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Contents

1. Loan Market Panorama p.3
- 1.1 Impact of Regulatory Environment and Economic Cycles p.3
- 1.2 Impact of the COVID-19 Pandemic p.3
- 1.3 The High-Yield Market p.4
- 1.4 Alternative Credit Providers p.5
- 1.5 Banking and Finance Techniques p.5
- 1.6 Legal, Tax, Regulatory or Other Developments p.6

2. Authorisation p.7
- 2.1 Authorisation to Provide Financing to a Company p.7

3. Structuring and Documentation Considerations p.7
- 3.1 Restrictions on Foreign Lenders Granting Loans p.7
- 3.2 Restrictions on Foreign Lenders Granting Security p.8
- 3.3 Restrictions and Controls on Foreign Currency Exchange p.8
- 3.4 Restrictions on the Borrower's Use of Proceeds p.8
- 3.5 Agent and Trust Concepts p.8
- 3.6 Loan Transfer Mechanisms p.8
- 3.7 Debt Buy-Back p.9
- 3.8 Public Acquisition Finance p.9

4. Tax p.9
- 4.1 Withholding Tax p.9
- 4.2 Other Taxes, Duties, Charges or Tax Considerations p.10
- 4.3 Usury Laws p.10

5. Guarantees and Security p.11
- 5.1 Assets and Forms of Security p.11
- 5.2 Floating Charges or Other Universal or Similar Security Interests p.11
- 5.3 Downstream, Upstream and Cross-Stream Guarantees p.12
- 5.4 Restrictions on Target p.12
- 5.5 Other Restrictions p.12
- 5.6 Release of Typical Forms of Security p.13
- 5.7 Rules Governing the Priority of Competing Security Interests p.13

6. Enforcement p.13
- 6.1 Enforcement of Collateral by Secured Lenders p.13
- 6.2 Foreign Law and Jurisdiction p.14
- 6.3 A Judgment Given by a Foreign Court p.14
- 6.4 A Foreign Lender's Ability to Enforce Its Rights p.14

7. Bankruptcy and Insolvency p.14
- 7.1 Company Rescue or Reorganisation Procedures Outside of Insolvency p.14
- 7.2 Impact of Insolvency Processes p.15
- 7.3 The Order Creditors Are Paid on Insolvency p.15
- 7.4 Concept of Equitable Subordination p.15
- 7.5 Risk Areas for Lenders p.16

8. Project Finance p.16
- 8.1 Introduction to Project Finance p.16
- 8.2 Overview of Public-Private Partnership Transactions p.17
- 8.3 Government Approvals, Taxes, Fees or Other Charges p.17
- 8.4 The Responsible Government Body p.17
- 8.5 The Main Issues When Structuring Deals p.18
- 8.6 Typical Financing Sources and Structures for Project Financings p.18
- 8.7 The Acquisition and Export of Natural Resources p.18
- 8.8 Environmental, Health and Safety Laws p.18

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1. Loan Market Panorama

1.1 Impact of Regulatory Environment and Economic Cycles

Following the global financial crisis and in connection with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, US federal regulators issued Leveraged Lending Guidance (the "Guidance") in 2013 to address concerns about heightened leverage levels in the US loan market. The Guidance mandated that regulated lenders must consider a borrower's ability to de-leverage as a fundamental component of their credit analysis in making a loan, and stated that a leverage level higher than six times total earnings before interest, depreciation and amortisation (EBITDA) "raises concerns" for borrowers in "most industries". This statement led to increased reticence by regulated US financial institutions to make highly leveraged loans, thereby allowing less heavily regulated non-bank lenders and foreign institutions to increase their market share in the leveraged finance market.

While the leveraged loan market perceived considerable regulatory easing of the Guidance in 2017 and 2018, including as a result of a joint statement of federal regulators indicating that they would not enforce the Guidance systematically as a rule, the leveraged loan market has not been free of critics. In 2019, prominent figures – including former Federal Reserve Chair Janet Yellen and Senator Elizabeth Warren – warned about the potential economic concerns and negative impact of excessive corporate debt. In response, the Loan Syndications and Trading Association and other industry groups argued that these concerns were misguided or exaggerated, citing strong credit performance, historically low default rates and improvements in systemic trends.

During this time, highly leveraged financings – with debt multiples commonly approaching or even exceeding seven times EBITDA – accounted for a growing share of new leveraged loan issuance and, in fact, surpassed pre-financial crisis highs. Furthermore, the rapid growth of non-bank "direct" lenders increased competition in the US loan market, permitting borrowers to seek and regularly obtain even more aggressive terms, including higher leverage multiples. While some of these aggressive terms are subject to push-back when market cycles or sentiment cool, as was evident in the terms sought by lenders in reaction to the commencement of the COVID-19 pandemic and its impact on the market in the spring and early summer of 2020, market observers continue to note a more long-term trend toward weakened covenant and other customary lender protections, including the prevalence of "covenant lite" term loans and higher permitted leverage levels.

1.2 Impact of the COVID-19 Pandemic

For many borrowers, the COVID-19 pandemic has had, and continues to have, widespread implications on all aspects of their loan facilities.

Increased Focus on Liquidity

One of the initial impacts of the COVID-19 pandemic in the US loan market, as the effects began to be manifest in March and April 2020, was a dramatic increase in borrowings under revolving credit facilities. By early summer, it was reported that more than 700 borrowers had collectively drawn over USD300 billion under revolving facilities. Among the primary considerations for borrowers in drawing on revolving facilities were the ability to satisfy the conditions to borrowing, including representations of "no material adverse effect", the accuracy of financial information and solvency, and the ability to comply with ongoing maximum leverage, minimum interest coverage or other financial maintenance covenants. In particular, such covenants – in the case of leveraged revolving facilities – often "spring" only upon outstanding revolving exposure exceeding a minimum threshold, and are usually based on EBITDA, which in the COVID-19 pandemic environment has been severely impaired for many borrowers (with forward-looking visibility inherently unclear).

Many borrowers, especially investment grade borrowers, also sought to shore up their balance sheets and potential liquidity needs during the pandemic by entering into new loan facilities (typically with a one- to three-year maturity), often in the form of delayed-draw term loans to most efficiently manage their borrowing costs and financial covenant ratio compliance.

Proactively Addressing Potential Issues

In addition to the liquidity solutions referred to above, many borrowers also sought to address the compliance challenges under their loan agreements arising from the COVID-19 pandemic. Faced with increased debt loads together with lower EBITDA, many borrowers pre-emptively sought covenant and other forms of relief from their lenders, including to:

- permit COVID-19-specific addbacks to EBITDA (including both costs and, more controversially, lost revenues) and/or replace EBITDA for certain quarters with stipulated or formulaic amounts designed to mirror such amounts from periods prior to COVID-19-related effects;
- provide financial maintenance covenant "holidays" or level resets;
- exclude the effects of COVID-19 from material adverse effect conditions and representations;
- permit more time for delivering periodic financial statements to account for auditor delays;

- permit additional time to complete certain collateral perfection actions requiring the involvement of a government agency or other third party; and
- permit pay-in-kind interest for some period of time.

While lenders were generally amenable to providing some of the requested relief, they in turn sought concessions from borrowers, including:

- increased pricing and amendment/consent fees;
- the imposition of a minimum liquidity maintenance covenant;
- the inclusion of anti-"cash hoarding" provisions as a condition to revolver drawings to encourage more liquidity in the form of available revolving commitments rather than cash drawn and held on the balance sheet;
- limitations on further debt incurrence and on opportunities for leakage to junior parts of the capital structure – including restricted payments and junior debt prepayments – and other negative covenant flexibility during the waiver periods; and
- additional reporting (eg, monthly reporting and cash flow forecasts).

Liability Management

For many borrowers, especially in the retail, entertainment, travel and energy sectors, the near-term liquidity options and covenant and other relief referred to above have been either entirely unavailable or insufficient to meet their needs during the COVID-19 pandemic. To address often dire financial circumstances, these borrowers have been required to seek more creative forms of financing, commonly liability management transactions. While there is a wide range of liability management transactions, borrowers operating under secured loan facilities with conventional leveraged finance terms have often pursued one of two models: a drop-down financing or an uptiering transaction.

Drop-down financings (structural subordination)

In a drop-down financing, a borrower identifies assets that may be readily separated from the rest of its business (such as a separate business line or easily transferable intellectual property) and transfers the assets to either an unrestricted subsidiary or a non-guarantor restricted subsidiary (NewCo). Upon such transfer, the lien securing the borrower's existing credit facility is automatically released and such (newly) unencumbered assets are available to secure the (newly incurred) indebtedness of the NewCo provided by creditors on a structurally senior basis to the claims of the existing lenders.

Uptiering transactions (contractual/lien subordination)

In an uptiering transaction, a borrower offers lenders under a new facility a claim against the existing guarantor and collateral package that is contractually senior (either through lien or payment priority) to the claims of existing lenders. Such uptiering transaction will typically be offered to existing lenders who provide all or a portion of the new senior financing, and typically will be permitted to exchange (or refinance) all or a portion of their existing exposure into contractually senior debt, often reducing overall leverage or at least pushing out near-term maturities or amortisations.

Looking Forward

As noted above, by late summer 2020, the leveraged finance markets appeared to have rebounded and reopened to heavy demand, with financial institutions and non-bank "direct" lenders providing large and committed financings on terms as aggressive – and sometimes even more so – than those available immediately prior to the pandemic, though with particular buy-side focus on lender protective provisions in reaction to the types of liability management transactions that have become more common during the pandemic.

1.3 The High-Yield Market

Companies increasingly look to both the syndicated loan and high-yield bond markets to meet their financing needs, depending on market conditions and capital structure requirements. With the expectation of the Federal Reserve raising interest rates during 2018, issuers focused on the loan market, where high investor demand offered attractive high-yield-like terms along with customary loan prepayment flexibility. Conversely, as the Federal Reserve reversed course and, as of September 2019, lowered its target rates, demand has moderately shifted toward the fixed-rate bond market. This trend continued during the spring and early summer of 2020, as high-yield bond issuances reached record levels, even as demand in the broadly syndicated leveraged loan market remained suppressed.

The high-yield bond market has continued to show significant overlap on structural terms with the leveraged loan market, as highlighted by the proliferation of covenant-lite loan structures, representing approximately 80% of all loan issuances in 2019 compared to 17% in 2007, and the increasing interest in secured high-yield bonds, with the second quarter of 2020 producing more secured high-yield secured bond issuances than institutional loan volume for the first time since 2009. Furthermore, certain economic terms in the loan market increasingly reflect those that are customary in high-yield secured bonds, including "no call" or "hard call" periods requiring the payment of a make-whole or premium upon any voluntary prepayment. In particular, in leveraged buyout transactions, where buyers/borrowers seek to obtain financing in both the loan and high-

yield bond markets, sponsors have increasingly pushed for substantially identical substantive terms and flexibility across their loans and bonds.

Certain differences do remain between loan and high-yield bond terms. Loans continue to provide lesser "call" protection – in terms of the scope, amount and duration of the premium – in connection with voluntary prepayments. Additionally, where leveraged loans and bonds are issued in a single capital structure, lenders typically continue to drive the guarantee and, where applicable, collateral structure, with the loan agent controlling enforcement proceedings and bondholders simply "piggy-backing" the scope of the loan collateral and guarantee package. Certain loans, but not bonds, continue to restrict investments in non-guarantor subsidiaries and require interest rate spreads to reset upon the issuance of higher yielding loans (commonly referred to as "MFN protection"). Finally, there have been a few instances where a loan will contain terms that are more permissive than those that would be contained in a bond, such as the lack of a fixed charge coverage governor on the usage of available builder amounts for restricted payments, or allowing such amounts to build for positive cumulative consolidated net income without taking any negative amounts into consideration – or where bonds have been revised to conform to loan terms, such as by permitting the incurrence of debt by stacking based on priority (ie, first lien debt incurred in reliance on a first lien leverage ratio and junior lien debt incurred in reliance on a secured leverage test) rather than a standard secured leverage governor for all such debt.

Despite these differences, the increasing similarity of terms continues to have a profound impact on the US syndicated leveraged loan market.

1.4 Alternative Credit Providers

With private debt funds raising more than USD100 billion over the past four years, alternative credit providers have become an increasingly visible presence in the US loan market, with direct lending (ie, loans made without the use of a bank or other arranger acting as intermediary) continuing to grow dramatically. Assets under management across the direct lending industry have nearly tripled, from USD275 billion in 2009 to more than USD800 billion in 2020, with much of the funding coming from insurance companies, endowments, pension funds, "business development companies" (BDCs) and sovereign wealth funds. While these asset managers historically operated largely in the middle market, focusing on smaller corporate borrowers, direct lenders are increasingly viewed as "go-to" financing sources for top-tier transactions, including by providing "bought" tranches or one-stop financing solutions to large corporate borrowers and private equity sponsors. Competing directly with traditional bank arrangers, direct lenders have provided borrowers with greater flexibility when seeking commitments for complex financing structures. In particular, direct lenders are often willing to provide financing at higher leverage multiples, especially for borrowers lacking access to the traditional bank lending or high-yield debt markets, and to parts of the capital structure that are virtually unavailable in the leveraged finance market such as second lien facilities or blended unitranche facilities. In addition, direct lenders can offer greater speed of execution and certainty on terms, as their intent to hold the loans through maturity obviates the need for a marketing process and potential for terms to be "flexed" in the course of syndication efforts.

1.5 Banking and Finance Techniques

Banking and finance techniques continue to evolve in the face of the increased number of potential financing sources for loans, new strategies employed by debt activist funds and the proliferation of services offering covenant analysis services.

Increased Flexibility from Additional Financing Sources

As a result of intense competition amongst bank and non-bank lenders to lead financing transactions, there has been a marked increase in documentation flexibility in recent years, notably around incremental debt capacity, covenant-lite structures and the utilisation of unrestricted subsidiaries. Private equity sponsors have been a key driver of this increased flexibility as repeat players in both the syndicated leveraged and direct loan markets, by pushing for more aggressive terms in each subsequent loan transaction. Increasingly, borrowers require lenders to rely on an underwritten borrower-friendly documentation precedent to ensure that the terms of the new financing are "no worse than" their most recent financing (and on "market flex" rights to scale back the most aggressive terms solely to the extent necessary to facilitate a successful syndication). Correspondingly, to ensure they remain competitive, bank lenders have become increasingly selective as to the terms on which they push back, with heightened focus on foreclosing abuses witnessed in – and thus subject to the focus of – the syndicated market, including, most recently, aggressive liability management transactions.

Debt Activism

The US loan market has recently experienced unique forms of debt activism, leading to heightened awareness by market participants of documentation terms that could lead to adverse and unintended consequences. Examples include lenders to a distressed borrower being more willing to resist "accretive" liability management transactions and treating loan defaults as a commercial opportunity. Most prominently, certain debt activist funds have engaged in "net short activist" strategies, in which they amass large short positions against a borrower through credit default swaps and other derivatives (or other short positions) while simultaneously holding a smaller long

position in the borrower's loans or bonds, with the ultimate goal of asserting a default or otherwise taking an adverse position on their (smaller) long loan/bond position in order to benefit their (larger) short position. These debt activist strategies create anomalous economic incentives for holders of a borrower's debt and, consequently, adverse outcomes for borrowers and other creditors. Market participants affected by these strategies have increasingly called for regulatory action to address this use of derivatives, and borrowers have sought to prevent "net short lenders" from voting their loans/bonds in a manner adverse to the borrower or to forestall lenders from exercising remedies more than a negotiated period of time after becoming aware of a default.

Covenant Analysis Publications

Services offering analysis of covenant packages in loan documentation have become increasingly visible in recent years, which has led to increased publicity for and focus on documentation terms deemed to be of particular risk to lenders. While this publicity has allowed potential lenders to identify, organise and resist certain terms brought to the market, perhaps unsurprisingly private equity sponsors and other borrowers have also taken advantage of the more rapid spread of information and increasingly sought to "cherry-pick" the most aggressive terms that have "cleared" the market in (even non-comparable) financings. Most recently, these services have begun producing "covenant ratings" designed to permit collateralised loan obligations and other institutional lenders to efficiently assess the quality of loan documentation, leading to heightened concerns regarding the fairness and accuracy of the analysis.

1.6 Legal, Tax, Regulatory or Other Developments

The US loan market has seen several recent legal, regulatory, tax and other developments that will shape the terms of loan financings in the near future, with the most prominent being the tax reform under the Tax Cuts and Jobs Act, the transition away from the London Interbank Offered Rate (LIBOR) as the benchmark rate for loans, the enactment of the Beneficial Ownership Regulation, and QFC Stay and Delaware LLC division rules.

Tax Reform

Recent tax reform in the US has begun to affect the structuring of credit support for loans. In late 2017, Congress passed the Tax Cuts and Jobs Act, which, among other things, reduced the US federal corporate tax rate, introduced a territorial dividend exemption regime and limited interest deductibility. In May 2019, the US Treasury Department and the Internal Revenue Service issued final regulations, which effectively eliminated the "deemed dividend" rules under Internal Revenue Code Section 956, allowing US corporate borrowers (and partnership borrowers with US corporate owners) to obtain credit support from non-US entities without incurring US tax liability, in certain circumstances. Although it is now easier for certain US corporate and partnership borrowers to obtain foreign credit support, most qualifying US borrowers continue to retain customary carve-outs of foreign credit support and consequently domestic-only guarantee and collateral packages. Additionally, the new tax regime creates an incentive to borrow at foreign subsidiaries in higher tax jurisdictions, which increases pressure to eliminate customary restrictions on debt incurrence by non-loan parties. Finally, because of the greater discrepancy between US individual and corporate rates post-tax reform, loan agreement provisions allowing dividends by pass-through entities based on the highest personal tax rate now create a material discrepancy between the actual taxation of corporations and permitted tax distributions for pass-through entities.

LIBOR Successor Rate Provisions

LIBOR is currently relied upon as the benchmark rate for the vast majority of US loan issuances. Criticism of the integrity of the process by which LIBOR has historically been determined – and the depth of the "observed transactions" on which it supposedly rests – has led to calls for its replacement, and the UK's Financial Conduct Authority has announced that after 2021 it will no longer compel reference banks to submit LIBOR quotations. In response, regulators and loan market participants have begun preparing for a transition away from LIBOR to a replacement benchmark rate, with consensus that the successor in the US dollar-based loan market will be the Secured Overnight Financing Rate, a rate based on a deep market of overnight secured financings monitored by the Federal Reserve. Arrangers and borrowers have increasingly included LIBOR successor provisions in their loan documents to accommodate an orderly transition away from LIBOR, although the precise terms of the replacement – especially the corresponding adjustments to address its differences from LIBOR – have not yet been determined. These provisions generally focus on identifying the trigger event(s), the replacement rate and the mechanism for amending loan documentation to effectuate such replacement. In October 2019, the Internal Revenue Service published proposed regulations addressing certain tax consequences of the LIBOR transition. Taxpayers may rely on these proposed regulations, which, among other things, generally establish that a qualified rate (such as the Secured Overnight Financing Rate) may replace or be added as a fallback to LIBOR in an existing debt instrument without triggering a taxable event.

On 30 June 2020, the Alternative Reference Rates Committee of the Federal Reserve released its most recent recommended form of "hardwired" LIBOR fallback language for US dollar-denominated syndicated loans, as a template for parties to agree in advance to adopt a new industry- or regulator-recommended benchmark and related adjustments when announced without the need of further lender consent or formal amendment pro-

cess (other than for administrative and ministerial changes). The stated goal is to reduce the practical challenges and economic disruption and uncertainty of the transition, avoiding the need where possible for market participants to engage in an open-ended amendment process for each loan agreement at the time that LIBOR becomes unavailable.

QFC Stay Rules
In 2017, US banking regulators adopted the "QFC Stay Rules", which are intended to ensure that, if the Federal Deposit Insurance Corporation (FDIC) becomes the receiver of a US globally systemically important bank (GSIB), the FDIC's powers to transfer the swaps, derivatives and other qualified financial contracts (QFCs) of the failed institution to a bridge bank will be respected. This is accomplished by requiring QFCs of GSIBs and related entities to include language establishing that the banking regulators have the ability to stay termination of such QFCs and transfer such contracts in the same manner as they would under US bank insolvency law. GSIBs have begun complying with the QFC Stay Rules by including such provisions in loan agreements to the extent the guarantee and collateral package also applies to the borrower's obligations under swaps or similar QFCs.

Beneficial Ownership Regulation
The Financial Crimes Enforcement Network issued a final rule in May 2016, which became effective in May 2018, requiring covered financial institutions to establish and maintain written procedures that are reasonably designed to identify the beneficial owner(s) of legal entity customers, and clarifying the enhanced customer due diligence requirements for financial institutions under the Bank Secrecy Act. As a result, in connection with offering new lending or account services, covered financial institutions are required to verify information related to individuals who control the legal entity customer (including executive officers and senior managers), or who directly or indirectly own 25% or more of the equity interests of such legal entity customer. These requirements are in addition to existing "know your customer" rules mandated by the USA PATRIOT Act, and are addressed in recent loan documentation by a requirement on covered borrowers to deliver a certificate as to its beneficial ownership at closing (and certain other specified events) and provide lenders with updated information during the term of the financing.

Delaware LLC Divisions
In April 2018, the Delaware Limited Liability Company Act was amended to provide for, among other things, the division of a Delaware limited liability company into two or more separate limited liability companies. The amendments provide specific protections for lenders, including the application of joint and several liability of the divided companies to the extent the division constitutes a fraudulent transfer under applicable law. In addition, for limited liability companies formed prior to August 2018, restrictions included in loan agreements with respect to mergers, consolidations or the transfer of assets are deemed to apply to a division. Lenders have, nevertheless, also begun to incorporate specific clarifications in loan documentation to address such divisions, including prohibiting the transfer of assets to divisions and limiting the ability for limited liability companies that are loan parties to consummate divisions.

2. Authorisation

2.1 Authorisation to Provide Financing to a Company

Financings in the US are typically provided by either traditional regulated banking institutions or by non-traditional alternative credit providers, which are less heavily regulated. The US operates under a "dual-banking system", in which banks can apply for a state bank charter or a federal charter from the Office of the Comptroller of the Currency (OCC). Banks chartered by a state banking authority are primarily subject to the regulations of that state authority in addition to the Federal Reserve or the FDIC, while nationally chartered banks are subject to regulation by the OCC and are required to become members of the Federal Reserve System. Federal law also requires national and state banks to obtain deposit insurance from the FDIC.

Alternative credit providers, or direct lenders, may be subject to regulation under the Investment Company Act as an "investment company", often operating under an exemption from many of the requirements, and are subject primarily to the regulations of the Securities and Exchange Commission.

3. Structuring and Documentation Considerations

3.1 Restrictions on Foreign Lenders Granting Loans

Foreign banking organisations are subject to the International Banking Act of 1978 and the Foreign Bank Supervision Enhancement Act of 1991, and are regulated by the Federal Reserve, whose approval is necessary to establish a foreign banking institution in the US. Furthermore, foreign banking institutions must seek regulatory approval from the OCC or state banking supervisor to establish US branches and agencies. Upon receiving the appropriate licensing, foreign bank branches may provide a full range of banking services, including making loans.

In 2019, the Federal Reserve finalised new regulatory requirements for US subsidiaries of foreign banks, providing relaxed

capital and stress testing requirements, while also imposing stricter liquidity requirements.

3.2 Restrictions on Foreign Lenders Granting Security

Under US law, there are generally no restrictions on or impediments to a US entity granting security interests to, or providing a guarantee in favour of, foreign lenders that differ from granting or providing them to a domestic lender.

3.3 Restrictions and Controls on Foreign Currency Exchange

The US does not currently impose any controls on foreign currency exchange that affect the US loan market, unless a party is in a country that is subject to sanctions enforced by the Office of Foreign Assets Control (OFAC) of the US Department of the Treasury. OFAC administers and enforces economic and trade sanctions based on US foreign policy and national security goals.

3.4 Restrictions on the Borrower's Use of Proceeds

Most US loan agreements include a restrictive covenant limiting the borrower's use of loan proceeds to specified enumerated purposes, which may be limited to specific transactions (eg, to finance an acquisition or to refinance existing debt), or generally for the borrower's working capital or other "general corporate purposes". US loan documentation also prohibits borrowers from using loan proceeds in violation of relevant US and foreign anti-corruption and anti-money laundering regulations (principally the Foreign Corrupt Practices Act of 1977 and sanctions enforced by OFAC). In addition to these contractual restrictions, US law restricts the use of loan proceeds in violation of the margin lending rules under Regulations T, U and X, which limit loans used to acquire or maintain certain types of publicly traded securities and other "margin" instruments if the loans are also secured by such securities or instruments, thereby limiting the amount of collateral value the lender may assign to such securities or other instruments (currently, to 50%).

3.5 Agent and Trust Concepts

In US syndicated loan financings, an administrative agent is typically appointed to act on behalf of the lending syndicate to administer the loan, including managing borrowings, receiving and distributing payments, enforcing remedies and acting as an intermediary for communications between the borrower and lender syndicate. In secured transactions, a collateral agent will typically be appointed to administer collateral-related matters, and the grant of security and any guarantee is made to (or in favour of) such collateral agent for the benefit of the lending syndicate. While the lead arranger commonly acts as both administrative agent and collateral agent, in distressed situations where the exercise of agent duties and discretion may lead to disagreements among the lender syndicate and/or with the borrower, an independent, unrelated financial institution is often appointed by the syndicate to perform this function. Where financings involve debt securities or multiple lending groups sharing the same collateral, the security interests are sometimes granted to a collateral trustee or other "intercreditor" agent to act on behalf of all holders of the debt, with the trust or intercreditor arrangements setting out the relative rights of the various creditor groups. Trusts are used to supplement the agency relationship, either as simple collateral devices or, less often, as a way to comply with legal restrictions specific to the transaction.

3.6 Loan Transfer Mechanisms

In the US loan market, interests in loans held by lenders are transferred between market participants 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, upon which the assignee replaces the assigning lender under the loan agreement with respect to the portion of loans assigned. As the lender "of record" under the loan agreement, the assignee benefits from all of the rights and remedies available to lenders thereunder.

US loan agreements typically require certain conditions to be satisfied in order for a lender to assign a loan. Typically, a minimum principal amount (and minimum increments above such amount) must be assigned, and assignments generally require the consent of the borrower, the administrative agent and, in connection with unfunded commitments, fronting lenders. Loan agreements usually provide for limitations on the borrower's consent rights during the continuation of any event of default (or, increasingly, during the continuation of a payment or bankruptcy event of default). Furthermore, borrower consent is typically not required when the assignment is to an existing lender or affiliate of such lender, nor if the borrower has not objected to the proposed assignment within a specified period of time (usually five to 15 business days).

In contrast, a participation involves only a transfer of a subset of the lender's rights, principally the right to receive payments on the loan and limited voting on "sacred" rights that are viewed as essential to protect those rights. The transferee of such rights becomes a "participant" in the loan, but does not become a lender under the loan documentation and has no contractual privity with the borrower. As such, even the limited voting rights granted to a participant are exercised by the lender, at the participant's direction, not by the participant itself. Unlike assignments, participations almost never require notice to or consent from the borrower or any other party.

Finally, loan agreements typically permit a lender to pledge or assign a security interest in all or any portion of its rights in the loans to secure obligations of the lender, generally without the consent of the borrower, but do not allow the pledgee or assignee to realise on the interest to become a lender other than with consent and if the other requirements described above are met.

Increasingly, loan agreements (particularly those involving private equity sponsors) restrict assignments and participations to "disqualified institutions" designated by the borrower or its controlling equity holder. These disqualified institutions generally include competitors of the borrower and certain financial institutions that the private equity sponsor or borrower deem undesirable, including as a result of such institution being likely to engage in "net short" or other activist strategies. These provisions are often heavily negotiated, with borrowers seeking to maintain flexibility to designate additional entities throughout the life of the financing, and lenders seeking to minimise such flexibility in order to maintain liquidity in the loan. In response to recent transactions in which "net short activist" strategies were employed by lenders, private equity sponsors increasingly seek to require potential lenders to represent that they do not have a net-short position as a condition of becoming a lender (and, thereafter, to exercise voting rights).

3.7 Debt Buy-Back

Debt buy-backs by borrowers and their affiliates (including private equity sponsors) are generally permitted in the US syndicated loan market, subject to customary requirements. In particular, borrowers and their subsidiaries are generally permitted to buy-back loans pursuant to "Dutch" auctions made available to all lenders on a pro rata basis, or on a non-pro rata basis on the open market. Loan agreements typically require that, in connection with any such buy-back, the purchased loans are cancelled and such buy-backs are not financed with loans under any corresponding revolving facility.

Alternatively, the private equity sponsor and its affiliates (other than the borrower and its subsidiaries) are typically permitted to make "open-market" purchases on a non-pro rata basis. Once held by an affiliate of the borrower, loans are generally subject to restrictions on voting, participating in lender calls and meetings and receiving information provided solely to the lenders. Additionally, loans held by a private equity sponsor and its fund-level affiliates are subject to a cap of the aggregate principal amount of the applicable tranche of term loans – typically 25%. Bona fide debt fund affiliates of a private equity sponsor that invest in loans and similar indebtedness in the ordinary course of business are usually excluded from these restrictions, but are still restricted from constituting 50% or more of the loans voting in favour of amendments that require the consent of a majority of the lenders.

3.8 Public Acquisition Finance

While the US does not have any specific rules or regulations mandating "certain funds" requirements with respect to financing acquisitions of public companies, market dynamics have evolved such that financing commitments with respect to both public and private company acquisitions are generally subject to a limited and standardised set of conditions, colloquially referred to as "limited conditionality" or "SunGard" provisions. The narrowing of conditions precedent in a typical acquisition financing has been driven largely by the increased focus on deal certainty in M&A transactions, with the buyer/borrower seeking to align the conditions precedent to the financing with the conditions precedent to the acquisition, to the greatest extent possible. The most important of these conditions are as follows:

- the accuracy of certain "specified representations" relating to the enforceability and legality of the financing itself;
- the accuracy of certain representations of the seller or target made in the acquisition agreement, the breach of which would permit the buyer to terminate the acquisition;
- the absence of a material adverse change with respect to the target (identical the corresponding condition to the acquisition); and
- conditions relating to the information and timing required by the arrangers to properly syndicate the loans in advance of acquisition closing.

Given these dynamics, it is customary for the buyer and arrangers to execute a commitment letter, including a detailed term sheet, upon signing the acquisition agreement, thereby providing the buyer with committed financing subject to customary "limited conditionality". If public, the company will typically announce the transaction along with details about the committed financing by filing information on a Form 8-K with the Securities and Exchange Commission. The buyer and the arrangers will then negotiate the definitive documentation for the financing prior to the closing of the acquisition, during which time the arrangers – with the assistance of the buyer and target – will seek to syndicate the loan commitment to the broader market.

4. Tax

4.1 Withholding Tax

Generally, there is a 30% US withholding tax on the gross amount of interest paid to a non-US lender. If a loan is issued at a discount in excess of a de minimis amount ("original issue discount" – OID), that discount is treated as interest income when paid, subject to the 30% withholding tax. Certain fees may also be treated as original issue discount for this purpose.

However, there are several important exceptions to withholding on interest, as a result of which the expectation is usually that lenders to a US obligor should be able to avoid withholding on interest so that a gross up should not apply, without a change in law. Those exceptions include treaty exemptions, the portfolio interest exemption and an exemption from withholding if the interest is paid to a non-US lender that is engaged in a trade or business within the US (such as a non-US bank operating through a US branch).

The portfolio interest exemption applies to eliminate withholding on interest if:

- the non-US lender does not own (actually or constructively) 10% or more of the voting equity of the borrower;
- the non-US lender is not a controlled foreign corporation related to the borrower for US tax purposes;
- the non-US lender is not a bank extending credit pursuant to a loan agreement entered into in the ordinary course of its trade or business; and
- the interest is not subject to certain contingencies (such as interest based on the income or profits of the borrower).

To qualify for an exemption to withholding, a non-US lender will generally be required to provide a US tax form to the borrower or agent – typically an IRS Form W-8BEN-E (for treaty benefits or the portfolio interest exemption) or an IRS Form W-8ECI (if the interest is effectively connected with the non-US lender's US trade or business).

Principal payments and the proceeds from a sale or other disposition of a debt instrument are generally not subject to US withholding tax (except to the extent such payments are treated as a payment of interest or original issue discount). However, fee income that is not treated as original issue discount may be subject to 30% withholding unless a treaty applies or the recipient is engaged in a US trade or business – the portfolio interest exemption may not apply because the fee may not be treated as interest for US tax purposes.

Finally, in 2010, the US enacted the Foreign Account Tax Compliance Act (FATCA), which imposes a 30% US withholding tax on non-US banks and financial institutions (including hedge funds) that fail to comply with certain due diligence, reporting and withholding requirements. FATCA withholding tax applies to payments of US-source interest and fees, without any exemptions for portfolio interest or treaty benefits. FATCA was scheduled to apply to payments of gross proceeds from a sale or other disposition of debt instruments of US obligors beginning on 1 January 2019, but the Internal Revenue Service and US Department of the Treasury issued proposed regulations on 13 December 2018 (the preamble to which specifies that taxpayers are permitted to rely on the proposed regulations pending finalisation), stating that no withholding will apply on payments of gross proceeds. Many countries have entered into agreements with the US to implement FATCA, which may result in modified requirements that apply to financial institutions organised in such countries.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Under Section 956 of the Internal Revenue Code, if a foreign subsidiary of a US borrower that is a "controlled foreign corporation" (CFC) guarantees debt of a US-related party (or if certain other types of credit support are provided, such as a pledge of the CFC's assets or a pledge of more than two-thirds of the CFC's voting stock), the CFC's US shareholders could be subject to immediate US tax on a deemed dividend from the CFC. Following regulatory changes published by the US Treasury and Internal Revenue Service in 2019, US corporate borrowers may now obtain credit support from CFCs without incurring additional tax liability, if certain conditions are met. However, despite the renewed ability for CFCs to provide credit support to US borrowers in certain circumstances, the majority of loan documents today continue to maintain customary Section 956 carve-outs, excluding CFCs from the guarantee requirements and limiting pledges of first-tier subsidiary CFC equity interests to less than two-thirds. In addition, the deemed dividend rules may still have an effect on US individuals.

Separately, non-US lenders should closely monitor their activities within the US to determine whether such activities give rise to a US trade or business or a permanent establishment within the US, in which case they could be subject to US taxation on a net-income basis. 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 that the non-US lender (and its agents) undertakes from within the US.

4.3 Usury Laws

National and state-chartered banking institutions are subject to usury laws, which are largely enforced at the state level. For purposes of these laws, "interest" may include overdrafts and late fees, among other things. Nationally chartered banks may not charge interest exceeding the rate permitted by the state in which the bank is located or 1% above the discount rate on 90-day commercial paper in effect in the bank's Federal Reserve district, whichever is greater. If the state where the bank is located does not prohibit usurious interest, the bank may not charge interest exceeding the greater of 7% and 1% above the discount rate on 90-day commercial paper in effect in the bank's Federal Reserve district. In general, state-chartered banks are permitted to charge the same interest rate as national banks

and Federal law will pre-empt any state usury law that prohibits state-chartered banks from applying the same interest rate as a nationally chartered bank.

Under New York law, with certain exceptions, charging interest in excess of 16% constitutes civil usury, and charging interest in excess of 25% constitutes criminal usury. However, loans in excess of USD250,000 are exempt from the civil statute, but remain subject to the criminal statute. Loans in excess of USD2,500,000, which would include nearly all broadly syndicated loans in the US, are exempt from both the civil and criminal statutes.

5. Guarantees and Security

5.1 Assets and Forms of Security

Determining the Collateral Package

US law places few limitations on which assets of borrowers and their subsidiaries are available to be pledged as collateral to lenders. The (substantially) "all asset" pledges of real and personal property of borrowers and their subsidiaries are not uncommon, with negotiated exclusions of specific assets generally addressing overly burdensome, expensive and time-consuming perfection requirements or consequences. Common examples of exclusions from US collateral packages are licences prohibited by law or contract (but the proceeds thereof are generally included), assets that provide de minimis value, assets subject to burdensome perfection regimes like certificates of title (including motor vehicles), and "intent-to-use" applications for the registration of a trade mark.

Creating an Enforceable Security Interest

The creation and perfection of a security interest for most categories of personal property are governed by the Uniform Commercial Code (UCC), which has been adopted with some local differences in most states. In order to create an enforceable security interest with respect to personal property under Article 9 of the UCC:

- the lender must provide value to the grantor of the security interest;
- the grantor must have rights in the collateral or the power to transfer rights in the collateral to the lender; and
- either the grantor must execute a security agreement providing a description of the collateral or, in the case of certain types of collateral, the collateral must be in possession or control of the lender.

To create and perfect a security interest in assets not governed by the UCC – real property and certain kinds of intellectual property, for example – the parties will typically create a separate collateral document or mortgage pursuant to the applicable requirements of the law of the jurisdiction governing the property.

Perfection Requirements

Once an enforceable security interest has been created, lenders will need to perfect such security interest in order to "put the world on notice" and be able to enforce the security interest against other creditors and in bankruptcy proceedings. Article 9 of the UCC provides for the following four methods of perfecting security interests in domestic personal property:

- filing a financing statement (known as a UCC-1) in the appropriate jurisdiction, which includes the required description of the collateral;
- possession, in the case of certain tangible assets;
- establishing control, which may be effected by entering into control agreements in the case of deposit accounts, letter of credit rights, investment accounts and electronic chattel paper; and
- automatic perfection, in the case of certain other personal property.

Timing and Cost Considerations

US loan documentation provides that minimum security interest creation and perfection requirements must be satisfied either at the closing of the financing or within a limited period thereafter. Post-closing creation and perfection steps are generally limited to categories of collateral that require extended periods of time, including filing real property mortgages and negotiating deposit and securities account control agreements. Certain assets that cannot be perfected solely by the filing of a UCC-1 financing statement under Article 9 of the UCC and/or that require separate documentation with respect to the creation of security interests therein, including real property or motor vehicles, will typically result in additional costs to be borne by the borrower. These may include the engagement of specialist counsel, including the provision of legal opinions, and the payment of applicable filing or recording fees.

5.2 Floating Charges or Other Universal or Similar Security Interests

Article 9 of the UCC permits the granting of a floating lien in the form of an "all assets" pledge, which will include all personal property owned or later acquired by the grantor of the security interest, subject to any negotiated exclusions. As with other security interests in property governed by Article 9 of the UCC, floating liens arise when an enforceable security interest is perfected by the filing of a UCC-1 financing statement in the appropriate jurisdiction. While UCC-1 financing statements may perfect the floating lien by simply describing the collateral as "all assets" of the grantor, lenders should take care to specifi-

cally describe the categories of collateral (including proceeds thereof) when creating the security interest in the security or pledge agreement in accordance with the requirements under Article 9 of the UCC. Importantly, the floating lien will only apply to personal property that is subject to the requirements of Article 9 of the UCC (with certain exceptions for asset types such as commercial tort claims, which must be described with more specificity), as other assets – such as real property and federally registered copyrights – cannot be subject to a floating lien.

5.3 Downstream, Upstream and Cross-Stream Guarantees

In the US, there are no general limitations or restrictions applicable to downstream, upstream or cross-stream guarantees other than the requirements applicable to guarantees generally. Because of the nature of cross- and upstream guarantees, lenders are conscious of the risk of limitation or invalidation on grounds of fraudulent conveyance, which requires that the entity providing the upstream or cross-stream guarantee either receives adequate consideration for provision of the guarantee, or is solvent after giving effect to it. This is an inherently fact-based inquiry addressed by loan market participants by including "savings clauses" or other limitations on the amount of the guarantee obligation to ensure continued enforceability. Furthermore, lenders often draft guaranty agreements to increase the likelihood of enforcement by, for example, requiring that the guarantees be "absolute and unconditional" (to avoid common law defences) and not contingent upon commencing or exhausting remedies against the primary obligor or any collateral. In certain regulated industries, such as a financing to acquire a registered broker-dealer, however, a guarantee by the broker-dealer or other regulated entity may be limited or precluded as a practical matter.

Additionally, certain considerations may apply in the context of upstream guarantees provided by a foreign subsidiary of a CFC US borrower. Prior to 2019, Section 956 of the Internal Revenue Code created adverse tax consequences for shareholders of a CFC guaranteeing or otherwise providing collateral to support the debt of a US obligor. Following regulatory changes published by the US Treasury and Internal Revenue Service in 2019, however, Section 956 now permits US corporate borrowers to obtain credit support from CFCs without incurring additional tax liability, so long as certain conditions are met. Despite this renewed ability for CFCs to provide credit support to US borrowers in certain circumstances, loan documentation continues to maintain customary Section 956 "carve-outs" in nearly all circumstances, excluding CFCs from the guarantee requirements and limiting pledges of first-tier subsidiary CFC voting equity interest to less than two-thirds of the amount held by the pledgor. To the extent subsidiaries of a borrower are unable to provide guarantees or credit support, whether because of regulatory or tax issues or otherwise, lenders have traditionally relied solely upon the application of the restrictive covenants and events of default in the loan documentation to provide protection.

5.4 Restrictions on Target

In the US, a target company is not generally prohibited from guaranteeing or granting a security interest in its assets, or from otherwise providing financial assistance for a financing utilised to acquire its shares. These guarantees and security interests, however, will be subject to review for fraudulent conveyance and may be subject to regulatory schemes that make providing a guarantee impracticable even if legal. Subject to such limitations, the provision of such guarantees and security interests is generally subject to negotiation between the borrower and the lenders providing such acquisition financing. Lenders will typically require guarantees and security interests to be provided by the target company, along with delivery of any certificated securities of the target company, as a condition to the financing, with borrowers pushing to align the required target creation and perfection steps with the corresponding requirements of the target under the acquisition agreement.

5.5 Other Restrictions

The provision of guarantees and the granting of security interests in assets by US entities are authorised by the entity's board of directors, members or other governing body, in accordance with the business laws under its jurisdiction of formation. While these authorisations are typically obtained from a borrower's subsidiaries through standardised corporate governance processes, some subsidiaries of the borrower – such as joint ventures and other non-wholly owned entities – may require additional consents from third parties. Once such consent is obtained, the provision of guarantees and the granting of security interests in collateral do not generally result in significant incremental costs. However, assets that require additional consents, notices, filings, or burdensome arrangements to perfect such security interests, may impose a substantial burden on the borrower. This burden must be weighed against their relative value to the overall collateral package and the benefits derived to the lenders and, in many such circumstances, such assets are likely to be excluded from the collateral package.

Anti-assignment provisions in commercial contracts pose similarly difficult issues for lenders in secured financings. While a statutory override of anti-assignment provisions in contracts is generally available under the UCC, if the restricted collateral is critical to the lender's collateral package, lenders are likely to request consent from the third party to the pledge of such collateral as a condition to making the loan.

5.6 Release of Typical Forms of Security

In the US, loan documentation typically authorises the administrative agent or collateral agent to acknowledge or confirm the release of the lenders' security interest in the collateral at the sole cost of the borrower upon termination and payment in full of the obligations under the loan agreement. Additionally, these agents are generally pre-authorised to acknowledge or confirm the release of security interests in specific assets that are disposed of, or guarantees of entities that are no longer subject to the guarantee requirements, in transactions permitted under the loan documentation. Further action may be required by the agents in order to evidence the termination of security interests that have been perfected, including the filing of UCC-3 termination statements, terminating control agreements or executing other types of releases that may need to be recorded in the appropriate filing office.

Lenders are increasingly focused on the unintended consequences of such provisions. For example, borrowers may rely upon exclusions from the guarantee requirements to release a guarantor that is no longer wholly-owned by the borrower (even if wholly-owned by the borrower and its affiliates). Furthermore, borrowers have previously relied upon "trap-doors" in investment covenants to move valuable IP and other assets from guarantors to non-guarantor entities, automatically releasing the lenders' security interest in such assets in the process.

5.7 Rules Governing the Priority of Competing Security Interests

Priority of Conflicting Security Interests

The relative priority of security interests held by different creditors in the same assets of a borrower is generally determined by the UCC of the applicable jurisdiction and is subject to the following rules:

- a perfected security interest has priority over a conflicting unperfected security interest;
- conflicting perfected security interests rank in priority according to the time of filing or perfection; and
- conflicting unperfected security interests rank in priority according to the time at which the security interest attached or became effective.

In addition, the UCC allows certain categories of collateral to be perfected by multiple methods, with priority determined based on the "preferred" method regardless of the rules set forth above. For example, with respect to investment property, securities accounts and certificated securities, perfection via "control" or possession generally has priority over perfection by "filing" UCC-1 financing statements.

Subordination

Lenders and borrowers may agree to structure a financing to provide for payment subordination or lien subordination, which can be accomplished contractually, structurally or both.

Where lenders agree to contractually subordinate the repayment of their loans or the priority of their liens, such subordination is typically accomplished through a subordination agreement or intercreditor agreement among the separate creditor groups. These written contractual arrangements define the relative rights of the senior creditors and junior creditors in the shared collateral and/or with respect to the priority of payments made by the borrower. With respect to lien subordination, such arrangements will typically provide that, among other things, junior creditors are subject to a "standstill" period prior to exercising any enforcement rights or remedies with respect to the collateral, payments received by junior creditors in violation of the agreement will be held in trust and turned over to senior creditors, and certain specified amendments to both senior- and junior-priority loan documents will be subject to agreed limitations.

Structural subordination arises where obligations incurred or guaranteed solely by a company are effectively junior to obligations incurred or guaranteed by a subsidiary of the company, to the extent of that subsidiary's assets. In such a situation, the creditors of the subsidiary have the right to be repaid by such subsidiary (or out of its assets) as direct obligations of such entity in any insolvency scenario and before creditors of the parent company, such subsidiary's equity holder, are repaid. Of course, the effect of this arrangement will depend on the relative asset value of the different obligors, but where the parent company is primarily a "holding company" for the equity interests of its operating subsidiaries, creditors of an operating subsidiary will necessary be paid in priority to creditors of the holding company from assets of such subsidiary.

Section 510 of the Bankruptcy Code provides that subordination agreements are enforceable in a bankruptcy proceeding to the same extent they would be enforceable under applicable non-bankruptcy law.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

In general, loan documentation provides for a customary set of rights and remedies exercisable by the agents, on behalf of the lenders, following the occurrence and continuation of "events of default". Typically, events of default include a failure to make timely payments when due, misrepresentations, defaults under affirmative and negative covenants (either immediately or fol-

lowing a specified grace period), the commencement of an insolvency or bankruptcy proceeding with respect to the borrower and certain subsidiaries, or a change of control of the borrower. Upon an event of default, the agents may exercise the rights and remedies available to it under the loan documents, or may be directed to do so by a majority of the lenders. Alternatively, lenders may decide to continue working with the borrower to address the cause of the underlying event of default and either waive the event of default or enter into a forbearance agreement, thereby agreeing not to exercise such default rights and remedies for a set period of time, subject to compliance with specified conditions.

Article 9 of the UCC provides a secured party with several remedies following an event of default giving rise to enforcement rights, including the right to collect payments directly from the obligor under accounts receivable, deposit accounts and certain other types of intangible assets, the right to repossess collateral, either through judicial proceedings or non-judicially, and the right to further dispose of the collateral through either a public or private sale.

In order to exercise the remedies available to them under Article 9 of the UCC, lenders must comply with certain requirements intended to protect the borrower, primarily that the time, place and manner of any such remedy be commercially reasonable, including, in connection with a public sale, providing sufficient advance notification of the sale to the debtor and certain other creditors. Notably, an obligor filing for protection under the Bankruptcy Code will result in an automatic stay of most remedies against collateral (with exceptions for securities contracts, derivatives and other specific categories of assets), such that the resolution of secured claims against corporate debtors will, as a practical matter, typically occur through the bankruptcy claims process, rather than the direct exercise of contractual and common law foreclosure or other enforcement of remedies.

6.2 Foreign Law and Jurisdiction

New York courts generally permit parties to select foreign law as the governing law of a loan agreement, but may decline to enforce a governing law clause if the law selected has no substantial relationship to the parties or the transaction, if there is no reasonable basis for the parties' choice of law, or if the provision is contrary to a fundamental policy.

New York's conflict of laws rules uphold foreign forum selection clauses, so long as the jurisdiction chosen has a reasonable relationship to the transaction – ie, a significant portion of the negotiating or performance of the underlying agreement occurs or is to occur in such jurisdiction.

Additionally, in cases involving a foreign state, the Foreign Sovereign Immunities Act permits a waiver of immunity either explicitly or by implication.

6.3 A Judgment Given by a Foreign Court

New York courts will generally recognise and enforce a foreign judgment, subject to certain conditions, including due process and reciprocity. Despite the adoption of uniform laws among many states, a significant amount of diversity exists within the US in connection with both the procedure and substance relating to the recognition and enforcement of foreign judgments. Under federal common law, courts generally rely upon the principles of international comity set forth in Hilton v Guyot with respect to the recognition and enforcement of foreign judgments.

6.4 A Foreign Lender's Ability to Enforce Its Rights

The above provides only a general guideline to the relevant landscape, and does not contemplate all possible matters that are relevant to a particular financing (or even to financings generally), which depend on the facts and circumstances in each case.

7. Bankruptcy and Insolvency

7.1 Company Rescue or Reorganisation Procedures Outside of Insolvency

As a company becomes distressed and at risk of insolvency, management may seek to reorganise the capital structure in an attempt to restructure the business as a viable going concern. Prior to filing a petition for relief under Title 11 of the United States Code ("Bankruptcy Code"), the company may attempt this reorganisation with its creditors non-judicially and in a consensual manner. This is typically referred to as an "out-of-court restructuring".

Companies typically prefer an out-of-court restructuring as a way to expeditiously address capital structure problems in a cost-effective manner without the complications inherent in a bankruptcy court proceeding. Additionally, out-of-court restructurings tend to be completed more discreetly and out of view of employees, suppliers and other counterparties and stakeholders, as opposed to the scrutiny that may result from a public bankruptcy process.

Out-of-court restructurings can take many forms and are highly dependent on the structure of a company's debts, the flexibility or lack thereof in the covenants in its outstanding debt instruments, the threshold lender consent requirements needed to effect changes to each piece of the structure under the applicable documents, and the willingness of creditors to agree to those

changes. These reorganisations may include maturity extensions, debt-for-debt exchanges, debt-for-equity exchange offers or simply waivers of financial or other covenants.

Due to the need to obtain broad creditor support to implement material out-of-court restructurings, a company may find it difficult – if not impossible – to obtain the agreement of all lender groups and may, thus, be required to settle for only targeted changes to certain levels of its debt. Furthermore, fundamental changes to the terms of any debt, including extending the maturity date or reducing the principal, will typically require the consent of all lenders holding the debt (or, at least, all holders affected by the change). This issue is particularly acute where a company's loans or bonds are broadly syndicated and therefore held by many entities with potentially divergent interests, creating a "holdout" problem.

A company's debt documents may provide flexibility to modify certain terms with less than 100% lender consent, which, when combined with an exchange offer or similar refinancing transaction, may be used to coercively initiate liability management transactions that push holdout lenders into a reorganised structure. This is most prominently seen in the high-yield bond market with the utilisation of exit consents, in which the company offers bondholders the opportunity to exchange existing bonds for new bonds issued with a lower principal amount (or other company-friendly structural change) but a higher priority claim (whether through the grant of collateral, structural seniority, or payment seniority) or otherwise enhanced terms. In return, the exchanging bondholders agree to amend the existing notes to adversely affect the terms applicable to non-participating holders by way of "covenant-stripping". This creates an incentive for the bondholders to exchange their notes so as not to be left holding the existing bonds now devoid of meaningful covenant protections.

7.2 Impact of Insolvency Processes

If a bankruptcy filing is unavoidable but a distressed company has time to prepare in advance, it can be beneficial to lay a foundation for an in-court restructuring by negotiating a restructuring support agreement prior to the filing, in which the company and creditors agree to a pre-negotiated plan of reorganisation that will be presented to the bankruptcy court and which will take effect upon the completion of the Chapter 11 bankruptcy proceeding. This sort of "prepackaged" or "prearranged" bankruptcy plan is intended to shorten and simplify the bankruptcy proceeding and reduce the cost of the proceeding and the potential for negative impact on the business.

Whether a bankruptcy is voluntary or involuntary, the filing of a petition for relief under any chapter of the Bankruptcy Code will immediately result in an injunction referred to as an "automatic stay", without the need for further action by the bankruptcy court. The automatic stay prevents lenders and other creditors from enforcing or perfecting pre-petition liens or guarantees, foreclosing on collateral, enforcing pre-petition judgments or terminating contracts on account of pre-petition defaults, among other things. The automatic stay is intended to preserve the going-concern value of the debtor by addressing the collective action problem of creditors taking uncoordinated unilateral enforcement action to preserve their own investment to the detriment of other creditors (sometimes referred to as the "race to the courthouse").

The bankruptcy court may grant creditors relief from the automatic stay, under certain circumstances. One basis for relief is "for cause", which can include mismanagement, failure to preserve collateral or a lack of "adequate protection" of a secured lender's interest in its collateral. "Adequate protection" refers to steps taken by the debtor to protect a secured creditor against diminution in the value of their collateral during the pendency of the bankruptcy proceeding. If a creditor is entitled to adequate protection and the debtor is unwilling or unable to provide it, then the bankruptcy court can grant the creditor relief from the automatic stay to seize its collateral. Furthermore, a creditor may seek relief where the debtor does not have "equity" in certain collateral (ie, the value of the collateral does not exceed the amount of loans secured by such collateral) and such collateral is not necessary to an effective reorganisation.

7.3 The Order Creditors Are Paid on Insolvency

The Bankruptcy Code requires any liquidation or reorganisation plan to be "fair and equitable" with respect to any class of creditors that does not consent to different treatment; therefore, senior creditors must be paid in full (unless otherwise agreed) prior to any payments being made to junior creditors, and equity holders may only receive assets or payments after all creditors are paid in full. This hierarchy is commonly referred to as the "absolute priority rule". The value of collateral securing creditor claims is distributed in accordance with the relative priority of the lienholders, while unencumbered value is distributed to unsecured creditors in accordance with their statutory priority.

7.4 Concept of Equitable Subordination

The Bankruptcy Code permits the court to subordinate all or a portion of a creditor's allowed claim to all or a portion of another creditor's allowed claim in order to remedy misconduct by the subordinated creditor.

Equitable subordination can only be granted if:

- the claimant engaged in inequitable conduct;
- the conduct injured other creditors or conferred an unfair advantage on the claimant; and

- it is not contrary to the principles of the Bankruptcy Code.

While "inequitable conduct" is not defined in the Bankruptcy Code, it is typically considered to include fraud, breach of fiduciary duties and illegality. Additionally, insiders and fiduciaries are usually held to a higher standard in determining inequitable conduct. Equitable subordination is rarely granted by the court, as it is considered to be an extraordinary remedy.

7.5 Risk Areas for Lenders

Lenders face several risks when a borrower, credit support provider or guarantor becomes insolvent, including the use and dissipation of its cash collateral, fraudulent conveyance risk, preference risk and subordination to debtor-in-possession (DIP) financing.

Use of Cash Collateral

During a Chapter 11 bankruptcy proceeding, the court may permit a debtor or bankruptcy trustee to use cash collateral in order to continue operating the business over a secured lender's objection only if "adequate protection" is provided to the lender to protect against the value of the lender's security interest declining. Adequate protection may be accomplished in a variety of ways, including in the form of replacement liens or cash payments. In practice, debtors typically negotiate the terms of a consensual stipulation with creditors holding liens on their cash allowing for continued use of the cash, and rarely seek permission to use cash collateral over the objection of their lienholders. Debtors in bankruptcy require the affirmative permission of the court to use cash collateral pledged to a creditor and, as such, negotiations regarding use of cash collateral typically occur in the lead-up to a bankruptcy filing, giving the relevant secured creditor an opportunity to negotiate protections for itself.

Fraudulent Conveyance

The Bankruptcy Code grants the debtor or bankruptcy trustee the power to "avoid" certain prior transfers that constituted fraudulent conveyances in order to recover assets for the benefit of the estate. A fraudulent conveyance occurs where the debtor received less than reasonably equivalent value in exchange for a transfer or obligation and, either before or after the transfer the company was insolvent, had unreasonably small capital or believed it would incur debts beyond its ability to repay. This concern is generally heightened in leveraged buyouts, where courts may deem the "transfer" to a lender of the collateral of the target or the incurrence of the target's obligation to repay the debt incurred to fund the transaction voided as a transfer for which the borrower did not receive reasonably equivalent value if it did not retain the proceeds of the loan.

Preference Risk

Generally, the debtor or bankruptcy trustee may recover certain "preference" payments made to unsecured or undersecured creditors within the 90-day period prior to a bankruptcy filing (or one year prior for insiders). Lenders may be able to avoid this preference risk where the payments by the debtor were intended to be in exchange for new value provided to the debtor, or where they are in the ordinary course of business. Lenders will seek to address preference risk in loan documentation by requiring that additional junior debt incurred by a company does not mature earlier than 91 days following the maturity of such lender's loans.

DIP Financing

A debtor will sometimes require financing shortly after filing for bankruptcy under Chapter 11 to fund its operations during the bankruptcy case. In these circumstances, the debtor or bankruptcy trustee can seek the bankruptcy court's approval to incur debt, which may include "priming" liens senior to the liens securing debt outstanding prior to the bankruptcy filing as well as superpriority claims senior to all other unsecured claims. Such DIP financing may be approved over the objection of the existing lenders if, after notice and hearing, the debtor is otherwise unable to obtain financing and the existing lenders' liens are adequately protected – ie, they are compensated for any harm suffered by virtue of the priming.

8. Project Finance

8.1 Introduction to Project Finance

There is a long history in the US of natural resources and infrastructure projects being developed and financed through classical and innovative project finance techniques. Fundamental to a successful project financing is the allocation of risks through a robust contractual framework – for both the commercial arrangements (such as for construction, raw material supply and product offtake) and the financial arrangements (including enforcement of the security package). Both domestic and foreign participants have confidence that, in the US, arrangements clearly documented in definitive contracts will be upheld by the courts in a consistent manner without undue delay, especially where the parties elect New York law as the governing law for their contractual arrangements. This is due to the large amount of existing case law producing more certainty regarding the outcome of a dispute.

Trends that point to a continuing lively amount of activity utilising project finance techniques include the surplus of natural gas that has developed rapidly over recent years through the shale gas revolution – leading to the aggressive construction of liquefied natural gas (LNG) plants for product export. Another

equally relevant trend is the pressure from climate change concerns to produce cleaner energy, less dependent on coal. More activity in the renewable energy (solar and wind) sector and in both new and conversion projects to construct natural gas fired power plants is expected. The natural gas revolution is also driving a need for a more extensive gas pipeline network across the country.

8.2 Overview of Public-Private Partnership Transactions mentions the President's Initiative for Rebuilding Infrastructure, highlighting an obvious need at all governmental levels to deal with antiquated and deteriorating ports, airports, roads, local and long distance rail networks and bridges. Several projects are currently in progress in these sectors, and significant additional activity is expected, involving private and public co-operation where possible.

8.2 Overview of Public-Private Partnership Transactions

The public-private partnership (PPP) is often cited by politicians and business interests alike as a model for a way forward for increased infrastructure improvement and other projects in the US. Despite the appeal of the idea, practice has not coalesced around a single paradigm for allocating risk, reward and responsibility among the private and public participants. Some states have undertaken large projects, but the practice is largely state-by-state and specific to the particular project, with no significant guidance through a centralised, federal agency. As a result, transaction costs and challenges can be higher than anticipated, and the promise of PPP as a way to effect important improvements to roads, bridges, public transportation systems and airports (among other public projects) has perhaps been under-realised. Large programmes are often discussed at the federal level – including the President's Initiative for Rebuilding Infrastructure in America proposed in 2018 by the Trump Administration, with the goal of stimulating USD1.5 trillion in infrastructure – but so far without the level of specificity that suggests a single structure. However, given the bipartisan attractiveness of the idea of a federal policy supporting infrastructure projects and an umbrella initiative to do so, this could change quickly.

8.3 Government Approvals, Taxes, Fees or Other Charges

The need for regulatory and governmental approval for a project, including the related financing, will depend on the nature of the project itself, and is not specific to the nature of the financing involved. For example, an energy project may require approval or at least be subject to the jurisdiction of the Federal Energy Regulatory Commission. Sponsors and financing parties must also look to the applicable state and local law requirements.

8.4 The Responsible Government Body

As a general matter, US projects in the oil and gas, power and mining sectors seeking financing from banks and other financing sources will need to be able to demonstrate ongoing compliance with federal, state and municipal zoning, building and construction codes, occupational health and safety regulations and environmental requirements.

The generation, transmission and distribution of electric power in the US is subject to extensive regulation at both the federal and state levels.

The US wholesale electricity market consists of multiple distinct regional markets that are subject to federal regulation, as implemented by the Federal Energy Regulatory Commission (FERC), and regional regulation, as defined by rules designed and implemented by Regional Transmission Organizations (non-profit corporations that operate the regional transmission grid and maintain organised markets for electricity). These rules, for the most part, govern such items as the determination of the market mechanism for setting the system marginal price for energy and the establishment of guidelines and incentives for the addition of new capacity.

Retail electricity markets are regulated at the state level. In exchange for the right to sell or distribute electricity directly to end-users in a service territory, utility businesses are subject to government regulation at the state level by public utility commissions, which sets the framework for the prices ("tariffs") that utilities are allowed to charge customers for electricity to earn a regulated return on assets, and establishes service standards that they are required to meet, the issuance of long-term securities by the utility, and certain other matters.

The siting, design, construction and operation of natural gas and appurtenant facilities, the export of LNG and the transportation of natural gas are subject to extensive regulation under federal, state and local statutes, rules, regulations and laws. Approval from FERC, acting under the authority of the Natural Gas Act of 1938 and other statutes, must be obtained in order to construct, own, operate and maintain LNG facilities, terminals and interstate pipelines. Retail delivery of natural gas is subject to local regulation.

Foreign sponsors of projects in the US also need to be aware of the jurisdiction of CFIUS (the Committee on Foreign Investment in the US), which is authorised to review certain transactions involving foreign investment in the US in order to determine their effect on national security. The Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) is aimed at strengthening and modernising CFIUS, and became law on

13 August 2019. It expands the scope of covered transactions to include:

- the purchase, lease or concession by or to a foreign person of real estate located in proximity to sensitive government facilities;
- "other investments" in certain US businesses that afford a foreign person access to material non-public technical information in the possession of the US business;
- any change in a foreign investor's rights resulting in foreign control of a US business or "other investment" in certain US businesses; and
- any other transaction designed to circumvent CFIUS jurisdiction.

8.5 The Main Issues When Structuring Deals

Please see **Chambers Global Practice Guide: Project Finance 2020** for a discussion of the issues relevant to structuring a project finance transaction.

8.6 Typical Financing Sources and Structures for Project Financings

Given the complexity of this topic, an interested reader is advised to consult **Chambers Global Practice Guide: Project Finance 2020**.

8.7 The Acquisition and Export of Natural Resources

Issues affecting the acquisition and export of natural resources are of growing importance as the US is expected to become a net exporter of energy by 2020, with the production of crude oil, natural gas and natural gas plant liquids outstripping the growth in US energy consumption. Exports of natural resources may be subject to general or specific economic sanction regimes. In addition, approvals from the Department of Energy are required for the export of domestically produced LNG.

8.8 Environmental, Health and Safety Laws

Projects in the US are subject to the US Clean Air Act, the US Clean Water Act and various other federal, state and local laws and regulations enforced by the US Environmental Protection Agency and comparable state and local governmental bodies relating to the following, among other matters:

- the protection of the environment and natural resources;
- the generation, storage, handling, use, treatment, disposal and transportation of hazardous materials;
- the emission and discharge of hazardous materials into the ground, air or water, including greenhouse gases;
- the use of water;
- habitat protection, wetlands preservation and coastal zone management;
- remediation of contamination;
- waste disposal;
- endangered species, historic property, antiquities and cultural preservation; and
- noise regulation.

It should be noted that, although not a legal requirement, it is an internal requirement of most banks that projects being financed by them comply with the Equator Principles.

Projects will also be subject to a number of federal and state laws and regulations, including the federal Occupational Safety and Health Act, and comparable state statutes, whose purpose is to protect the health and safety of workers. Projects will be required to develop an internal safety, health and security programme designed to monitor and enforce compliance with worker safety requirements, and to routinely review and consider improvements to such programmes.

The nature and extent of the regulation will depend on the location and industry sector.

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Trends and Developments

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Impact of COVID-19 on the Loan Market and Recent Liability Management Transactions

For many, the COVID-19 pandemic has had widespread implications on all aspects of their loan facilities, and continues to do so. As the effects of the pandemic began to be manifest in March and April 2020, there was a dramatic increase in borrowings under revolving credit facilities. Many borrowers, especially investment grade borrowers, also sought to shore up their balance sheets and potential liquidity needs by entering into new shorter-term loan facilities, often in the form of delayed-draw term loans designed to efficiently manage their borrowing costs and financial covenant ratio compliance. In addition to seeking liquidity solutions, borrowers also attempted to address short and medium-term compliance challenges under their loan agreements arising from the COVID-19 pandemic by pre-emptively obtaining covenant and other forms of relief from their lenders. This relief typically came in the form of COVID-19-specific EBITDA addbacks, financial maintenance covenant "holidays" and resets, and extended periods for financial statement delivery and collateral perfection actions.

One consequence of borrowers' need for liquidity and compliance challenges during this period has been the marked increase in liability management transactions that have benefited certain classes of creditors at the expense of others. While liability management transactions have come in many forms, the two basic structures upon which nearly all permutations are based are uptiering transactions and drop-down financings.

Uptiering transactions

In an uptiering transaction, a borrower offers potential lenders a claim against the existing guarantor and collateral package that is contractually senior to the claims of existing creditors, most typically through collateral or lien priority, but, in certain cases, in the form of waterfall payment priority. An uptiering transaction will typically be offered to existing lenders who provide all or a portion of the new financing and are, in many cases, permitted to exchange all or a portion of their existing loans into the contractually senior debt. These exchanges are usually at a discount to the par value of the existing loans and, to facilitate the transaction, the participating lenders will often effect necessary amendments to the existing credit facility through an "exit" consent. The benefits of such a transaction for the borrower are additional liquidity in the form of the new financing, reduced overall debt burden arising from the deleveraging exchange and, in many cases, additional covenant flexibility.

Drop-down financings

In a drop-down financing, rather than re-tranching the existing guarantees and collateral, a borrower identifies assets that may be readily separable from its business – often intellectual property – and transfers such assets to an unrestricted subsidiary or, in certain cases, a non-guarantor restricted subsidiary ("NewCo"). Upon the transfer to the subsidiary, the liens of existing creditors on the transferred assets are automatically released and the (now) unencumbered assets are available to secure the newly incurred indebtedness of NewCo. Similar to uptiering transactions, drop-down financings often include a roll-up feature permitting existing lenders providing the new financing to exchange their existing debt of the borrower (at a discount) for the new structurally senior debt of NewCo. Depending on the structuring of the financing, the quantum of indebtedness that may be incurred by NewCo may be limited by the existing credit facility covenants (in the case of excluded restricted subsidiaries) or unlimited (in the case of unrestricted subsidiaries). In either case, the claims of the new creditors against NewCo and the transferred assets are structurally senior to the claims of the existing lenders and, in limited cases, may also have a pari passu or junior claim against the borrower (and existing credit parties).

From the perspective of existing lenders, the most challenging aspect of liability management transactions is that non-participating lenders (who may not even be offered an opportunity to participate) may find themselves contractually or structurally subordinated to other creditors, directly contrary to a key assumption in extending senior secured loans. In contrast, from the perspective of borrowers, liability management transactions allow them the flexibility to manage their capital structure, since obtaining covenant relief and other amendments or incremental liquidity under the existing facility in times of distress may not be economically feasible. To increase the likelihood of financing being available in these circumstances, borrowers seek to ensure that their loan documentation provides them with the ability to offer priming liens and/or senior claims to creditors who are willing to provide additional liquidity and, where necessary, covenant flexibility. Liability management transactions thus offer critical optionality to distressed borrowers, which borrowers note often benefits lenders in the long run, as it provides the additional runway necessary to stabilise the underlying business and avoid a value-destructive bankruptcy filing.

Reconciling these competing interests and negotiating a set of contractual provisions that clearly delineate the compromise position is challenging. While there is not yet any consensus – between or amongst arrangers, lenders, borrowers and sponsors – as to the most appropriate balance between these concerns, it is clear is that unambiguous, express contractual provisions will generally be respected by the courts. As such, borrowers and lenders have an incentive to reach and document a readily comprehensible understanding of the commercial resolution of these opposing objectives, if only to reduce future litigation costs.

The contractual provisions in loan documentation implicated by liability management transactions, and subject to the most detailed negotiation, include the following:

- The investmentscovenant is implicated in drop-down financings, in which a company's assets are transferred to – invested in – an unrestricted subsidiary or non-guarantor restricted subsidiary and used as collateral for new structurally senior debt. As a result of the specific facts of certain high-profile transactions of this type, the focus of lenders in recent yearshas been on imposing limitations on borrowers' ability to transfer assets (or certain categories of assets – eg, intellectual property) from the borrower and other loan parties to subsidiaries outside the credit group. Lenders have also sought to eliminate "trapdoor" provisions, pursuant to which investments by loan parties in non-loan restricted subsidiaries may be further invested by the non-loan party in unrestricted subsidiaries or for any other purpose. In analysing the investment capacity of a borrower, it is critical to factor in that multiple baskets may be used, collectively, to transfer/invest assets in a drop-down financing, so all such baskets must be considered in the aggregate. A common challenge in determining a borrower's capacity to engage in a drop-down financing is valuing the transferred intellectual property or other assets.
- Unrestricted and excluded subsidiaries – unrestricted subsidiaries are subsidiaries of the borrower that are not subject to the representations, covenants, events of default and other limitations included in loan documentation. As these entities provide borrowers with significant operating flexibility, loan documentation generally restricts the borrower's ability to invest in such entities, subject to the agreed baskets referred to above. Given the inapplicability of the limitations on debt and liens included in the loan documentation to these entities, unrestricted subsidiaries may be used to incur structurally senior indebtedness in a drop-down financing, limited only by a borrower's capacity to transfer assets – serving as collateral for the financing – to such subsidiary. As noted, drop-down financings may also be effected through excluded restricted (often foreign) subsidiaries of the borrower who, while subject to the restrictions of the loan documentation, are excluded from the guarantee and collateral requirements of the existing financing. Lenders are thus well advised to carefully consider the scope of these exclusions from the collateral and guarantee package and the applicable tests for the designation of unrestricted subsidiaries.
- Subordination of all or substantially all collateral – credit facilities nearly uniformly require 100% of lenders to consent to the release of all or substantially all of the collateral securing such facility, subject to an exception for dispositions, transfers and other transactions otherwise permitted by the facility documentation. While an investment of material intellectual property or other material assets in an unrestricted (or excluded) subsidiary in a drop-down financing may, in practice, dilute (potentially materially) the existing collateral package, such investments would be permitted by investment covenant, obviating the need for a 100% lender vote. In contrast, in challenging the permissibility of uptiering transactions, affected creditors have argued that the subordination of existing loans to a material quantum of new super-priority financing constitutes, as a practical matter, a release of the exiting collateral, thereby necessitating an all-lender vote. Courts have generally rejected this argument on the basis that, by the terms of the loan documentation, the 100% vote requirement is triggered solely by a formal release of collateral, and not an effective release on account of the subordination. In reaching their decisions, courts have noted that the parties could easily have contracted for a 100% lender vote to subordinate the existing obligations, so reading this concept into the loan documentation after the fact is inappropriate.
- Pro rata sharing – as noted, a key feature of many liability management transactions is the ability of participating lenders to exchange or roll up their existing loan exposures into the new structure of contractually senior loans. Borrowers may offer this ability to the extent the loan documentation includes exceptions to the general rule that all lenders under a credit facility share in payments and recoveries on a pro rata basis. The erosion over the past few years of "pro rata" protections – both directly (permitting amendment or waiver with a majority lender vote) and indirectly (through non-pro rata, open market debt buy-back provisions) – has been a key factor in permitting many of the recent liability management transactions. In addition, even where amendments and waivers of pro rata sharing provisions remain 100% lender votes, this requirement has been narrowed in many cases to apply solely to amendments and waivers that "by their terms" impact the pro rata sharing provisions (eg, express modifications to the default waterfall), but not to a broader set of amendments and waivers that have "the effect" of modifying pro rata sharing provisions (eg, permit-

ting the incurrence of senior debt that, in effect, subordinates one group of lenders to another).

In conclusion, while liability management transactions have been a common strategy in the high-yield bond market for years, their application to the syndicated loan market has frustrated many traditional expectations of loan market participants. While there are potential methods for lenders to address the issues referred to above – materially tightening investment capacity in unrestricted and excluded subsidiaries, requiring a 100% lender consent to subordinate senior secured term loans, and restricting a borrower's ability to engage in certain forms of non-pro rata buy-backs – there is not yet any market consensus on these solutions. As such, lenders and borrowers should continue to engage in a thoughtful analysis of loan documentation and agree to targeted adjustments that balance borrowers' need for flexibility to manage their business and capital structure with lenders' desire for certainty in their credit position.

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