

KEY ELEMENTS OF THE REVISED MODEL CREDIT AGREEMENT PROVISIONS

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In August 2011, the Loan Syndications and Trading Association (“LSTA”) through its Primary Market Committee (“PMC”) published its revised Model Credit Agreement Provisions 2011 (“Revised MCAPs”). This represented the first major over-haul of the MCAPs since 2005, and followed a more than 12-month process of discussion by the PMC and consultation with the LSTA’s membership. The Revised MCAPs have quickly become, with certain variations, standard market terms in many bank forms. In this note we review key elements of the Revised MCAPs.

Defaulting Lender Provisions

Although defaulting lender provisions are not new, the dramatic increase in bank failures (including Lehman) following the credit crisis focused the attention of market participants on the issue of defaulting lenders, and highlighted some of the weaknesses of typical defaulting lender provisions. The PMC sought to address those weaknesses in the Revised MCAPs. A key objective of that effort was to craft a set of provisions that were crisp enough to address with certainty issuing lenders’, swingline lenders’ and borrowers’ exposure to defaulting lenders, but flexible enough to address issues that might arise in the bankruptcy or receivership of the defaulting lender (*e.g.*, the automatic stay).

Under the Revised MCAPs, a lender will be a defaulting lender if:

- it fails to fund borrowings or to meet its funding obligations to the administrative agent, issuing bank or swingline lender within two days of the date when due;
- it delivers a written notice to the borrower, the administrative agent or any issuing bank or swingline lender that it does not intend to comply with its funding obligations (or makes a public statement to that effect);
- it fails to confirm its intention to comply with its prospective funding obligations following written request by the administrative agent or the borrower (the “Failure to Confirm Limb”); or
- it or its parent becomes subject to any bankruptcy or receivership proceedings.

Note three things about the defaulting lender definition. First, a lender will not be a defaulting lender due to its failure to fund borrowings or its delivery of a notice of intent not to fund (or public statement to that effect) if it expressly states that such failure or notice is the result of its determination that one or more conditions precedent have not been satisfied (the so-called “Good Faith” exception). Second, the Failure to Confirm Limb is designed to be a useful self-help tool. For example, many earlier formulations would have rendered a lender a defaulting lender if it failed to satisfy its obligations under, or was a defaulting lender for the purpose of, other credit facilities. The PMC dropped that difficult-to-pin-down limb and took comfort that if there was any question of a lender’s willingness to fulfill its prospective obligations, the Failure to Confirm Limb would offer the agent and the borrower a mechanism for clarifying that lender’s status. Finally, the list of criteria for defaulting lenders is an objective one (rather than, as was the case in many prior formulations, one that is dependent on an agent and/or the borrower determination). However, to settle any uncertainty that might arise, the agent may determine that, applying the limbs referred to above, a lender is a defaulting lender, and such determination will be conclusive.

The consequences of becoming a defaulting lender have also been clarified and expanded. A defaulting lender may be replaced, its vote will not be counted with respect to majority vote items, and it will not be entitled to receive certain fees. Furthermore, any fronting exposure of a letter of credit issuer or swingline lender to a defaulting lender will, subject to satisfaction of normal borrowing conditions, be reallocated to non-defaulting lenders up to the amount of such non-defaulting lenders’ unused commitments. To the extent that the letter of credit issuer or swingline lender has any fronting exposure to a defaulting lender following such reallocation, the borrower is required to repay (in the case of swingline loans) or cash collateralize (in the case of letters of credit) that exposure. Letters of credit need not be issued, and swingline loans need not be made, if after giving effect thereto there would be any remaining uncollateralized fronting exposure to a defaulting lender. It should be noted that there is a continuing debate about the extent to which the reallocation of exposure should be subject to conditions, and the market practice on this is not yet settled.

The Revised MCAPs also require that payments otherwise due to a defaulting lender be diverted to support the defaulting lenders' present and future funding obligations pursuant to a detailed waterfall. To address concerns that this might run afoul of various bankruptcy/receivership regimes, certain safety valves were included to ensure that the agent would not be required to apply amounts in accordance with the waterfall if that would be contrary to law, and to enable the agent to place an administrative hold on funds pending receipt of a court order.

Tax Provisions

The Revised MCAPs divides the universe of taxes into those imposed on payments, which are covered by the tax gross-up and tax indemnity, and those that are not, which are addressed instead by the increased costs provision. Thus, subject to various exclusions, typical withholding taxes are covered by the tax gross-up and tax indemnity, while bank taxes on a lender's capital or liabilities are covered by the increased costs provision.

Scope of the Tax Gross-up and Tax Indemnity

Consistent with prior versions of the MCAPs, certain taxes are excluded from the tax gross-up and tax indemnity. Some of the exclusions did not change; others are new to, or have been modified in, the Revised MCAPs.

The PMC broadened slightly the exclusion for net income taxes. As in the prior version, the Revised MCAPs excludes net income taxes, franchise taxes and branch profits taxes, but rather than merely excluding such taxes to the extent they are imposed by the jurisdiction of the lender, the lender's principal office or the lending office, the Revised MCAPs excludes such taxes to the extent they result from any connection between the lender and the taxing jurisdiction.

The PMC also excluded taxes imposed under the recently enacted FATCA regime, under which a U.S. withholding tax will be imposed on interest and gross proceeds paid to certain foreign entities that fail to comply with new U.S. tax reporting requirements. For purposes of this exclusion, FATCA is limited to the statutory provisions as of the date of the agreement or any amended or successor version that is "substantively comparable and not materially more onerous to comply with" and any current or future regulations or official interpretations thereof. Thus, the LSTA struck a balance between protecting borrowers in the event of minor future amendments and protecting lenders from an unknown, potentially onerous modification to the statute.

The Revised MCAPs now allow a participant to receive a greater payment under the tax gross-up and tax indemnity than the participating lender would have received, provided that the additional tax is due to a change in law that occurred after the participant acquired its participation interest. The revised tax sections also acknowledge that the administrative agent, rather than the borrower, will often be the withholding agent, and include more extensive tax forms provisions.

Increased Costs

One of the most significant tax changes to the Revised MCAPs, the new increased costs provision, was drafted with an eye to protecting lenders from the various proposed bank taxes. The PMC took the view that a newly imposed bank tax is similar to an increased cost resulting from a regulatory change and, therefore, should be similarly covered by the increased costs provision.

While the increased costs provision has some complicated cross-references, essentially the provision covers taxes that (i) are not imposed on payments and (ii) are not net income or franchise taxes imposed because of a lender's connection with the taxing jurisdiction.

Participation Register

Also new to the Revised MCAPs is the inclusion of a participation register. Non-U.S. lenders that are not in treaty jurisdictions or engaged in a U.S. trade or business rely on the "portfolio interest" exemption to receive interest without U.S. withholding tax; this exemption requires that the debt be in registered form for U.S. federal tax purposes. For this reason, it has long been market practice for the administrative agent to maintain a register of assignments.

More recently, parties to credit agreements have been concerned that a register may also be required for participations on the theory that participations may represent beneficial ownership in the underlying loan for U.S. federal tax purposes. The Revised MCAPs requires lenders to maintain a register of their participations. Because lenders are typically reluctant to reveal the identity of participants, the provision only requires lenders to disclose the information contained in the register when necessary to establish that the loan is in registered form.

Lender Tax Indemnity

The Revised MCAPs also requires each lender to indemnify the administrative agent for taxes attributable to the lender or taxes attributable to the lender's failure to maintain a participation register.

Other Provisions

The PMC also made certain modifications in the Revised MCAPs designed to update the form for recent regulatory developments and market trends. The increased cost protections provided to lenders now expressly include Basel III and Dodd-Frank, to address uncertainties regarding implementation and timeline of those new regulations and standards. In response to cases like *Clear Channel* and *Hexion*, and consistent with now standard market practice, the borrower's submission to jurisdiction has been modified to be exclusive (typically New York). The indemnification provisions were modified to ensure that the lenders' obligation to indemnify the agent in connection with suits by lenders was clear, in part driven by arguments raised in the *Harbinger* case. Other provisions, such as agency, assignment and electronic communications, have also been augmented and modernized, including by adding a mechanism in the agency provision for the removal of an agent that has become subject to bankruptcy or receivership proceedings (addressing a challenge many faced following the Lehman bankruptcy).