

European Intercreditor Agreements

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European Framework Developments

Loan Market Association

- Loan Market Association was founded in December 1996 by seven leading international banks in London.
- Aim to encourage liquidity and efficiency in both the primary and secondary loan markets by promoting market depth and transparency, as well as by developing standard forms of documentation and codes of market practice.
- The LMA has gained recognition in the market and has expanded its activities to include all aspects of the primary and secondary syndicated loan markets.
- The deluge of regulatory initiatives has required the LMA to increase its lobbying activity both in Europe and the United States.

LMA Intercreditor Agreement

- The European Loan Market Association launched its new recommended form of Intercreditor Agreement in 2009.
- Created in response to demand from members to help lenders to agree intercreditor arrangements more transparently, easily and efficiently.
- With the goal of assisting recovery, during the drafting process, issues arising from some recent restructurings have been taken into account. Form deals with the handling of derivatives in the context of complex transactions.

Choice of Documentation

- The LMA Intercreditor Agreement designed for use with the LMA leveraged facility agreement. Persuasive and useful, but intercreditor arrangements will continue to be negotiated on a deal-by-deal basis according to the specific circumstances.
- Use of LMA standard forms is widespread with investment grade and leveraged suites of documents widely accepted. However, circumstances – e.g. mid-market loans – may involve some debate about what base to start with.
- The common base of the LMA precedents mean that provisions can be taken from one into the other easily. Treatment of ancillary facilities, hedging, mandatory prepayment provisions and general covenants may need to be developed on a case-by-case basis.

LMA Form Limitations

- While the LMA Intercreditor Agreement is gaining recognition as a starting point for negotiations, it does not provide guidance on all issues and leaves room for further discussion.
- Does not always provide sufficient mezzanine protections; criticised for being written from senior perspective.
- March 09 form revised in Nov 09 with notes to draft with enhanced mezzanine rights optionalities, but market conditions have meant that there has been limited market experience with these.
- There are opportunities to negotiate mezzanine position improvement.
- May not apply in all circumstances - e.g., mid-markets/ situations that do not fit within the “leveraged” model. Customization required.

LMA Form Issues

- Ability of security agent to release claims without mezz consent.
- Permitted mezz payments (e.g. various fees) very limited.
- Debt to equity swap not provided for.
- Option to buy-out senior is not provided for.
- Ability to convert senior interest to PIK is permitted.
- Ability to convert mezzanine cash pay to PIK is not typical.
- Framework for right to exercise sponsor's equity cure right (or other cure rights) need to be individually negotiated.
- Cross-default to be individually negotiated.
- Trigger of mezzanine payment stop event – whether auto or not.
- Role of hedge counterparties in decision making.

European Regulation - Loan Issues

- Basel III and the related EU Capital Requirements Directive (to be implemented in the form of CRD 4) are to impose various amendments to the existing capital adequacy regime. These changes, to be implemented between 2013 and 2018, include new leverage, liquidity coverage and net stable funding ratios.
- From LMA intervention, revolving credit facilities for working capital have now been broadly carved out of the liquidity provisions.
- The LMA continues to lobby, particularly with regards to the liquidity coverage and net stable funding requirements, which the market views as likely to have the biggest impact on the loan product.
- The LMA also intends to respond to the FSA's consultation on CRD 3, which includes adoption of the CEBS guidelines in relation to existing Article 122a 'skin in the game' requirements for CLOs.

Senior Secured Bonds

- The most significant development in the European high yield market since the crisis has been the emergence of senior secured bonds. These first appeared in refinancing transactions but more recently have also been used to finance acquisitions.
- Before the credit crisis, European high yield bonds usually ranked junior to the senior bank debt in the capital structure. The bonds were typically structurally subordinated to the senior bank debt and structured to be repayable only after the senior bank debt had been discharged .
- In more recent transactions, the picture has changed dramatically. European senior secured bonds are now commonly issued to sit (US-style) alongside a so-called “super senior” revolving credit facility, or there are variations of structures where the senior bond sits *pari passu* with the bank debt (in fact not subordinated at all).

“Double Luxco” Structures

- So-called “Double LuxCo” structure has evolved in the context of French financings where security enforcement is particularly unfavourable to creditors (e.g. borrower-friendly six month statutory standstill).
- Two LuxCo SPVs inserted above OperatingCo and share pledge taken by TopCo over BottomCo. Enforcement of share pledge takes place outside France.
- Although originally developed for the French market, these structures could be applied in other jurisdictions where security enforcement is difficult (e.g. Spain).

European Legal Developments

Lehman “Flip” Clause Litigation

- So-called “flip” clauses provide that payment obligations to different creditors “flip” in priority following an event of default. These have been routinely used by lenders and investors to mitigate the practical effect on cashflows of an insolvency event of counterparties.
- In Jan 2010, the US Bankruptcy Court ruled that a flip clause was an unenforceable *ipso facto* provision on the grounds that it was triggered by the bankruptcy of LBSF and did not fall within the safe harbour protections of the US Bankruptcy Code.
- Judge Peck’s decision directly contradicted the decisions of the English courts in parallel proceedings which held that the flip clause did not violate the anti-deprivation principle and was therefore enforceable under English law.

UK “Test” Case

- Because of the divergence in the outcome of the UK and US litigation on the *Perpetual Trustee* litigation, *Belmont Park* was the test case to establish the law in the highest court in the U.K., for European deals under English law.
- The potential unenforceability of “flip” clauses in European deals and apparent disparity between US and UK law has created considerable market uncertainty; that uncertainty has now been resolved. The decision of the UK Supreme Court on the *Belmont Park* case was handed down on Wed 27 July.

UK Decision Upheld

- The divergence between the US position and the UK position is now law. Therefore, this is a "game changer" in terms of the lending business: more emphasis will be placed on the jurisdiction under which a payee falls.
- Lenders may prefer English law as the governing law and, where possible, may prefer to avoid contracts with swap or other counterparties that are subject to US bankruptcy laws. Legal opinion assurances may need to be obtained and products will need to be structured to take into account the issue.
- May prompt other litigation in the US to re-examine the "flip" clause issues in that jurisdiction.

English Restructurings of Foreign Borrowers

- Recent High Court case of *Rodenstock GmbH* ([2011] EWHC 1104; [2011] WLR (D) 150) ruled that an English law scheme of arrangement should be sanctioned, despite the fact that the borrower is incorporated in Germany and has its centre of main interests there.
- “Sufficient connection” established by choice of law and jurisdiction clause governing the senior facilities agreement despite the the company having no establishment, or assets likely to be affected by the scheme, in the U.K.
- It is expected that this decision will facilitate future restructurings of European companies in cases where the debt being restructured is governed by English law. Expected that a greater number of foreign companies will accept English law and jurisdiction in documentation.