support

Which entities in the organisational structure (eg, parent companies, holding companies and sister companies) typically provide collateral and guarantee support for bank loan financings? Are there limitations (regulatory, tax or otherwise) on which entities in the organisational structure are permitted to provide (or are customarily selected to provide) such support?

The guarantor group in respect of bank loans made to a US debtor varies depending upon several factors, including whether the debtor is a public company or privately held, the purpose of the bank loans and the tax status of the debtor and its subsidiaries. As a general matter, bank loans to a US debtor will be guaranteed by the US subsidiaries of the debtor, but not by the non-US subsidiaries of the debtor, owing to certain adverse US tax consequences to the debtor if a 'controlled foreign corporation' provides guarantee or collateral support for the loans. Although the regulations with respect to this issue have recently been amended, in many instances loan documents have continued to maintain the same guarantor exclusions. In addition, US subsidiaries that function as holding companies for foreign assets may also be excluded from the guarantor group owing to the same tax considerations.

If the debtor has a parent holding company, the entity will often provide a 'downstream' guarantee of the bank loans. This is often the case in financings for leveraged buyouts, where the purchaser establishes a holding company to acquire the stock of the target company, which ultimately becomes the debtor. The holding company structure allows the lenders to receive a pledge of the equity interests of the debtor, thereby providing the lenders with the ability to foreclose on the stock in the event the debtor fails to repay the loan and sell the debtor as an operating enterprise (although for practical reasons relating to the US Bankruptcy Code it is very rare for the lenders to actually foreclose on the collateral).

Although not always the case, it is typical for any entity that provides a guarantee of the US debtor's bank loans to also provide some form of collateral support for such loans.

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What types of obligations (eg, swap and hedging obligations or treasury services obligations) typically share with the bank loan obligations in the collateral and guarantee support? If so, are all such obligations equally and ratably covered by the collateral and guarantee support?

The collateral and guarantees will cover all the obligations under the bank loan documentation, including principal and interest on the bank loans, unreimbursed disbursements on letters of credit, fees accruing on the unutilised bank commitments, fees payable to the issuers of letters of credit as compensation for fronting those letters of credit for the lenders, expenses of the agent banks for administration of the bank loan documentation and the collateral documentation, and indemnification obligations arising in connection with the bank loan documentation and the transactions thereunder.

In addition, the bank loan documentation will often extend the coverage of the collateral and the guarantees to ancillary services provided by the bank group to the debtor and its related parties, such as interest rate, foreign exchange and other hedging arrangements, and cash management and treasury services, such as account overdraft protection. The extension of collateral and guarantee coverage to these services provides the bank group members with an incentive to offer to the debtor services that are necessary for the ordinary course operation of the debtor’s business.

While the relative treatment of the secured and guaranteed obligations may differ from deal to deal, it is most often the case that the obligations under the bank loan documentation, the hedging arrangements and the cash management arrangements will share rateably the proceeds of collateral and guarantees, although all of those obligations will be paid out after reimbursement of any administrative expenses of the collateral agent arising from the exercise of remedies under the bank loan documentation.

Law stated - 27 April 2023

Commonly pledged assets

Which categories of assets are commonly pledged to secure bank loan financings? Describe any limitations on the pledge of assets.

Collateral generally falls into two categories: real property and personal property.

Real property comprises land, minerals and other interests in the ground, and structures such as buildings on the land.

Personal property comprises all other types of property that do not constitute real property. This category of collateral includes inventory, receivables, equipment, investment property (such as securities), goods, deposit and securities accounts and general intangibles (such as intellectual property and payment obligations).

Law stated - 27 April 2023

Creating a security interest

Describe the method of creating or attaching a security interest (or other lien) on the main categories of assets.

The creation of a security interest in personal property is governed by state law rather than federal law. Article 9 of the Uniform Commercial Code, which is a collection of uniform commercial statutes promulgated by each of the 50 states and the District of Columbia, governs, among other things, the creation, perfection and priority of security interests in personal property. Under article 9 of the Uniform Commercial Code, a security interest generally attaches to personal property when it becomes enforceable against the debtor, which, in turn, requires that:

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- value has been given by a secured party (eg, the secured party has extended credit to the debtor);
- the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and
- the debtor has executed a security agreement that provides a description of the collateral.

The security agreement includes a granting clause by which the debtor grants to the secured party a security interest in the collateral so described.

Like security interests in personal property, security interests in real property are created under state law. However, unlike security interests in personal property, the law governing the creation of security interests in real property is not uniform across the states. Generally, a security interest in real property is created by the execution and delivery of a security agreement referred to as a mortgage or, in some states, a deed of trust.

Law stated - 27 April 2023

Perfecting a security interest

What steps are necessary to perfect a security interest (or other lien) on the main categories of assets? What are the consequences (including in a bankruptcy or insolvency proceeding) of failing to perfect a security interest (or other lien)?

Generally, perfection of security interests in personal property is governed by state law, although for certain categories of property, such as registered copyrights, federal law pre-empts state law with respect to perfection. With certain exceptions, such security interests are perfected by filing a Uniform Commercial Code financing statement in the central filing office of the state where the debtor is located, which for registered organisations such as corporations and limited liability companies is the state in which such entity is organised. For certain categories of personal property, perfection can also be achieved by possession of the property (eg, instruments) or by control of the property (eg, securities). However, security interests in certain categories of property, such as deposit and securities accounts, can only be perfected by control.

Security interests in real property are perfected by filing the applicable mortgage or deed of trust in the central filing office in the local jurisdiction (typically, at the county level) where the real property is located.

If a security interest in any collateral has not been perfected at the time that a bankruptcy proceeding has commenced, then the secured party will be treated as an unsecured creditor with respect to such collateral in the bankruptcy proceeding. Furthermore, if a security interest is not perfected within 30 days of the security interest attaching, then the secured party is at risk of having the perfection step voided by the bankruptcy trustee as a preferential transaction in the event that a bankruptcy petition is filed against the debtor within 90 days (or, if the secured party is an insider, one year) after the perfection step is taken.

Law stated - 27 April 2023

Future-acquired assets

Can security interests (and other liens) extend to future-acquired assets? Can security interests (and other liens) secure future-incurred obligations (eg, post-closing drawings under a revolving credit facility)?

The Uniform Commercial Code states that a security agreement may create or provide for a security interest in after-acquired collateral, except for commercial tort claims and, in certain circumstances, consumer goods. However, once a bankruptcy petition has been filed, an existing security interest will cease applying to after-acquired collateral, except

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for proceeds of prepetition collateral.

The Uniform Commercial Code further states that a security agreement may provide that collateral secures future advances or other value, regardless of whether such future advances or value are given pursuant to a pre-existing commitment. However, the security interest covering a future advance may have junior priority to intervening liens unless that future advance is made pursuant to a pre-existing commitment and, in the case of certain intervening federal liens (eg, federal tax liens and liens imposed by the Pension Benefit Guaranty Corporation), that security interest may have junior priority to such liens regardless of whether that future advance is made pursuant to a pre-existing commitment.

Law stated - 27 April 2023

Maintenance

Describe any maintenance requirements to avoid the automatic termination or expiration of security interests (and other liens).

Uniform Commercial Code financing statements generally expire five years after the filing. To continue the perfection and maintain the priority of a security interest in the assets covered by a financing statement, the secured party must file a continuation statement in the applicable filing office within six months before the date on which the financing statement expires. Failure to file a continuation statement would cause the security interest in such assets to cease to be perfected until the secured party files a new financing statement covering such assets. Even if the secured party files a new financing statement with respect to such assets, the Uniform Commercial Code provides that the priority of the secured party's lien would date back only to the date of the new filing (and not to the date of the original filing, as would have been the case if a continuation statement was properly filed). As a result, any existing lien on such assets that is perfected prior to the date of filing of the new financing statement would have priority over the secured party's security interest in such assets.

Law stated - 27 April 2023

Release

Are security interests (or other liens) on an asset automatically released following its sale by the debtor? If so, are the releases mandated by law or contract?

US law generally provides that a lien remains attached to the collateral upon its sale, other than in limited circumstances. For example, a buyer of goods (such as inventory) in the ordinary course of business will receive the goods free of the creditor's pre-existing security interest in the goods created by the buyer's seller. For a buyer to qualify as a 'buyer in the ordinary course of business', the buyer must purchase the goods:

- in good faith;
- without knowledge that the sale violates another person's rights in the goods;
- in accordance with usual or customary practices in the business of the seller; and
- from a person in the business of selling goods of that kind.

Most bank loan documentation provides for a contractual release of the secured party's lien on assets sold by the debtor. So long as the sale is made in accordance with the covenants in the bank loan documentation, and is not made to another affiliate of the debtor that is pledging its own assets to support the debtor's obligations under the bank loan documentation, the secured party's lien on the assets sold will be automatically released upon the sale of such assets.

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The bank loan documentation provides that the secured party will, at the debtor's cost, take actions reasonably requested by the debtor to reflect such release, such as executing release acknowledgements or amending or terminating Uniform Commercial Code financing statements to evidence such release.

Law stated - 27 April 2023

Non-fulfilment of guarantee obligations

What defences does a guarantor have against claims for non-fulfilment of guarantee obligations? Can such defences be waived?

Guarantors of bank loan facilities have several common law and statutory defences to the fulfilment of their guarantee obligations, including:

- material alterations of the underlying debt (eg, increases in the size of the bank loan facility or the interest rate accruing on the loans);
- release of co-guarantors;
- impairment of any collateral underlying the guarantee;
- failure of the guaranteed party to notify the guarantors of adverse facts concerning the debtor;
- statute of limitations;
- failure by the guaranteed party to demand payment of the amounts due (known as 'presentment'); and
- debtor's defences on the underlying debt (eg, violation of usury laws).

The guaranteed parties typically demand that the guarantors waive all common law and statutory defences available to them. Depending on the law of the state that governs the guarantee, the guarantor may be required to waive certain defences expressly in the guarantee rather than rely on a blanket waiver of all available defences.

Law stated - 27 April 2023

Parallel debt requirements

Describe any parallel debt or similar requirements applicable in a secured bank loan financing where an agent acts for multiple investors.

Under US law, an agent is permitted to serve as the secured party on behalf of multiple interchangeable lenders under the bank loan facility without the need for a parallel debt provision.

Law stated - 27 April 2023

Enforcement

What are the most common methods of enforcing security interests (and other liens)? What are the limitations on enforcement (including bankruptcy and insolvency regulations)?

Typically, the collateral agent is authorised by the lenders under the bank loan documentation to enforce remedies if an event of default has occurred and is continuing. The remedies available to the collateral agent may be set forth in the bank loan documentation or may arise under law, such as the Uniform Commercial Code, or both. The collateral agent may obtain a judgment on the debt in court and foreclose on the collateral pursuant to court proceedings conducted in accordance with state law rules. Under the Uniform Commercial Code, the collateral agent may also exercise 'self-help'

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remedies without the assistance of a judicial process. For example, the debtor may deliver the collateral to the collateral agent, or the collateral agent may take possession of the collateral by entering the premises of the debtor, so long as such action does not breach the peace. Once in possession of the collateral, the collateral agent may arrange for a sale of the collateral at a public or private auction. However, the Uniform Commercial Code requires that the collateral agent's actions be commercially reasonable and that the lender enforce its remedies in good faith. This may require that the collateral agent provide the debtor with advance notice of any sale of the property conducted by the collateral agent.

However, upon the filing of a bankruptcy petition against the debtor, an 'automatic stay' is immediately triggered. With limited exceptions, the automatic stay prevents the collateral agent from taking substantially all actions against the debtor and its property, including the enforcement of remedies against the collateral.

Law stated - 27 April 2023

Fraudulent conveyance and similar doctrines

(Briefly) Describe the impact of fraudulent conveyance, financial assistance, thin capitalisation, corporate benefit and similar doctrines on the structure of bank loan financings (including in the context of acquisition financing).

A transfer of assets by a debtor, or the incurrence of an obligation by the debtor, will be fraudulent (and subject to avoidance) if either the transfer or incurrence is made with the intent to defraud or hinder creditors (known as 'actual' or 'intentional' fraudulent conveyance) or, the debtor was insolvent on the date on which the transfer or incurrence is made (or became insolvent as a result of such transfer or incurrence) and the debtor received less than a reasonably equivalent value in exchange for such transfer or incurrence (known as 'constructive' fraudulent conveyance).

In US bank loan financings, the risk of 'constructive' fraudulent conveyance is addressed in several manners. Where the proceeds of the bank loan financing are expected to be paid to the seller or shareholders of an acquired company in connection with an acquisition financing, or to the shareholders of the debtor in connection with a dividend recapitalisation financing, the bank loan documentation will include a representation by the debtor that, at the time of and after giving effect to the transaction, the debtor will be solvent, thereby attempting to rebut one of the two prongs of the 'constructive' fraudulent conveyance analysis. Rebutting the 'reasonably equivalent value' prong of the 'constructive' fraudulent conveyance analysis is difficult in such transactions given that the loan proceeds are not retained by debtor.

Similarly, where a debtor's obligations under a bank loan facility are being guaranteed on a joint and several basis by its subsidiaries, or where such subsidiaries are providing collateral support for such obligations on a joint and several basis, the bank loan documentation will include a similar solvency representation with respect to the debtor and its subsidiaries, taken as a whole, given that the guarantee or collateral support itself would be a transfer by the applicable subsidiary for purposes of a fraudulent conveyance analysis. In addition, the bank loan documentation will provide that each guarantor make on a rateable basis a contribution payment to any other guarantor that is required to make a guarantee payment or transfer assets to support the debtor's bank loan obligations, on the theory that the inter-guarantor contributions would allow the creditors to make a fraudulent conveyance analysis based on the combined financial position of the guarantor group rather than solely on the financial position of the individual guarantor making the payment or transferring its assets.

Law stated - 27 April 2023

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INTERCREDITOR MATTERS

Payment and lien subordination arrangements

What types of payment or lien subordination arrangements, or both, are common where the debtor has obligations owing to more than one class of creditors? (How do those arrangements interact with bankruptcy statutes? What risk, if any, is there that such arrangements would not be enforceable in a bankruptcy or insolvency proceeding?)

Intercreditor arrangements for bank loan facilities where there is more than one group of secured creditors most commonly provide for lien subordination rather than payment subordination, primarily because secured debt obligations are most often 'senior' debt obligations. The lien subordination provisions are set forth in a written intercreditor agreement that is executed by the secured parties or the agents acting on their behalf.

The US Bankruptcy Code expressly provides that a subordination agreement is enforceable in a bankruptcy case to the same extent that it is enforceable under non-bankruptcy law.

Law stated - 27 April 2023

Creditor groups

What creditor groups are typically included as parties to the intercreditor agreement? Are all creditor groups treated the same under the intercreditor agreement (eg, do they all have voting rights)?

The most common form of intercreditor agreement is between a group of senior lien (or 'first lien') creditors and a group of junior lien (or 'second lien') creditors (or, in each case, an agent or trustee acting on behalf of such group of creditors), although the debtor's capital structure may require an intercreditor agreement among two or more groups of creditors that are secured on a pari passu basis.

The creditors within each group are treated the same under the intercreditor agreement, although it is often the case that, where there is more than one subgroup of senior lien creditors, for example, the agent or trustee acting on behalf of the subgroups will take action under the intercreditor agreement at the direction of the subgroup of creditors holding the greater outstanding principal amount of indebtedness.

Law stated - 27 April 2023

Rights of junior creditors

Are junior creditors typically stayed from enforcing remedies until senior creditors have been repaid? What enforcement rights do junior creditors have prior to the repayment of senior debt (eg, rights of unsecured creditors generally, rights to file claims)?

Often, the intercreditor agreement provides that senior lien creditors (or their agent or trustee) maintain control of the exercise of remedies against the debtor and the collateral until all of the senior lien obligations have been discharged and the commitments to lend in respect thereof have been terminated. However, prior to the discharge of the senior lien obligations, the junior lien creditors will maintain several rights relating to their respective claims against the debtor, including:

- filing of a proof of claim or statement of interest in a bankruptcy proceeding with respect to the junior lien obligations;

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- taking any actions to preserve and protect the validity and enforceability of the junior priority liens;
- filing of any defensive or responsive pleadings in opposition to any motion, claim, adversary proceeding or other pleading made in a bankruptcy proceeding by any person objecting to or seeking the disallowance of the junior lien claims; and
- exercising the rights of unsecured creditors, although this right is typically subject to compliance with the other provisions of the intercreditor agreement (including the agreement not to exercise remedies against the debtor and the collateral).

In deals where the junior lien creditors have greater bargaining leverage, such creditors may request a standstill period, which prevents the second lien creditors from exercising remedies against the debtor and the collateral only for a specified period of time (usually 120 to 180 days) after the occurrence and during the continuation of a default event. Once the standstill period has expired, the junior lien creditors would be permitted to exercise remedies against the debtor and the collateral, unless the senior lien creditors have commenced and are diligently pursuing an enforcement action against the debtor and the collateral.

Law stated - 27 April 2023

What rights do junior creditors have during a bankruptcy or insolvency proceeding involving the debtor?

Intercreditor agreements generally provide that, prior to the discharge of the senior lien obligations and the termination of the commitments to lend in respect thereof, the junior lien creditors may not object to certain actions approved by the senior lien creditors during a bankruptcy proceeding, including the debtor's use of cash collateral or the debtor's obtaining 'debtor-in-possession' financing (although the permitted amount of debtor-in-possession financing is often capped). In addition, except as discussed below, the junior lien creditors typically agree not to seek adequate protection (which is value (typically liens on additional assets) provided to secured creditors for the use of the collateral of those creditors) in respect of their claims in connection with any such use of cash collateral or incurrence of debtor-in-possession financing or to seek relief from the automatic stay imposed upon the commencement of the bankruptcy proceeding. Finally, the junior lien creditors may agree to support any reorganisation plan in respect of the debtor that is approved by the senior lien creditors, although this provision is often resisted by the junior lien creditors (in which case, the intercreditor agreement will make clear that the senior lien claims and the junior lien claims are separate classes for the purposes of voting on reorganisation plans in the bankruptcy proceeding).

However, if the senior lien creditors are granted adequate protection with respect to their claims in the form of a lien on replacement or additional collateral, then the junior lien creditors are permitted to request adequate protection with respect to their claims in the form of a subordinated lien on such replacement or additional collateral. In addition, if the senior lien creditors are granted relief from the automatic stay, then the junior lien creditors are permitted to seek similar relief.

Law stated - 27 April 2023

Pari passu creditors

How do the terms of the intercreditor arrangement change if creditor groups will be secured on a pari passu basis?

Typically, one group of pari passu creditors (often, the group holding the highest aggregate principal amount of outstanding obligations) will be designated as the 'controlling group' for the purposes of the intercreditor group. In such

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cases, the controlling group will dictate the exercise of remedies against the debtor and the collateral. In addition, the other creditor groups party to the intercreditor agreement will not be permitted to object to certain actions approved by the controlling group during a bankruptcy proceeding, including the debtor's use of cash collateral or the debtor's obtaining debtor-in-possession financing, so long as the affected groups receive adequate protection of their respective claims.

Law stated - 27 April 2023

LOAN DOCUMENT TERMS

Standard forms and documentation

What forms or standardised terms are commonly used to prepare the bank loan documentation? (Do trade associations (eg, the Loan Market Association or the Loan Syndications and Trading Association) establish or recommend bank loan documentation terms and are such terms generally recognised by the investors and the debtors as the market 'norm' when negotiating bank loan documentation?)

The Loan Syndications and Trading Association (LSTA), a not-for-profit organisation that was formed to develop standardised market practices to improve the liquidity of the secondary trading market for corporate loans, maintains model terms for bank loan agreements, as well as forms of certain ancillary bank loan documentation, that are commonly recognised by investors as the market norm. The model terms for bank loan agreements are limited to certain loan mechanics provisions and boilerplate provisions, such as the defaulting lender provisions and provisions regarding capital requirements, and do not extend to the commercial terms of the bank loan agreements – in particular, the covenants and default provisions.

Most agent banks maintain their own internal forms of bank loan documentation that incorporate (with slight variance) most of the provisions proposed by the LSTA in its model terms. Generally, the initial drafts of the bank loan documentation are prepared using the internal form of the applicable agent bank, although for many financial sponsor-led acquisition financings, a market practice has developed whereby the initial draft of the bank loan documentation is prepared using precedent documentation from one or more previous transactions led by the applicable financial sponsor, with modifications to take into account, among other items, the debtor's size and industry and any applicable changes in law.

Law stated - 27 April 2023

Pricing and interest rate structures

What are the customary pricing or interest rate structures for bank loans (eg, fixed versus floating rates, LIBOR versus prime rate)? Do the pricing or interest rate structures change if the bank loan is denominated in a currency other than the domestic currency?

For bank loans denominated in US dollars, the most common interest rate structures are the following.

- Base rate interest, which floats on a daily basis and is typically defined as the greatest of:
  - the 'prime rate' offered by the agent bank (or otherwise quoted in a publicly available source, such as the Wall Street Journal);
  - the average rate at which banks with Federal Reserve surpluses are willing to lend such surpluses on an overnight basis to other banks to satisfy reserve requirements, plus 50 basis points; and
  - one-month Term SOFR plus 100 basis points; and

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- Term SOFR interest, which is fixed for a period specified by the debtor (referred to as the interest period and which is usually one, three or six months or, if agreed by the participating lenders, 12 months) and is the forward-looking term rate based on the secured overnight financing rate administered and published by the Federal Reserve Bank of New York and based on inter-bank overnight lending secured by US Treasuries.

In each case, a market-driven interest rate ‘spread’ or ‘margin’ will be added to the underlying interest rate, with the spread for Term SOFR interest conventionally being 100 basis points greater than the spread for base rate interest, given that the base rate interest already has a profit component built into it. The debtor will have the option, during the term of the bank loan agreement, to choose to apply either base rate interest or Term SOFR interest to the bank loans and to alternate between the two types of interest by written notice to the agent bank.

During the LIBOR transition process, the expectation was that SOFR-based loans would include a credit spread adjustment component in addition to margin, which was supposed to compensate the lenders for the fact that SOFR has historically been lower than LIBOR. The Alternative Reference Rates Committee, which is in charge of overseeing an orderly transition away from LIBOR in the US, initially recommended credit spread adjustments of 11.448 bps for a one-month interest period, 26.161 bps for a three-month interest period and 42.826 bps for a six-month interest period. However, many loans issued in 2022 have lower credit spread adjustments (often 10/15/25 bps or 10 bps for all tenors), or in some cases do not include any credit spread adjustment at all.

While Term SOFR has become the preferred LIBOR replacement option for most borrowers and lenders, there are also some borrowers that have decided to use Compounded Daily SOFR to more closely align their loan exposure with their derivatives instruments, as the Compounded SOFR is ISDA’s recommended fallback option.

For bank loans denominated in a currency other than US dollars, the bank loan documentation will provide for interest rate mechanics that are customary for bank loans denominated in that currency. A variation of base rate interest is also made available for bank loans denominated in certain currencies, such as Canadian dollars.

Law stated - 27 April 2023

Have any procedures been adopted in bank loan documentation in your jurisdiction to replace LIBOR as a benchmark interest rate for loans?

On 5 March 2021, the UK Financial Conduct Authority (FCA) and the ICE Benchmark Administration announced that USD LIBOR for one-week and two-month interest periods would cease to be published on 31 December 2021 and that all of the other USD LIBOR tenors would be discontinued on 30 June 2023. These announcements were followed by statements by the US regulators that strongly discouraged the US banks from using USD LIBOR after 31 December 2021, notwithstanding the fact that most tenors would continue to be published until mid-2023. This regulatory pressure has resulted in a widespread adoption of SOFR in the US institutional loan market in 2022.

SOFR credit agreements generally include fallback provisions intended to apply in the, hopefully, unlikely event of SOFR-discontinuation that generally provide for a ‘hard-wired’ fallback to Daily SOFR (assuming that Term SOFR is the applicable benchmark) or, in the absence of Daily SOFR, another rate selected by the agent and the borrower.

Separately, there continues to be a large volume of legacy LIBOR-based loan agreements. According to the LSTA, more than 70 per cent of leveraged loans and collateralised loan obligations still referenced LIBOR as of February 2023, though remediation has accelerated sharply in 2023 ahead of the 30 June 2023 cessation date.

Furthermore, on 3 April 2023 the FCA announced that it will require LIBOR’s administrator, ICE Benchmark Administration Limited, to continue to publish, one-, three- and six-month USD LIBOR on a 'synthetic' basis (for use in certain legacy LIBOR contracts) until 30 September 2024, which will be calculated using one-, three- and six-month

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CME Term SOFR, published by CME Group Benchmark Administration plus the applicable fixed spread adjustment (ie, 0.11448 per cent, 0.26161 per cent and 0.42826 per cent for one-, three- and six-month tenors, respectively).

Law stated - 27 April 2023

Other loan yield determinants

What other bank loan yield determinants are commonly used? (Are bank loans issued with original issue discount? Are pricing floors instituted in respect of the determination of interest rates?)

Term loan facilities – in particular, tranche B term loan facilities – are often issued with original issue discount, while the lenders participating in revolving credit facilities sometimes receive an up-front fee at closing.

The interest rate for tranche B term loan facilities may also be subject to a pricing floor, whereby the minimum SOFR will be a specified percentage and, by convention, the minimum base rate interest will be 100 basis points greater than corresponding minimum SOFR.

Law stated - 27 April 2023

Yield protection provisions

Describe any yield protection provisions typically included in the bank loan documentation (such as increased cost provisions, prepayment premiums and withholding tax gross-up provisions).

The yield protection provisions customarily included in the bank loan documentation are as follows.

- Increased costs: this provision protects the lenders from increases in the cost of making or maintaining SOFR loans resulting from changes in law occurring after the closing of the bank loan facility (eg, from the implementation of a reserve requirement with respect to deposits held by the London branches of the lenders). The affected lenders are permitted to make a request on the debtor to reimburse the lenders for such costs, and the determination of the amount of such increased costs by the lenders is deemed to be conclusive, absent manifest error.
- Capital costs: similarly, if a lender determines that a change in law regarding capital or liquidity requirements will have the effect of reducing the rate of return on the lender’s capital, or on the capital of the lender’s holding company as a consequence of the bank loan documentation or the commitments or loans thereunder, then the lender can request that the debtor compensate the lender for such a reduction.
- Tax gross-up: the lenders are entitled to a gross-up by the debtor with respect to certain ‘indemnified’ taxes. The ‘indemnified’ taxes include basically all taxes incurred by the lenders with respect to payments made under the bank loan documentation, other than income taxes and withholding taxes paid by the debtor on interest payments on the bank loan facilities (unless such withholding taxes are instituted after the date on which the applicable lender acquires its interest in the bank loan).
- Break-funding: if the debtor fails to borrow a SOFR loan after submitting a borrowing request, or prepays a SOFR loan on any day other than the last day of the interest period for such SOFR loan, then the debtor is required to reimburse the lenders for the redeployment costs of the proceeds of such SOFR loan.

Typically, the lenders will have an obligation to mitigate the costs that are reimbursable by the debtor under the increased costs, capital costs and tax gross-up provisions, including by designating a new lending office if the effect of

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doing so would be to reduce the reimbursable costs. If a lender requests compensation from the debtor under the increased costs, capital costs or tax gross-up provision, the debtor will have the option to force the lender to assign its loans and commitments to an eligible assignee so long as the assignment would result in a material reduction in the debtor's reimbursement obligation under such provision.

It is not entirely clear that the increased costs and break-funding provisions are applicable to SOFR given certain fundamental differences between SOFR and LIBOR but currently most credit facilities continue to include these provisions despite their potential inapplicability.

Law stated - 27 April 2023

Accordion provisions and side-car financings

Do bank loan agreements typically allow additional debt that is secured on a pari passu basis with the senior secured bank loans (ie, accordion provisions or side-car financings)?

Bank loan agreements typically include an incremental facility provision, which allows the debtor to increase the size of the existing revolving credit commitments or of the existing term loans, or, in some transactions, to create additional tranches of revolving credit commitments or term loans under the bank loan agreement, up to a cap without requiring the consent of the existing lending group. Such incremental facilities typically share rateably, on a pari passu basis with the existing bank loan facilities, in any guarantees and collateral supporting the obligations in respect of the existing bank loan facilities. The availability of the incremental facilities may be subject to, among other things, the accuracy of the representations and warranties, the absence of defaults and, in many cases, pro forma compliance with a leverage test. Furthermore, the incremental facilities are generally subject to limitations on maturity date and weighted average life to maturity and, 'most favoured nation' pricing, subject to certain exceptions.

Bank loan agreements also often permit the debtor to utilise availability under the incremental facility provision to incur indebtedness outside of the bank loan agreement in the form of debt securities and, in some cases, standalone bank loan facilities, although in certain loan documentation the lenders will require that standalone bank loan facilities be secured on a junior basis to the obligations under the bank loan agreement. These facilities are generally also subject to limitations on maturity date and weighted average life to maturity, but depending on the loan documentation may not trigger most favoured nation pricing.

Law stated - 27 April 2023

Financial maintenance covenants

What types of financial maintenance covenants (eg, leverage tests and interest or fixed charge coverage tests) are commonly included in bank loan documentation, and how are such covenants calculated? (Are the covenant levels established by incorporating a cushion against the debtor's projected results of operations during the term of the bank loan facility? Do the investors permit the debtor to net cash on hand when calculating a leverage test? Can breaches of the financial maintenance covenants be cured by capital contributions from the debtor's shareholders (ie, equity cures)?)

The two most common financial maintenance covenants included in bank loan documentation are leverage covenants and coverage covenants. In today's leveraged market, financial maintenance covenants generally apply only to the tranche A facilities and revolving facilities, and are rarely included in tranche B facilities.

A leverage covenant requires that the ratio of the debtor's indebtedness (which may be total indebtedness, senior

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indebtedness or priority lien indebtedness, as agreed by the debtor and the creditors) on the test date to its EBITDA (earnings before interest, taxes, depreciation, and amortisation) for the applicable testing period (usually the four fiscal quarters of the debtor most recently ended) does not exceed a maximum level. In certain deals, the maximum level specified for the leverage covenant will reduce pursuant to an agreed-upon schedule, forcing the debtor to deleverage as the bank loan facility matures. In addition, the creditors will often agree to permit the debtor to net against the indebtedness component of the ratio any cash or cash equivalents held by the debtor and its subsidiaries so long as such cash is 'unrestricted' (ie, it is not subject to a lien in favour of any other creditor). However, the amount of cash and cash equivalents permitted to be netted may be subject to a cap.

A coverage covenant requires that the ratio of the debtor's EBITDA for the applicable testing period (again, usually the four fiscal quarters of the debtor most recently ended) to either interest expense or fixed charges (which is often defined to include interest, taxes, maintenance capital expenditures and scheduled amortisation of indebtedness) for the testing period exceeds a minimum level. The minimum level specified for the coverage covenant is most often fixed for the life of the bank loan facility.

Financial maintenance covenants are typically tested on the last day of each fiscal quarter of the debtor, and a failure to comply with any financial maintenance covenant as of such day results in an automatic event of default under the bank loan documentation. Where the equity interests of the debtor are held by a financial sponsor or are otherwise privately held, the debtor may negotiate for an 'equity cure', which permits the holder or holders of such equity interests to make a cash equity contribution to the debtor in an amount necessary to cause the debtor to be in compliance with the breached covenant (with such cash being equated to EBITDA for purposes of the relevant calculation). The debtor is permitted to exercise the 'equity cure' no more than twice in any four fiscal quarter period, and the number of 'equity cures' permitted during the life of the bank loan facility is usually capped at five. Furthermore, the cash received by the debtor in connection with an 'equity cure' is not permitted to reduce the indebtedness of the debtor for purposes other than curing the financial covenant, including for calculating the leverage covenant for incurrence purposes.

Law stated - 27 April 2023

Other covenants

Describe any other covenants restricting the operation of the debtor's business commonly included in the bank loan documentation.

Bank loan documentation for debtors that do not have investment grade ratings commonly includes covenants that limit the incurrence of indebtedness, the incurrence of liens, the making of investments, the sale of assets, the payment of dividends and other distributions in respect of equity interests, the prepayment of subordinated indebtedness, limitations on sale or leaseback transactions, limitations on mergers, consolidations and other fundamental changes to the debtor's business, limitations on amendments to organisational documents and material agreement, and limitations on changes in fiscal periods.

For debtors that have investment grade ratings, the negative covenant package is less restrictive and is typically limited to limitations on priority indebtedness (eg, indebtedness that is structurally senior to the bank loan obligations), limitations on liens on the debtor and the guarantors, limitations on sales of all or substantially all assets, limitations on sale or leaseback transactions, and limitations on mergers, consolidations and other fundamental changes to the debtor's business.

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Mandatory prepayment

What types of events typically trigger mandatory prepayment requirements? May the debtor reinvest asset sale or casualty event proceeds in its business in lieu of prepaying the bank loans? Describe other common exceptions to the mandatory prepayment requirements (eg, adverse tax consequences that may result from the repatriation of cash from a non-domestic subsidiary to the debtor's jurisdiction of organisation).

Bank term loans are typically required to be prepaid from the following sources:

- net cash proceeds from certain non-ordinary course asset sales, casualty events and condemnation proceedings. This prepayment requirement is often limited to events that result in net cash proceeds that exceed a minimum threshold, both on an individual basis and on an aggregate basis for each fiscal year. The debtor will have the option to reinvest the net cash proceeds of any such event in assets that are used or useful in the debtor's line of business, so long as such net cash proceeds are reinvested within a specified period of time after the event occurs (normally, 365 days or, if the debtor has contracted to reinvest the net cash proceeds during the 365-day period, within 180 days after the end of such 365-day period). A number of term loan B facilities include provisions that require only a certain percentage of such net cash proceeds be used to prepay the term loans if the borrower meets with certain leverage ratio thresholds;
- net cash proceeds from the incurrence of indebtedness that is not permitted under the terms of the bank loan documentation; or
- a percentage of the amount by which the debtor's operating cash flow for any fiscal year exceeds certain of the debtor's operating cash expenditures for that fiscal year (or excess cash flow) that exceed a minimum threshold, where the percentage – typically, initially 50 per cent could be reduced based on the debtor's leverage ratio at the end of the applicable fiscal year is at or below a specified ratio down to 25 per cent or zero per cent.

The bank loan documentation will often include an exception for prepayments with the net cash proceeds from non-ordinary course asset sales, casualty events and condemnation proceedings involving the assets of subsidiaries organised in any non-US jurisdiction if the repatriation of the non-cash proceeds from such jurisdiction would result in adverse tax consequences to the debtor or would be limited by the laws of such jurisdiction. Many bank loan financings will extend this exception to the excess cash flow prepayment requirement.

Law stated - 27 April 2023

Debtor's indemnification and expense reimbursement

Describe generally the debtor's indemnification and expense reimbursement obligations, referencing any common exceptions to these obligations.

The debtor typically indemnifies each agent and lender against all losses, claims, damages and expenses (including legal expenses) incurred by or asserted against those entities arising in connection with, among other items, the arrangement and syndication of the bank loans, the preparation and administration of the bank loan documentation, and the performance by the parties to the bank loan documentation of their respective obligations thereunder. The debtor's indemnification obligation extends to any litigation, investigation or other proceeding relating to these matters, regardless of whether that action is initiated by a party to the bank loan documentation or by a third party and regardless of whether the indemnified entity is a party to that action. Customary carve-outs from the debtor's

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indemnification obligation include losses, claims, damages and expenses resulting from:

- the wilful misconduct, bad faith or gross negligence of the indemnified entity, as determined in a final and non-appealable judgment of a court of competent jurisdiction;
- a claim brought by the debtor against the indemnified entity for a material breach in bad faith of the indemnified entity's obligations under the bank loan documentation, as determined in a final and non-appealable judgment of a court of competent jurisdiction; or
- a proceeding not involving an act or omission by the debtor that is brought by one indemnified entity against another indemnified entity, other than a proceeding brought against any agent or arranger under the bank loan documentation in its capacity as an agent or an arranger.

The debtor is also responsible for reimbursing, upon written demand, the reasonable and documented out-of-pocket expenses of the agents and the arrangers under the bank loan documentation in connection with the structuring, arrangement and syndication of the bank loans, and the preparation, administration and enforcement of the bank loan documentation.

Law stated - 27 April 2023

UPDATE AND TRENDS

Key developments

Are there any current developments or emerging trends that should be noted?

In February 2021, the United States District Court in the Southern District of New York issued a decision in In Re Citibank in which it ruled that certain lenders were entitled to retain approximately US$500 million in funds erroneously sent by the administrative agent under a credit facility to Revlon. In response, virtually all agents are requiring credit agreements to incorporate 'clawback' language into the agency provisions so that they contractually have recourse to recipients in the event that an erroneous payment is made. This decision was ultimately vacated by the Second Circuit on appeal in September of 2022, though 'Revlon' provisions remain prevalent in US loan documentation.

In addition, in 2020, the United States District Court for the Southern District of New York concluded in Kirschner v JPMorgan Chase Bank, NA that loans are not securities. However, the case is currently under appeal with the Second Circuit, and market participants are closely watching for a decision anticipated in 2023.

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Jurisdictions

Jurisdiction	Firm
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