

The ACT Borrower's Guide
to LMA Loan Documentation
for Investment Grade
Borrowers
Dutch Edition

Produced by

SLAUGHTER AND MAY

and

DE BRAUW
BLACKSTONE
WESTBROEK

December 2010



Introduction to the Dutch Edition

In February 2010, Slaughter and May and the Association of Corporate Treasurers (the “ACT”) published an updated version of the ACT Borrower’s Guide to LMA Loan Documentation for Investment Grade Borrowers (the “Slaughter and May/ACT Guide”).

LMA loan documentation is widely used in the Dutch loan market.

This volume includes the Slaughter and May/ACT Guide plus a Dutch supplement for borrowers operating in the Dutch market, the “Dutch perspective on LMA Loan Documentation for Investment Grade Borrowers” (the “**Dutch Supplement**”).

The Dutch Supplement contains guidance for borrowers reviewing draft facility agreements based on the LMA’s recommended forms and which are being entered into by Dutch Obligor or which are to be governed by Dutch law.

We are grateful to the ACT and to Slaughter and May for permitting us to prepare the Dutch Supplement by reference to the Slaughter and May/ACT Guide.

The comments in the introduction to the Slaughter and May/ACT Guide apply equally to the Dutch Supplement. In particular, it is written in general terms and its application to specific situations will depend on the particular circumstances.

De Brauw Blackstone Westbroek N.V.
December 2010

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The ACT Borrower's Guide to LMA Loan Documentation for Investment Grade Borrowers

Produced by

SLAUGHTER AND MAY

February 2010

This guide has been produced for the ACT by Slaughter and May, to provide assistance for corporate treasurers reviewing draft facility agreements based on the LMA documentation for investment grade borrowers.

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Introduction

The ACT has been involved in the development of the LMA's loan documentation for investment grade borrowers since the project was first launched in 1996.

The LMA was established by a group of banks primarily to foster the development of the secondary loan market. One of the factors hampering the development of this market was, however, the range of differences in the terms of the underlying loan agreements. So the LMA's aim in publishing a form of facility agreement was to promote greater efficiency in both primary and secondary markets.

The recommended forms of investment grade facility agreement (the "**Investment Grade Agreement**") were first published in 1999. The text was settled by a working party of banks and solicitors, and included representatives of both the BBA and the ACT. The ACT has continued to work with the LMA on the revisions of the Investment Grade Agreement since then.

The LMA has not, however, consulted the ACT in relation to all its documentation. For example, the leveraged facilities agreement (the "**Leveraged Facilities Agreement**"), designed for non-investment grade borrowers, has not been agreed by the ACT. The LMA Finance Party Default and Market Disruption Clauses (the "**LMA Market Conditions Provisions**") were not discussed with the ACT prior to publication in June 2009.

This guide to the LMA's documentation for investment grade borrowers is in three parts:

- Part I is an overview of the main commercial issues for corporate treasurers in relation to the Investment Grade Agreement. This includes an introduction to the LMA Market Conditions Provisions, in section 6, which cross-refers to more detailed comments in Part II.
- Part II is a commentary on the provisions of the Investment Grade Agreement.
- Part III comments on some of the LMA ancillary documentation, including the LMA primary and secondary market confidentiality letters.

Terms defined in the Investment Grade Agreement have the same meanings in this guide. The guide refers to the clause numbers in the Investment Grade Agreement. As these are liable to change in a draft prepared for a transaction, the clause name is given as well as the number.

NOTE

This guide is written in general terms and its application to specific situations will depend on the particular circumstances involved. Whilst it seeks to highlight certain issues which are regularly raised by borrowers in relation to the Investment Grade Agreement, it does not purport to address every issue which borrowers could or should raise. It does not necessarily describe the most borrower-friendly approach that may be taken. The observations in this guide relating to market practice may not be appropriate or relevant to all types of transaction. What is achievable in any particular case will depend on a variety of factors, including the identity of the borrower and the lenders, and market conditions. In particular, the guide has been written in the period following the collapse of Lehman Brothers, when the financial markets have been the scene of exceptional difficulties and upheaval, the outcome of which is not yet clear.

Readers should therefore take their own professional advice. This guide should not be relied upon as a substitute for such advice. Although Slaughter and May have taken all reasonable care in the preparation of this guide, no responsibility is accepted by Slaughter and May or any of its partners, employees or agents or by the ACT or any of its employees or representatives for any cost, loss or liability, however caused, occasioned to any person by reliance on it.

Slaughter and May
February 2010

Part I: Overview

The aim of this overview is to help corporate treasurers to form a view on the terms contained in the Investment Grade Agreement. Their view will depend on a variety of factors, including the strength of their company's credit rating, the nature of the transaction in question, and so on. The points set out below fall under the following headings:

1. How to approach the Investment Grade Agreement
2. Transactions for which the Investment Grade Agreement is suitable
3. Key features of the Investment Grade Agreement
4. The alternatives
5. Amendments made to the Investment Grade Agreement in 2009
6. The LMA Market Conditions Provisions
7. Key points left for negotiation or insertion
8. Other LMA documentation

1. HOW TO APPROACH THE INVESTMENT GRADE AGREEMENT

Essential guidance on how to approach the Investment Grade Agreement is set out in a Joint Statement of the LMA, the BBA and the ACT. The Joint Statement is as follows:

JOINT STATEMENT

The recommended form of syndicated facility agreements (the "Primary Documents") were developed by a working party consisting of representatives of the Loan Market Association, the British Bankers' Association, the Association of Corporate Treasurers and major City law firms. It is hoped that the existence of the Primary Documents will facilitate more efficient negotiation of loan documentation for the benefit of primary and secondary loan markets.

Through the involvement of the three associations in the working party, together with the law firms represented, the objective was to balance the interests of borrowers and lenders. In the Primary Documents, financial covenants and related definitions have been deliberately left blank.

When considering use of the Primary Documents it is recommended that borrowers and lenders should:

- *consider the option of continuing to use existing documentation*
- *carefully consider changes to the Primary Documents that may be required*
- *always have the benefit of independent legal advice*

The three associations believe that the Primary Documents will provide a valuable aid to the development and efficiency of the syndicated loan market.

*Kim Humphreys
Chairman
Loan Market Association*

*Ian Mullen
Chief Executive
British Bankers' Association*

*Richard Raeburn
Chief Executive
The Association of
Corporate Treasurers*

Three essential points for treasurers emerge from the Joint Statement:

- ***Use of the Investment Grade Agreement is not mandatory.***
- ***It is a starting point only: the LMA, the BBA and the ACT expect the parties to negotiate changes to its provisions on individual transactions.***
- ***Independent legal advice will be necessary.***

The front page of the Investment Grade Agreement underlines this message, stating: "For the avoidance of doubt, this document is in a non-binding, recommended form. Its intention is to be used as a starting point for negotiation only. Individual parties are free to depart from its terms". Thus, although the Investment Grade Agreement is expressly intended to reflect market practice for a syndicated facility for a borrower with an investment grade credit rating, it will always need to be negotiated, whatever the status of the borrower. Borrowers should not be deterred from negotiating in their own interests.

The LMA Users' Guide to the Primary Documents recommends that the first draft of each loan agreement should be marked-up to show the changes made to the Investment Grade Agreement by the drafting law firm. Receiving a mark-up is very helpful for treasurers, as it is important to be aware of the changes made to the Investment Grade Agreement in the first draft.

2. TRANSACTIONS FOR WHICH THE INVESTMENT GRADE AGREEMENT IS SUITABLE

The Investment Grade Agreement is designed for “plain vanilla” loans to UK corporates. It is available as a single currency or multi-currency term and/or revolving facility or facilities. The revolving facility can incorporate a letters of credit facility and a dollar or euro swingline facility.

The Investment Grade Agreement assumes the following:

- the Borrower has a single A investment grade credit rating;
- the Agent is based in London;
- syndication takes place primarily in London and the euromarkets;
- the Lenders may be banks, financial institutions or a wide range of investment entities;
- there are multiple Borrowers and Guarantors, the main Borrower being a holding company, with some of its Subsidiaries as additional Borrowers and/or Guarantors;
- all the Obligors are companies incorporated in England and Wales;
- no security is provided; and
- English law is the governing law.

The Investment Grade Agreement is however now widely used in different circumstances, including loans which are not “plain vanilla” and/or where the Borrower is not a UK corporate. In such circumstances, it is important to appreciate that although the Investment Grade Agreement may be used as the basis for documentation, substantive amendment will be required.

3. KEY FEATURES OF THE INVESTMENT GRADE AGREEMENT

On the whole, the Investment Grade Agreement reflects market practice for investment grade Borrowers.

The following features of the Investment Grade Agreement might be regarded as standard for investment grade Borrowers, and hence attractive to less powerful credits:

- the Borrower’s consent is required for most loan transfers;

- rollover of revolving facility loans is permitted when a potential Event of Default is outstanding;
- many provisions are qualified by materiality: for example, representations must be true in all material respects when repeated at utilisation;
- similarly, the concept of a Material Adverse Effect is used to soften various provisions, such as the representation as to no litigation;
- the Lenders are required to take reasonable steps to mitigate the effect of certain circumstances on the Borrower (for example the requirement to gross up payments); and
- grace periods and threshold amounts are envisaged, for example in the negative pledge and cross default provisions.

It can however be difficult to negotiate a draft which is presented by Lenders as a market standard, and the following features of the Investment Grade Agreement may be regarded as unattractive by most Borrowers:

- Lenders do not have to be banks or financial institutions: although Borrower consent is required for most transfers, organisations of many kinds can be Lenders;
- the tax gross up provisions are not borrower-friendly, especially where Treaty Lenders are involved;
- there is a very broad tax indemnity;
- the indemnities given to the Lenders and the Agent by the Borrower are extensive;
- the representations, covenants and Events of Default catch not only all the Obligors, but in many cases also their Subsidiaries or the entire Group;
- the negative pledge and covenant against disposals are very restrictive;
- there is a "material adverse change" Event of Default and representation;
- there is a mandatory prepayment on a change of control;
- the set-off provision is very broadly drafted;
- the consent of all Lenders is required for a non-committed currency to become an Optional Currency; and

- the definition of Break Costs does not give the Borrower credit for one day's interest: this is, in effect, a prepayment premium.

4. THE ALTERNATIVES

As mentioned in section 1 above, use of the Investment Grade Agreement is not mandatory. Alternatives include:

- existing loan documentation, updated as necessary; or
- the Investment Grade Agreement, but with the representations, covenants and Events of Default from the Borrower's existing loan documentation substituted; or
- documentation based on a law firm's template. In cases where the law firm is acting for the banks, Borrowers need to be aware that a description of documentation as "LMA compliant" may prove to be misleading: investigation may show that the extent of the "compliance" is limited.

The views that Borrowers will take of these alternatives will naturally depend on their varying circumstances: some will feel more comfortable with their existing documentation or existing Events of Default.

It is not unknown for the Borrower's lawyers to do the drafting, but usually only strong credits are able to persuade the Arranger to agree to this: the Arranger's lawyers usually prepare the first draft. If the Borrower wishes the Investment Grade Agreement to be used, rather than a law firm's version of it, it needs to make this clear at an early stage.

5. AMENDMENTS MADE TO THE INVESTMENT GRADE AGREEMENT IN 2009

The changes to the Investment Grade Agreement made in January and April 2009 were discussed with and approved by the ACT.

The changes made in January 2009 were technical in nature and not contentious. Further changes were made in April 2009. These arose from a review of the Investment Grade Agreement by the LMA and the ACT which had started before the financial crisis.

The chief result of this review was the insertion of an express undertaking by the Lenders to protect the Borrower's confidential information, made at the request of the ACT, together with provisions catering for "public side only" Lenders. Further information on these topics is to be found under Clause 36 (*Confidentiality*), Clause 20 (*Information Undertakings*) and Clause 26.13 (*Relationship with Lenders*).

Other changes were made at the request of the ACT to bring the Investment Grade Agreement in line with some borrower-friendly provisions in the Leveraged Facilities Agreement. These included the insertion of a “yank the bank” provision (Clause 8.6 (*Right of repayment or replacement and cancellation of a single Lender*)), clarificatory drafting changes to the tax provisions (Clause 13 (*Tax*) and Clause 19.7 (*Deduction of Tax*)), the insertion of some standard exceptions to the negative pledge (Clause 22.3 (*Negative pledge*)) and a restriction on the insolvency proceedings Event of Default (Clause 23.7 (*Insolvency proceedings*)).

Other changes were market led, such as the inclusion of a procedure for assignment (Clause 24.6 (*Procedure for assignment*)), an optional provision for Lenders to grant security over their rights (Clause 24.8 (*Security over Lenders’ rights*)), and a procedure for the settlement of interest in relation to transfers made mid-Interest Period (Clause 24.9 (*Pro rata interest settlement*)).

6. THE LMA MARKET CONDITIONS PROVISIONS

The LMA Market Conditions Provisions, which were published in June 2009, include:

- provisions addressing the potential consequences of a Finance Party default; and
- amendments to the market disruption and cost of funds provisions.

As mentioned above, the LMA did not consult the ACT on this new language prior to publication, in contrast to previous practice in relation to investment grade documentation.

The need for provisions of this kind became apparent at the time of the collapse of Lehman Brothers in October 2008, and in its aftermath. Generally speaking, the concepts addressed by the LMA drafting will be familiar to those who have negotiated new or amended loan documentation since then.

Defaulting Lender

The bulk of the new provisions address the consequences of a Lender becoming a “Defaulting Lender”. In outline, a Defaulting Lender is a Lender:

- which fails to fund, or gives notice that it will do so;
- which rescinds or repudiates a Finance Document; or
- in respect of which an Insolvency Event occurs.

Once a Lender becomes a Defaulting Lender, the following provisions are triggered:

- The Borrower can cancel the undrawn Commitment of the Defaulting Lender, which can be immediately or later assumed by a new or existing Lender selected by the Borrower.
- The participation of the Defaulting Lender in the Revolving Facility is automatically termed out and can be prepaid (an optional provision).
- The Defaulting Lender can be forced to transfer its participation in the Facilities to a new Lender at par.
- No Commitment Fee is payable to the Defaulting Lender (an optional provision).
- The Defaulting Lender is disenfranchised to the extent of its undrawn Commitments.
- The identity of a Defaulting Lender may be disclosed by the Agent to the Borrower.

Similar provisions allow an "Impaired Agent" to be removed by Majority Lenders, and for Borrowers and Lenders to make payments direct to each other and communicate directly with each other, rather than through the Impaired Agent.

The proposals addressing the consequences of a Finance Party being in financial difficulty are to be welcomed, although some borrower-friendly adjustment of the detail is likely to be required. Substantive points for Borrowers to address include:

- the omission of a general right to prepay a Defaulting Lender: the Borrower may want the flexibility to prepay rather than have the Defaulting Lender remain in the syndicate with voting rights which it may or may not exercise; and
- the need to amend the definition of Majority Lenders, in the light of the provisions for disenfranchisement of a Defaulting Lender, and to include "snooze and lose" provisions.

Where to find more detailed comments on Defaulting Finance Parties:

Defaulting Lender definition: Clause 1.1 (*Definitions*).

Cancellation of Defaulting Lender's undrawn Commitment, and later assumption by a new Lender: Clause 2.2 (*Increase*) and Clause 8.6 (*Right of replacement or repayment and cancellation in relation to a single Lender*).

Term-out of Defaulting Lender's participation in the Revolving Facility: Clause 7.2 (*Repayment of Facility B Loans*).

No Commitment Fee payable to Defaulting Lender: Clause 12 (*Fees*).

Disenfranchisement of Defaulting Lender to the extent of its undrawn Commitments: Clause 35 (*Amendments and waivers*).

Replacement of Defaulting Lender: Clause 35 (*Amendments and waivers*).

Impaired Agent: Clause 1.1 (*Definitions*).

Market Disruption

Changes have been made to the market disruption provisions which are intended to reduce the likelihood of Lenders charging the Borrower interest at their individual cost of funds. While these changes are generally to be welcomed by Borrowers, more detailed issues are discussed under Clause 11 (*Changes to the calculation of interest*).

Cost of funds

In addition, the LMA has amended the definitions of LIBOR/EURIBOR so that the parties have the option of using Reference Bank rates from the outset, rather than BBA LIBOR/EURIBOR as published on screen. The optional abandonment of screen-based LIBOR in favour of a Reference Bank rate is not expected to find much favour with Borrowers generally. For further discussion, please see Clause 9 (*Interest*).

7. KEY POINTS LEFT FOR NEGOTIATION OR INSERTION

Key points which are left by the LMA for negotiation or insertion by the parties include:

Repayment, pricing and fees

Clause 7 (*Repayment*) is left largely blank for the parties to insert the provisions they have agreed.

The Investment Grade Agreement is drafted on the basis that there will be a fixed Margin which will be specified in Clause 1.1 (*Definitions*). Provision is made for a margin ratchet only in the Leveraged Facilities Agreement.

In the LMA Market Conditions Provisions, the LMA offers the parties the option of using Reference Bank rates from the outset rather than BBA LIBOR/EURIBOR as published on screen. This is discussed in more detail in Clause 9 (*Interest*). The screen rates are however expected to remain the standard choice.

Clause 12 (*Fees*) provides only for a commitment fee, while contemplating that arrangement and agency fees will be dealt with (as is usual) by letter.

Tax

Treaty Lenders are now routinely included in syndicates, in contrast to the position ten years ago. This is a welcome development from the point of view of liquidity, but entails a greater risk of withholding tax and grossing up. The negotiation of the definition of a Treaty Lender, which is required in Clause 13 (*Tax*), is critical in determining the extent of risk allocated to Borrowers.

Syndicate composition

Borrowers need to balance carefully their concerns about liquidity and pricing against the different risks presented by various categories of Lender. As mentioned above, Treaty Lenders present greater tax risks than UK bank Lenders. Non-bank Lenders may present relationship-type challenges which can be critical in the context of a request for a waiver or amendment. Lender default is a risk which has been in the spotlight since the collapse of Lehman Brothers.

Borrowers should consider the degree of control that they need to manage these risks, weighing them up against their need for funding and their concerns about pricing. Various tools are available, providing some protection against the different risks. The new LMA provisions dealing with a defaulting Finance Party are discussed in section 6 above. Other protective tools are to be found in Clause 24 (*Changes to the Lenders*), which defines the class of permitted Lender and requires the Borrower's consent for transfers. However, other provisions which can be effective in this context are the limitations on the gross up entitlement (see Clause 13 (*Tax*)), as well as "yank the bank" and "snooze and lose" provisions, discussed below under Clauses 8.6 (*Right of replacement or repayment and cancellation in relation to a single Lender*) and 35 (*Amendments and waivers*).

Financial covenants

Although the Investment Grade Agreement does not contain any financial covenants, the LMA does publish a set of pro forma stand-alone financial covenants, which are

based on the financial covenants set out in the Leveraged Facilities Agreement. These may be used as a starting point for discussion, but always require tailoring on a case-by-case basis. For more guidance on the LMA financial covenant provisions, please see the ACT Borrower's Guide to the LMA Leveraged Facilities Agreement.

Representations, covenants and Events of Default

The Investment Grade Agreement includes a set of basic representations, covenants and Events of Default: it is anticipated that adjustments will be required on a case-by-case basis, including not only additional provisions but also exceptions. In the current climate, Lenders are seeking tighter provisions generally. Main points for focus include:

- Scope: the representations, covenants and Events of Default cover not only Obligor but also, in many cases, all Group members. Often it will be appropriate to limit the scope of these provisions, for example to Subsidiaries or Material Companies (defined appropriately). Another issue requiring negotiation on a case-by-case basis is the list of representations which are to be repeated (Clause 19.14 (*Repetition*)).
- Materiality: though many provisions are qualified by reference to materiality, Borrowers usually feel that other provisions also require this sort of restriction. In addition, the parties will need to settle the definition of Material Adverse Effect.
- Clauses 22.3 (*Negative pledge*) and 22.4 (*Disposals*) are very restrictive but include blank provisions anticipating that the parties will negotiate further exceptions.
- Grace periods and thresholds: Clause 23 (*Events of Default*) anticipates that the parties will agree grace periods (for example in relation to non-payment) and threshold amounts (for example in relation to cross-default). Grace periods and threshold amounts have tightened generally since the credit crunch.
- Material adverse change Event of Default: Clause 23.12 (*Material Adverse Change*) is left blank for the parties to settle their own provision. However, many investment grade Borrowers continue (even since the credit crunch) to resist an Event of Default on this topic, while conceding a non-repeating representation that there has been no material adverse change since the most recent accounts date at the time of signing (Clause 19.11(c) (*Financial Statements*)).

8. OTHER LMA DOCUMENTATION

The LMA has published a number of other documents for use in connection with loan transactions, such as Confidentiality Letters, comments on which are set out in Part III of this guide. It is important to be aware that the LMA has generally not involved the ACT in these projects.

The ACT is also not consulted about the Leveraged Facilities Agreement, designed for non-investment grade Borrowers. For guidance on this, please see the ACT Borrower's Guide to the LMA Leveraged Facilities Agreement.

Versions of the Investment Grade Agreement designed to be governed by French and German law are available to LMA members on the LMA website, <http://www.loan-market-assoc.com>.

Part II: Commentary on The Investment Grade Agreement

This commentary is tailored for use with the multi-currency term and revolving facilities version of the Investment Grade Agreement, though it can also be used with any of the others, since they are the same in all but essential mechanics. Clause references are to the multi-currency term and revolving facilities version of the Investment Grade Agreement.

PARTIES

The parties are envisaged to be as follows:

- The Company is the holding company for the Group, and is usually a Borrower and a Guarantor.
- Named subsidiaries are Original Borrowers and Original Guarantors.
- The Obligor(s) are the Company, the Borrowers and the Guarantors.
- The Arranger(s) is/are the mandated lead arranger(s).
- The Original Lenders are the banks and financial institutions listed in Schedule 1.
- The Agent is appointed agent for the Finance Parties, which are the Arranger, Agent and Lenders.

CLAUSE 1: DEFINITIONS AND INTERPRETATION

Clause 1.1: Definitions

In this guide, most definitions are discussed in the context in which they are used in the Investment Grade Agreement. Definitions requiring focus at the outset are as follows:

“Business Day”

Please see comments under Clause 5.1 (*Delivery of a Utilisation Request*).

“Default”

Events of Default are defined in Clause 23 (*Events of Default*).

A Default is an Event of Default or any event or circumstance specified in Clause 23 which would be an Event of Default with the expiry of a grace period or the giving of

notice or the making of any determination under the Finance Documents. A Default thus includes both an Event of Default and events which used to be labelled Potential Events of Default.

“Defaulting Lender”

A Defaulting Lender is defined (in outline) in the LMA Market Conditions Provisions as a Lender:

- which fails to fund, or gives notice that it will do so;
- which rescinds or repudiates a Finance Document; or
- in respect of which an Insolvency Event occurs.

Once a Lender becomes a Defaulting Lender, the following provisions are triggered:

- The Borrower can cancel the undrawn Commitment of the Defaulting Lender, which can be immediately or later assumed by a new or existing Lender selected by the Borrower. For more, see Clause 2.2 (*Increase*) and Clause 8.6 (*Right of replacement or repayment and cancellation in relation to a single Lender*).
- The participation of the Defaulting Lender in the Revolving Facility is automatically termed out and can be prepaid (an optional provision). See Clause 7.2 (*Repayment of Facility B Loans*).
- No Commitment Fee is payable to the Defaulting Lender (an optional provision). See Clause 12 (*Fees*).
- The identity of a Defaulting Lender may be disclosed by the Agent to the Borrower.
- The Defaulting Lender is disenfranchised to the extent of its undrawn Commitments. See Clause 35 (*Amendments and waivers*).
- The Defaulting Lender can be forced to transfer its participation in the Facilities to a new Lender at par. See Clause 35 (*Amendments and waivers*).

These concepts have, to varying degrees and in varying formulations, been addressed in many loan transactions documented since the financial crisis.

Borrower Notes

Substantive points for Borrowers to address in relation to Defaulting Lenders include:

- the omission of a general right to prepay a Defaulting Lender: the Borrower may want the flexibility to prepay rather than have the Defaulting Lender remain in the syndicate with voting rights which it may or may not exercise. The right to prepay, which is widely accepted in the market, is discussed under Clause 8.6 (*Right of replacement or repayment and cancellation in relation to a single Lender*); and
- the need to amend the definition of Majority Lenders, in the light of the provisions for disenfranchisement of a Defaulting Lender, and include “snooze and lose” provisions. See Clause 35 (*Amendments and waivers*).

Recent deals have conformed to the LMA definition of a Defaulting Lender, though some banks (a minority) have refused to accept the insolvency limb to the definition. As a result, this element is presented as an option in the LMA’s drafting.

Points to note include the following:

- A Lender will not become a Defaulting Lender as a result of failure to fund where this is caused by administrative or technical error, or a Disruption Event (disruption to payment or communications systems or technical/systems failures beyond a party’s control). In these cases, there is a grace period for payment. This is similar to the carve-out to the non-payment Event of Default applicable to Borrowers. The length of the grace period is to be settled between the parties. Deals have featured periods of between three and ten Business Days. In contrast to the Events of Default which are applicable to Borrowers, the non-payment limb of the Defaulting Lender definition also features a carve-out where the Lender is disputing in good faith whether it is contractually obliged to pay.
- The LMA definition of an Insolvency Event is based on the ISDA “Bankruptcy” event of default. This is broad and protects the Borrower against a wide range of insolvency-type events. A notable addition is the inclusion of a reference to the exercise of the new powers under the Banking Act 2009 (the stabilisation options, bank insolvency or bank administration). This provision may not, however, achieve the desired result in practice since contractual provisions triggered by an exercise of the Banking Act powers can be disapplied when the powers are exercised.

- There is no obligation on the Defaulting Lender to notify the Borrower upon becoming aware of its Defaulting Lender status. There is also no obligation on the Agent to notify the Borrower if it becomes aware that a Lender is a Defaulting Lender. One might take the view that a notification obligation is unnecessary, as the various limbs of the definition will, of themselves, mean that the Borrower will become aware at some point that the Lender is a Defaulting Lender. It is interesting to note, however, that in the context of the Letter of Credit provisions, where the same point could be made, the LMA thought it necessary (for the benefit of the Issuing Bank) for each Lender to confirm whether or not it is a “Non-Acceptable L/C Lender” on the date it joins the syndicate, and to notify it subsequently upon becoming aware that it has become a Non-Acceptable L/C Lender. Borrowers may therefore seek a similar confirmation/notification obligation in relation to Defaulting Lender status.

“Financial Indebtedness”

The function of this definition in the Investment Grade Agreement is essentially to capture all kinds of indebtedness owed to banks, for the purposes of the negative pledge (Clause 22.3) and the cross-default clause (Clause 23.5). As a result, Borrowers often seek a general exclusion for intra-group debt and debt incurred in the ordinary course of trading.

Borrowers will need to give detailed consideration to the ways in which this definition is used in the draft agreement presented to them. For example, a narrower version of the definition may be required for the purposes of financial covenants, if the facility agreement includes these (see for example the definition of “Borrowings” in the Leveraged Facilities Agreement).

Moneys borrowed

Paragraph (a) is very broad, covering any obligation to pay in relation to moneys borrowed. This includes all borrowings, overdraft and otherwise, whether the creditor is another member of the Group or a bank or other financial institution.

Acceptance credits etc

Paragraph (b) catches payment obligations in relation to bills of exchange accepted under an acceptance credit facility, or dematerialised equivalent.

Bonds etc

Paragraph (c) includes the issue of bonds, debentures, medium term notes, commercial paper and so on.

Borrower Notes

Leasing

Paragraph (d) catches indebtedness under any lease or hire purchase arrangement treated as a finance or capital lease for accounting purposes. Under IAS 17, some leases which would have been off balance sheet under UK GAAP, as operating leases, will be on balance sheet as finance leases. An exception is however commonly made for finance leases of vehicles, plant, equipment and computers, sometimes with a fixed upper limit. The Leveraged Facilities Agreement contains this carve-out.

Discounting or factoring on recourse terms

Paragraph (e) catches receivables discounting and debt factoring on recourse terms. Receivables discounting and debt factoring on recourse terms often take the form of an assignment of debts, in return for a price paid to the Borrower. The bank's or factor's recourse to the Borrower may take the form of either a guarantee by the Borrower for the payment of the debts, or of the Borrower's undertaking to buy the debts back if they are not paid within a fixed period.

Receivables sold or discounted on a non-recourse basis are excluded. Non-recourse receivables financing can take a variety of forms, the most straightforward of which involves an outright sale (or assignment) of the receivables by the Borrower, in return for a cash advance; if the debtors fail to pay, the finance house has no recourse to the Borrower: its only claim is against the debtors. However, many "non-recourse" discounting or factoring arrangements involve recourse in certain circumstances, such as where the receivable is invalid or the counterparty has a right of counterclaim or set-off. As a result, it may be advisable to clarify the meaning of "non-recourse" for the purposes of this definition, to ensure that any proposed transactions fall within the exclusion.

Any amount raised having "the commercial effect of a borrowing"

Paragraph (f) is broadly drafted, to encompass any indebtedness (as defined) in respect of any amount raised under any other transaction which has "the commercial effect of a borrowing". Although this language is widely used, Borrowers may prefer the more specific alternative set out in the Leveraged Facilities Agreement, which requires the transaction to be classified as a borrowing for the purposes of GAAP.

A wide range of transactions can be caught by this paragraph, including for example forward purchases and sales of currency and repo arrangements. Conditional and credit sale arrangements could also be covered here. Under IAS 39, redeemable preference shares may be treated as liabilities. The definition of Financial Indebtedness in the Investment Grade Agreement does not specifically refer to them, but it is arguable that they could in certain circumstances qualify as “transactions having the commercial effect of a borrowing”. In the Leveraged Facilities Agreement, redeemable shares specifically qualify as Financial Indebtedness in certain circumstances. If the Borrower has redeemable preference shares, therefore, it may be best to deal with them specifically for the sake of clarity. It is usually agreed that they should not be included unless they are redeemable (other than at the option of the issuer) prior to maturity of the facility and classified as liabilities for the purposes of GAAP.

Derivatives

Paragraph (g) catches derivatives transactions, requiring their marked to market value (“fair value”) to be included in the Financial Indebtedness calculation, whether their purpose is “protection” or “benefit” from movements in a rate or a price, and so covers arbitrage as well as hedging.

Derivatives are usually excluded from the borrowings calculation for the purposes of the financial covenants (see for example the definition of Borrowings in the Leveraged Facilities Agreement), because of the volatility that their inclusion at fair value introduces into the calculation. It is more difficult for Borrowers to exclude them from Financial Indebtedness, the function of which is to cover all types of financing indebtedness relevant to the operation of provisions such as the cross-default and negative pledge. However, if the definition of Financial Indebtedness is used to define a threshold or limit (for example, if the facility agreement restricts the amount of Financial Indebtedness which may be incurred by the Borrower), the inclusion of derivatives at fair value may be a concern, and Borrowers may seek to delete the paragraph, or limit its application, so that it does not apply where the definition is used to set a limit or threshold. Borrowers may argue that inclusion at market value does not reflect the effectiveness of the hedge. The argument for exclusion is particularly strong in relation to derivatives which qualify for hedge accounting: if hedge accounting applies, the fair value should be deemed to be nil.

Counter-indemnity obligations

Paragraph (h) covers a company’s obligations to a bank or other financial institution which issues guarantees, bonds, letters of credit or other instruments on its behalf. The equivalent paragraph in the Leveraged Facilities Agreement is narrower.

Guarantee or indemnity for any of the above

Paragraph (i) covers the amount of any guarantee or indemnity given in support of any of the arrangements described above.

“GAAP” and “IFRS”

Please see comments under Clause 19.11 (*Financial Statements*).

“Impaired Agent”

The LMA Market Conditions Provisions include clauses designed to protect the Borrower and the Lenders against the risk that an Agent may get into financial difficulty.

These clauses apply when the Agent comes within the definition of an “Impaired Agent”. This is similar to the concept of a Defaulting Lender, discussed above. An Impaired Agent is, in outline, an Agent:

- which fails to make a payment required under the Finance Documents;
- which rescinds or repudiates a Finance Document;
- which is a Defaulting Lender; or
- in respect of which an Insolvency Event occurs.

If an Agent becomes an Impaired Agent:

- Majority Lenders can remove it, after consultation with the Borrower, by appointing a replacement Agent (new Clause 26.12 (*Replacement of the Agent*)).
- Lenders and the Borrower can make payments to each other direct, instead of through the Agent. Alternatively, payment can be made to a trust account in the name of the person making the payment, for the benefit of the payee (new Clause 29.5 (*Impaired Agent*)).
- Notices and communications can be made directly between the parties (new Clause 31.5 (*Communication when Agent is Impaired Agent*)).

“Majority Lenders”

This definition will need amendment in the light of the LMA Market Conditions Provisions (if these provisions are included). Please see comments on Clause 35 (*Amendments and Waivers*) and Clause 7.2 (*Repayment of Facility B Loans*).

“Material Adverse Effect”

Please see comments under Clause 19 (*Representations*).

“Quotation Day”

Please see comments under Clause 9.1 (*Calculation of interest*).

“Repeating Representation”

Please see comments under Clause 19.14 (*Repetition*).

“Rollover Loan”

Please see comments under Clause 2.1 (*The Facilities*).

“Subsidiary” and “Group”

The parties need to select an appropriate definition of Subsidiary, choosing between the statutory definitions of a “subsidiary” and a “subsidiary undertaking”; the latter includes a wider range of entities. The importance of the definition of a Subsidiary in the Investment Grade Agreement is that it is used in the definition of a Group, which then determines which companies are caught by many of the representations, covenants and Events of Default. Borrowers will wish to use the definition which captures only subsidiaries and not subsidiary undertakings. This is usually accepted.

Borrower Notes

The Lenders may say that every subsidiary undertaking should be included in the Group for the purposes of the facilities agreement, as their accounts will have to be consolidated with those of the parent undertaking, but the Borrower may take the view that it does not follow that every subsidiary undertaking should be included in the Group for the purposes of all the representations, covenants and Events of Default. Particular care needs to be taken where the Borrower has a subsidiary undertaking over which it cannot exercise full control. One possible solution may involve one set of definitions for the information and financial covenants, and another for the rest of the facilities agreement.

Clause 1.2: Construction

Borrower Notes

Paragraph (d) defines the meaning of “continuing” in the context of Defaults and Events of Default. There are two options here. Borrowers will want an Event of Default to be defined as “continuing” if it has not been remedied or waived. The question of whether or not an Event of Default is continuing arises for example in Clause 23.13 (*Acceleration*), where the Agent has the discretion to declare all Loans immediately due and payable, if there is an Event of Default which is “continuing”. If “continuing” is defined so that the Event of Default is continuing unless it has been waived, then the fact that it may have been remedied is of no consequence, if a waiver has not been granted: the Agent would still have the right to accelerate on the basis of an Event of Default, even though it had then been remedied. This is unacceptable to Borrowers. Utilisations are likewise dependent on there being no Default which is “continuing” (Clause 4.2 (*Further conditions precedent*)). Borrowers continue (even since the credit crunch) routinely to obtain the more favourable version, whether or not they are investment grade.

Clause 1.3: Third Party Rights

The Contracts (Rights of Third Parties) Act 1999 (the “CRTPA”) reformed the common law rule of privity of contract under which a person could only take action to enforce a contract if he was a party to it. The CRTPA gives a person who is not a party to a contract (a “third party”) the right to enforce that contract, broadly speaking, if either the contract expressly so provides, or the contract purports to confer a benefit on him, and the parties intend him to be able to enforce it.

Borrower Notes

The Investment Grade Agreement offers a choice. The first option excludes the CRTPA completely: this will be preferable for Borrowers, who will not want any person except the Finance Parties to have rights against them. The second option excludes the CRTPA in part, so that, for example, the employees of the Agent can rely on the exemption from liability provided by Clause 26.9 (*Exclusion of liability*).

CLAUSE 2: THE FACILITIES

Clause 2.1: The Facilities

The Investment Grade Agreement provides for two Facilities.

Facility A is a term facility (the “**Term Facility**”): once a Loan is repaid, it may not be re-drawn. Repayment may be in instalments or in full at the end of the life of the Facility, at the Termination Date. Interest is payable on the last day of each Interest Period. Borrowers have the option to switch the currency of a Term Facility Loan to a different currency at the start of each Interest Period. Borrowers can also elect to treat a Term Facility Loan as divided into two or more Loans.

Facility B is a revolving facility (the “**Revolving Facility**”): each Loan can be re-drawn at the end of its term, as long as (amongst other things) the total amount outstanding does not then exceed the amount of the Facility. The term of each Revolving Facility Loan is its Interest Period. Repayment is achieved either by scheduled reductions in the total amount of the Facility over time, or by all outstanding Loans being repaid on the Termination Date. Borrowers can select the currency of each Loan. A Revolving Facility Loan made to refinance another Revolving Facility Loan which matures on the same date as the drawing of the second Revolving Facility Loan is known as a Rollover Loan, if its amount is not greater than the first one and it is in the same currency and drawn by the same Borrower; the conditions for drawing a Rollover Loan are less onerous than for other Loans.

Clause 2.2: Increase

This is a new provision, put forward in the LMA Market Conditions Provisions as part of the package of provisions to cater for a Defaulting Lender. For an introduction to this topic, please see section 6 of Part I.

The procedure envisaged would allow the Borrower to cancel the undrawn Commitment of a Defaulting Lender, and arrange for that undrawn Commitment to be assumed by a new or existing Lender of its choice.

Borrower Notes

Some points of detail which may be unattractive to Borrowers in the proposed procedure for the assumption of the cancelled Commitments by a new Lender are as follows:

- The right to insert another Lender may (optionally) be limited in time to an agreed number of Business Days following cancellation. It could take weeks or even months to find another Lender.

- The LMA proposal envisages (optionally) that the new Lender must be approved by the Agent, albeit “acting reasonably”. This is not justified. Agent approval is not required for:
 - > secondary market purchases (including where the purchased Commitment is not fully drawn); nor
 - > for the replacement of a Lender where the Borrower has been required to gross up payments for withholding tax, or to pay increased costs.
- The new Lender cannot be a member of the Borrower Group. Borrowers may seek to resist this limitation if they want the flexibility to buy back their own debt, were it to trade below par.
- The Agent may (optionally) be entitled to a fee from the Borrower, together with its costs and expenses (including legal fees). The mechanics for the introduction of another Lender in this scenario are not more onerous than those applicable on a change in Lender of record following a secondary market purchase, so the need for the fee and indemnity for costs is not clear.
- No provision is made for the payment of a fee by the new Lender to the Agent, which would usually be the case on a secondary market transfer, but the provisions do (optionally) contemplate a fee payable by the Borrower to the new Lender.

This new right to arrange for a new or existing Lender to assume an undrawn Commitment applies not only where the cancelled Commitment is that of a Defaulting Lender, but also where it is cancelled due to illegality. Borrowers may take the view that if they are required to gross up payments for withholding tax or to pay increased costs, they should also in those circumstances be entitled to arrange for the Commitment of the affected Lender to be assumed by another Lender.

CLAUSE 4: CONDITIONS OF UTILISATION

Clause 4.1: Initial conditions precedent

Before the first utilisation, the Obligors must provide all the items listed in Part 1 of Schedule 2 to the Agent, in form and substance satisfactory to it. The Agent needs to know that they have the corporate capacity and all necessary authorisations to enter into the Agreement, borrow, guarantee and so on.

Borrower Notes

Borrowers commonly seek to ensure that the Agent should act reasonably in forming a view as to whether the documents provided are satisfactory in form and substance.

Clause 4.2: Further conditions precedent

These are additional tests that must be satisfied for any Utilisation to be made.

Paragraph (i) provides that, in the case of all Loans except Rollover Loans, no Default must be continuing or going to result from the Loan. This is standard for investment grade Borrowers, though (as discussed under Clause 1.2 (*Construction*)) it is important to ensure that the meaning of an Event of Default “continuing” is that it is “not remedied or waived”. Please see the comments under Clause 1.1 (*Definitions*) on the meaning of Default (in traditional terms, a potential or actual Event of Default).

The test is less onerous for Rollover Loans, which can be drawn even if there is (in traditional parlance) a potential Event of Default continuing or going to result from the Loan. Please see the comments on Clause 2.1 (*The Facilities*) in relation to Rollover Loans.

Borrower Notes

Investment grade Borrowers usually obtain the concession entitling them to draw a Rollover Loan where a potential Event of Default is outstanding, although it can be argued that the Lenders should not advance funds if a potential Event of Default is outstanding.

On rare occasions in the past, very strong credits have argued that Rollover Loans should be advanced even if there is an actual Event of Default outstanding, on the basis that the Lenders’ remedy in that situation is their right to accelerate: until the decision is taken to accelerate, the Rollover Loan should be advanced, because it does not increase the amount outstanding; also, if it is not advanced, the Borrower may be likely to default on the repayment which is due.

Paragraph (ii) provides that, in addition, the Repeating Representations must be true in all material respects. This is acceptable provided that the Borrower is satisfied that the representations selected as the Repeating Representations - see comments on Clause 19 (*Representations*) - can properly and safely be repeated on each Utilisation. The qualification “in all material respects” is important comfort for the Borrowers.

Clause 4.3: Conditions relating to Optional Currencies

Borrowers may feel that the criteria set out here for a currency to qualify as an Optional Currency are rather restrictive: the currency in question has either to be listed at the outset, or approved by all (not just Majority) Lenders; in addition, it must be readily available and freely convertible.

Borrower Notes

A list of committed Optional Currencies is usually helpful for Borrowers, though it can lead to difficulties in syndication, depending on the currencies in question and the institutions which have been approached by the Arranger. If a Borrower wishes to draw any other currency, it will not qualify as an Optional Currency until the consent of all the Lenders has been obtained. This may entail delay at the time of the proposed drawing, and means that a single Lender can block the availability of a currency. Borrowers may also feel that, in the case of sterling, US dollars and euro, the Lenders do not need the additional stipulation that the currency should be readily available and freely convertible. They can point out that, in the event of an Optional Currency not being available, the Lenders have the protection provided by Clause 6.2 (*Unavailability of a currency*) (see below).

CLAUSE 5: UTILISATION

Clause 5.1: Delivery of a Utilisation Request

The form of Utilisation Request is set out in Schedule 3. The last time for delivery of a Utilisation Request is often set as follows:

- Drawings other than in euro or sterling: 3 pm on the third Business Day before the Utilisation Date;
- Drawings in euro: 3 pm on the third Target Day beforehand; and
- Drawings in sterling: 3 pm on the Business Day beforehand.

The length of notice required depends on syndicate size and logistics.

Borrower Notes

A "Business Day" requires banks to be open for general business in London and the home financial centre of the Base Currency. In relation to any date for payment in any other currency, banks must also be open in the home financial centre of the currency in question.

A "TARGET Day" is any day on which TARGET2 is open for the settlement of payments in euro. TARGET is open on all weekdays every year except New Year's Day, Good Friday, Easter Monday, 1 May, Christmas Day and 26 December. Note that this means TARGET is open on the last Mondays in May and August, which are bank holidays in England, but closed on 1 May, which is not a bank holiday in England, unless it falls on a Monday.

Clause 5.2: Completion of a Utilisation Request

Note that although only one Loan may be requested in each Utilisation Request, there is no limit on the number of Requests that may be made on any one day, subject to the limit on the number of Loans outstanding at any one time (see Clause 4.4 (*Maximum number of Loans*)).

CLAUSE 6: OPTIONAL CURRENCIES

Clause 6.1: Selection of currency

Borrowers have to select the currency of a Loan in the Utilisation Request, when drawing a Loan, or in a Selection Notice, in relation to Interest Periods after the first one in the case of a Term Facility Loan. If a Borrower does not issue a Selection Notice in relation to a Term Facility Loan, it will remain denominated in the same currency for the next Interest Period.

Clause 6.2: Unavailability of a currency

This sets out the circumstances in which a Lender is not obliged to lend in the Optional Currency requested: either the Optional Currency is not readily available, or lending in it would be illegal. In this situation, the Lender is obliged to lend in the Base Currency instead.

The Borrower can be notified about unavailability or illegality up to a specified time on the Quotation Day (often 10 am).

Clause 6.3: Change of currency

The mechanism for currency-switching of Term Facility Loans is set out here.

The "Base Currency Amount" of any Loan is fixed at Utilisation. It does not change subsequently, except to the extent that the Loan is repaid or prepaid or consolidated or sub-divided. It is fixed by reference to the Agent's Spot Rate at 11 am on the third Business Day before Utilisation.

As a result, if a Borrower delivers a Selection Notice requesting that a Term Facility Loan should be denominated in a different currency for the next Interest Period, and that currency is an Optional Currency, the amount of that Loan for the next period will be the amount of the Optional Currency equal on the Quotation Date for that period to the Base Currency Amount for that Loan (paragraph (a)(i)).

Paragraphs (a)(iii) and (iv) set out the mechanics. The Borrower has to repay the Loan in the first currency, and the Lenders have to advance it in the new currency, although they can agree (paragraph (b)) that instead the Agent will use the funding provided by the Lenders in the new currency to purchase an amount in the old currency to satisfy the Borrower's obligation to repay. Paragraphs (c) and (d) then provide that if there is a shortfall, the Borrower must make up the difference in the old currency; and if there is a surplus, in the new currency, the Agent must pay it to the Borrower.

Note that, under paragraph (a)(iv), the currency-switching is subject to the same conditions precedent as a new Utilisation, and so will not take place if there is a Default continuing or any Repeating Representation is not true in any material respect. See comments on Clause 4.2 (*Further conditions precedent*) above.

Clause 6.4: Same Optional Currency during successive Interest Periods

Where a Term Facility Loan is to remain denominated in the same Optional Currency for two successive Interest Periods, the Agent is required to calculate the amount of the Loan in the Optional Currency for the second period: this will be the amount in the Optional Currency equal on the Quotation Date for the second period to the Base Currency Amount which was fixed at the time of the original Utilisation. If the amount in the Optional Currency for the second period is less than it was for the first, the Borrower is required to repay the difference (paragraph (a)(i)); if more, the Lenders must pay the difference (paragraph (a)(ii)). However, if the amount of the increase or reduction is less than a specified percentage of the Base Currency Amount (often 5%), the provision does not apply (paragraph (b)).

Optional language in paragraph (a)(ii) requires the parties to settle before signing whether the Lenders' obligation to pay the difference will be subject to there being no actual Event of Default continuing, or no Default (ie no actual or potential Event of Default) continuing. Borrowers will prefer the former, which was the position under the Investment Grade Agreement until November 2001. Borrowers may also ask that the drawdown of additional funds should be optional in this situation: they may not always want these additional funds.

CLAUSE 7: REPAYMENT

Please see the comments above on Clause 2 (*The Facilities*) regarding the nature of the Term and Revolving Facilities.

Clause 7.2: Repayment of Facility B Loans

A Facility B Loan (being a loan under the Revolving Facility) is repaid on the last day of its Interest Period. This raises particular issues for Borrowers where there is or may be a Defaulting Lender, and so the LMA Market Conditions Provisions (see section 6 of Part I for an introduction) cater here for:

- the term-out of Revolving Loans made by a Defaulting Lender, and
- cashless rollovers under the Revolving Facility.

Term-out of Revolving Loans made by Defaulting Lender

Under the LMA Market Conditions Provisions, the participation of a Lender in a Revolving Facility will be automatically termed out if it becomes a Defaulting Lender; this is an optional provision. It means that Revolving Facility advances, instead of becoming due at the end of each Interest Period, will not be due to be repaid until the last day of the Revolving Facility Availability Period or the Termination Date (whichever is selected). These advances are then known as “Separate Loans”, on which interest accrues during Interest Periods selected by the Borrower. Separate Loans can be prepaid.

Borrower Notes

Where the optional term-out provision is included, other provisions in the Investment Grade Agreement will require amendment to deal with the consequences of a Defaulting Lender remaining in the Facilities:

- The termed-out Defaulting Lender will retain voting rights in respect of its drawn Commitments. The definition of “Majority Lenders” in the Investment Grade Agreement will need to be amended to avoid the possibility of the voting power of the Defaulting Lender being dominant in a situation where the Revolving Facility is undrawn save for the termed-out loan (or otherwise where, following the term-out, the Lenders’ outstandings cease to be pro rata). This issue arises because the definition of “Majority Lenders” in the Investment Grade Agreement operates by reference to drawn Commitments. The issue does not arise in relation to the Leveraged Facilities Agreement, where the definition of Majority Lenders is different and operates on the basis of “Total Commitments”, which encompasses both drawn and undrawn Commitments. As a result, it is suggested that Borrowers using the Investment Grade Agreement should adopt the definition of Majority Lenders used in the Leveraged Facilities Agreement and make consequential amendments. Please also see the discussion on this topic at Clause 35 (*Amendments and waivers*).

- Borrowers may wish to incorporate “snooze and lose” provisions (included in a limited form in the Leveraged Facilities Agreement but not in the Investment Grade Agreement), to operate generally, but in particular in conjunction with the term-out mechanic.
- Borrowers should check that their other financing documentation does not contain cross-default or even insolvency Events of Default which could be triggered by the operation of the term-out mechanic.

Cashless rollovers

Experience in the wake of the collapse of Lehman Brothers highlighted a potential risk for a Borrower in relation to a revolving facility. This arises at the end of each interest period when there is a rollover.

It is market practice for revolving advances to be rolled over by book entry, without any cash payment. However, prior to the financial crisis, loan documentation did not make express provision for this to happen automatically. The concern for a Borrower is that the liquidator or other insolvency officer appointed to a Defaulting Lender might insist on repayment of the existing advance in cash, and then refuse to fund the new advance.

As a result, loan documentation signed since the financial crisis has often included a provision of the kind put forward by the LMA. This makes clear that where a revolving facility advance is to be made to refinance another revolving advance which (i) is due for repayment on the same day as the new advance is to be made and (ii) involves the same Borrower and the same currency, the advances will be netted to the extent possible, leaving cash payments to be made by either Lenders or Borrowers to the extent of the excess, if any.

CLAUSE 8: PREPAYMENT AND CANCELLATION

Clause 8.1: Illegality

If it becomes unlawful for a Lender to lend, the Borrowers must prepay, and the Lender’s Commitment is cancelled.

Borrower Notes

Borrowers may wish to extend this Clause, so that if it becomes unlawful for a Lender to lend, the Borrower may, instead, replace the Lender (see comments on Clause 8.6 (*Right of replacement or repayment and cancellation in relation to a single Lender*)). Borrowers can replace a Lender in these circumstances under the Leveraged Facilities Agreement.

Clause 8.2: Change of control

This Clause provides, in outline, that a change of control of the Borrower can trigger the cancellation of Commitments and mandatory prepayment of outstanding Loans, as well as potentially operating as a drawstop. Cancellation and prepayment can either be on a Lender by Lender basis, or a Majority Lender decision.

Borrower Notes

It is preferable for Borrowers to have this provision in Clause 8 (*Prepayment and cancellation*), rather than as an Event of Default, where it could potentially trigger the cross-default provisions in other debt documentation if it were exercised.

Borrowers often express legitimate concerns about there being a change of control prepayment, though it has become almost universally adopted. Even Lenders to a strong Borrower usually take the view that their assessment is based on its current ownership, so that any change in control should trigger at least the right to prepayment and cancellation. Borrowers, on the other hand, say that they cannot control the identity of their shareholders, and still less know who is acting in concert with them. The directors may also not be able to satisfy themselves that a change of control provision is in the company's best interests, or most likely to promote the success of the company for the benefit of its members as a whole. Particular concerns arise for listed companies, in the light of Rule 21 of the Takeover Code, which requires shareholder consent for certain board decisions (so-called "poison pills"). As a result, although in recent years investment grade Borrowers have often conceded the inclusion of this provision, they have also been able to negotiate some improvements to the terms of the Investment Grade Agreement.

This Clause contains some options for the parties to negotiate. The first issue is whether a change of control should be an automatic drawstop (other than in the case of Rollover Loans).

The parties are also required to select whether all outstandings will be repaid and all Commitments cancelled, or only those of Lenders opting to exit. In the first version, on a change of control, the Majority Lenders can require the Agent to cancel the Commitments and declare the Loans due and payable to all the Lenders at the end of a notice period. In the second version, on a change of control, each Lender has the right, during a limited period, such as 10 days, to require the Agent to cancel its Commitment and declare the Loans due to it due and payable at the end of a notice period. The Borrower's preference may depend on whether its assessment is that its prospects of retaining funding will be maximised by a Majority Lender decision, or allowing Lenders to exit individually.

Whichever version is settled, the Borrower should negotiate a long notice period, to allow time to arrange replacement bank debt. Borrowers are also sometimes able to alter the Clause so that, in addition, the Lenders' right to cancellation and prepayment is triggered only after the parties have negotiated the continuing provision of the Facilities for a period such as 30 days.

The definitions of "control" and "acting in concert" need to be settled with care. Ideally, Borrowers should avoid using a cross-reference to tax legislation in the definition of "control": using this legislation usually imports a wide measure of what constitutes control, which the Borrower may not be able to monitor.

Listed Borrowers also need to bear in mind the requirement of section 992 of the Companies Act 2006 ("CA 06") for the directors' report to disclose detailed information as to any "significant agreement" which can be terminated on a change of control following a takeover bid.

Clause 8.3: Voluntary cancellation

This provides that the Borrower can cancel the Term and Revolving Facilities. The notice period is commonly about 5 Business Days, though it is sometimes less.

Clause 8.4: Voluntary prepayment of Term Facility Loans

It is conventional to give Borrowers the right to prepay Term Loans, after the end of the Availability Period. The notice period is commonly 5 Business Days, though it can be useful to have a shorter period, such as 2 Business Days, for maximum flexibility.

Where Term Loans have to be repaid in instalments, Lenders to an investment grade Borrower usually require any amount which is prepaid to be set against the repayment instalments in reverse chronological order, ie repaying the last instalment first. Borrowers may however seek to have prepayments applied in chronological order, or pro rata, or even at their discretion. The Investment Grade Agreement leaves the parties to settle the provision here on a case-by-case basis.

Break Costs will be payable where the prepayment is not made at the end of an Interest Period. See Clause 11.4 (*Break Costs*).

Clause 8.5: Voluntary prepayment of Revolving Facility Loans

Borrowers are commonly permitted to prepay Revolving Facility Loans. The notice period is usually between 2 and 5 Business Days.

Break Costs will be payable where the prepayment is not made at the end of an Interest Period. See Clause 11.4 (*Break Costs*).

Clause 8.6: Right of replacement or repayment and cancellation of a single Lender

This Clause includes several slightly different provisions dealing with a single Lender where (in outline) the Borrower is required to pay increased costs or to gross up, or (under the LMA Market Conditions Provisions) the Lender becomes a Defaulting Lender. (For an introduction to the LMA Market Conditions Provisions, please see section 6 of Part I.)

Prepay and cancel affected Lender

Under this provision, the Borrower has the right to prepay and cancel the Commitment of a single Lender following a tax gross up or an indemnity claim for tax or increased costs.

“Yank the bank”

The Borrower can also replace a single Lender in the same circumstances. While it may be preferable to replace a Lender than to repay it and cancel its Commitment, the provision may be difficult to operate in practice, as it requires repayment of the outgoing Lender at par, and may also involve the Borrower in the payment of fees. The provision is similar to the equivalent provision in the Leveraged Facilities Agreement at Clause 41.3 (*Replacement of Lender*).

Cancellation of Defaulting Lender’s undrawn Commitments

The LMA Market Conditions Provisions dealing with a Defaulting Lender also allow the Borrower to cancel the undrawn Commitment of a Defaulting Lender, and separately arrange for that undrawn Commitment to be assumed by a new or existing Lender of its choice (see Clause 2.2 (*Increase*)).

The LMA propose that the Borrower should also be entitled to replace a Defaulting Lender. Please see Clause 35.4 (*Replacement of Defaulting Lender*).

Borrower Notes

“Yank the bank”

Borrowers may also wish to consider extending the “yank the bank” provision so that it is triggered by the operation of Clause 8.1 (*Illegality*), and also in relation to an individual Lender which does not consent to a request for a waiver or amendment for which more than a certain minimum level of consent has been given by the other Lenders. For more on this topic, please see the commentary on Clause 35 (*Amendments and Waivers*).

Borrowers may wish to adjust the timing provision here, which is a set number of days’ notice, to allow the notice to specify the date of the replacement, with a long stop at the end of the next Interest Period. This would treat the replacement in the same way as the repayment and cancellation of a single Lender.

It could also be advantageous to insert a mechanism to allow the Agent to execute the transfer documentation on behalf of the outgoing Lender, to avoid any practical difficulties.

Defaulting Lender

Although the LMA Market Conditions Provisions allow the Borrower to cancel the undrawn Commitment of a Defaulting Lender, and arrange for it to be assumed by a new or existing Lender (Clause 2.2 (*Increase*)), the Borrower is not permitted a general right of prepayment of a Defaulting Lender. The Borrower may want the flexibility to prepay rather than have the Defaulting Lender remain in the syndicate with voting rights which it may or may not exercise. This is a point for Borrowers to discuss with their Arrangers, as many syndicates have approved it to date (including in relation to Term Facilities). Under the LMA Market Conditions Provisions, the Borrower is only permitted to prepay the Defaulting Lender in relation to Revolving Facility drawings which are termed out (please see Clause 7.2 (*Repayment of Facility B Loans*)).

Note also that the cancellation of an undrawn Commitment in respect of a Defaulting Lender might trigger cross-default provisions in the Borrower’s other financing documentation, depending on their terms. The sensible conclusion is that a default by a Lender is not a trigger for the Borrower’s cross-default provisions, but it may be worth making it clear that cancellation via the Defaulting Lender mechanics is excluded from their scope.

Clause 8.7: Restrictions

If a prepayment is not made on the last day of an Interest Period, the Lenders will incur Break Costs, for which the Borrower is liable. Please see the discussion of the calculation of Break Costs under Clause 11.4 (*Break Costs*).

CLAUSE 9: INTEREST

Clause 9.1: Calculation of interest

The rate of interest for each Loan for each Interest Period is the percentage rate per annum which is the aggregate of LIBOR, the Margin and the Mandatory Cost. (EURIBOR may be selected for euro Loans.)

LIBOR is defined in the Investment Grade Agreement, in line with market practice, by reference to the screen rate known as BBA LIBOR, with Reference Bank rates as a fall-back: if BBA LIBOR is not available on screen, LIBOR will be (essentially) the arithmetic mean of the rates quoted by the Reference Banks, in response to a request from the Agent, rounded up to four decimal places.

LMA Market Conditions Provisions

The LMA Market Conditions Provisions provide an alternative option. LIBOR can remain defined primarily as BBA LIBOR, with use of the Reference Bank rate as a fall-back if BBA LIBOR is not available. Alternatively, the parties can dispense with BBA LIBOR, adopting the Reference Bank rate as the primary definition of LIBOR.

Adopting the Reference Bank rate as the primary definition of LIBOR raises a number of issues for Borrowers:

- Its impact on hedging transactions may be a decisive consideration in many cases. A move to Reference Bank rates could have significant effects on the effectiveness, cost and availability of hedging.
- A switch to the Reference Bank rate would be more onerous in practical terms for the Agent and the banks involved.
- Reference Bank rates could also, potentially, be less reliable and less transparent.

In general, Borrowers may be expected to prefer to retain BBA LIBOR. It has the advantages of transparency, convenience and ready availability. Furthermore, if the Borrower's hedging arrangements reference BBA LIBOR, the use of a Reference Bank rate in loan documentation could be disadvantageous.

However, in certain circumstances, the Arrangers might wish to select the Reference Bank rate as the primary rate. This might be the case, for example, if the initial syndicate and/or Reference Banks are not expected largely to comprise banks which are BBA panel banks, or if they may not be able to obtain funding on a comparable basis. In addition, in unusual circumstances, a Borrower might prefer to rely on the quotations provided by the Reference Banks, if it felt it had grounds to prefer these over the quotations provided by the BBA panel banks. Nonetheless, BBA LIBOR remains the standard choice to date, and this is expected to remain the position in most cases.

Borrower Notes

LIBOR

The screen rate known as BBA LIBOR has been the primary basis for syndicated lending since it was first launched in 1986. Until then, rates were set on the basis of quotations provided by the Reference Banks. Although there has been a great deal of debate about BBA LIBOR over the last couple of years, it has remained market practice to define LIBOR in loan documentation primarily by reference to BBA LIBOR as published on screen, with Reference Bank rates as a fall-back. The Investment Grade Agreement provides (as is customary) that if BBA LIBOR is not available on screen, LIBOR will be (essentially) the arithmetic mean of the rates quoted by the Reference Banks, in response to a request from the Agent, rounded up to four decimal places.

BBA LIBOR is calculated from the rates quoted by a panel of banks, as the rate at which:

- they could borrow funds;
- in a given currency and for a given maturity;
- in a reasonable market size;
- in the London inter-bank market at 11 am on a given day.

The top and bottom quartile quotations are discarded, so that the published rate is the arithmetic mean of the remainder, rounded up to five decimal places. Panel banks are selected with the aim of reflecting the balance of the market, on the basis of scale of market activity, credit rating and perceived expertise in the currency in question¹.

¹ More detail about the calculation of BBA LIBOR is provided on the BBA's LIBOR website at <http://www.bbabilbor.com/bba/jsp/polopoly.jsp?d=1627>.

BBA LIBOR attracted a great deal of criticism in autumn 2008, when liquidity was under intense pressure. Concerns focussed on the reliability of the quotations provided by the BBA's panel banks. However, after the beginning of 2009, these concerns subsided somewhat, as liquidity eased and rates came down in response to the Bank of England's base rate cuts.

The Reference Banks for a syndicated loan are appointed by the Agent in consultation with the Borrower. There are usually three of them. The extent of the potential divergence between BBA LIBOR and the Reference Bank rate will depend on a variety of factors. Chief amongst these will be the extent to which the Reference Banks appointed for the purposes of the Facilities do not reflect the characteristics of the BBA panel banks. The divergence would be expected to be very small where the Reference Banks appointed are BBA panel banks, but could be greater where the Reference Banks appointed are not as active or do not enjoy the same reputation in the London inter-bank market as the BBA panel banks, for example if most of them are smaller banks or from one particular region.

A related point relevant to the use of the Reference Bank rate (whether as the primary or as a fall-back rate) arises from a small drafting change made in the LMA Market Conditions Provisions. Historically, the LMA followed market convention in providing for the Reference Bank rate to be calculated on the basis of the deposit rates offered by the Reference Banks to leading banks in the London interbank market. The inclusion of the reference to leading banks imported a measure of protection for Borrowers. However, in the LMA Market Conditions Provisions, the LMA now follow the BBA LIBOR approach described above, by providing that quotations will be as to the rate at which the Reference Banks could borrow. Accordingly, Borrowers will want to ensure that as far as possible the Reference Banks are "leading banks", or that the Reference Bank rate is an average of the rates quoted by those banks to leading banks.

EURIBOR

The definition of EURIBOR is similar to that of LIBOR. The Screen Rate is based on the official rate for the Banking Federation of the EU, which shows rounding to 3 decimal places.

The LMA Market Conditions Provisions also apply to the definition of EURIBOR, providing for the optional replacement of the Screen Rate with Reference Bank rates.

Quotation Day

LIBOR and EURIBOR are fixed on the Quotation Day. The definition of Quotation Day reflects the different conventions for rate-fixing: rates for sterling are fixed on the same day as the Utilisation; rates for euro, two TARGET Days beforehand; and rates for all other currencies, generally two Business Days beforehand. Rate fixing is usually as of 11 am (Brussels time in respect of EURIBOR). For the definitions of Business Day and TARGET Day for these purposes, please see comments on Clause 5.1 (*Delivery of a Utilisation Request*).

Mandatory Costs

Please see the comments on Schedule 4.

Clause 9.2: Payment of interest

Interest is payable on the last day of each Interest Period. If the Interest Period is more than 6 Months, it must also be paid at 6 Monthly intervals, in line with market practice. For more on Interest Periods, please see comments on Clause 10.1 (*Selection of Interest Periods*).

Clause 9.3: Default interest

Default interest is payable on overdue amounts. The parties have to select the rate which will apply, and usually agree on 0.5% or 1% above the rate which would otherwise have applied.

Interest Periods for overdue amounts are set by the Agent, on the basis that the Lenders have to continue funding the overdue amounts in the market. When the overdue amount is a Loan which becomes due on a day which is not the last day of an Interest Period, the Lenders will already have obtained funding to the end of the then current Interest Period. This means that the first Interest Period for the defaulted amount is the rest of that current Interest Period, and the rate is the rate which has already been fixed for that current Interest Period, plus the default rate. Compounding at the end of each Interest Period for the defaulted amount is market practice.

Clause 9.4: Notification of rates of interest

The Agent is obliged to notify the Borrower of the applicable rate of interest for each period promptly after it has been fixed.

CLAUSE 10: INTEREST PERIODS

Clause 10.1: Selection of Interest Periods

The Borrower selects the length of Interest Period, either:

- in the Utilisation Request, in the case of the first Interest Period for a Term Facility Loan and for all Revolving Facility Loans, or
- in a Selection Notice, in the case of all subsequent Interest Periods for Term Facility Loans.

If a Facility has repayments or reductions in instalments, Borrowers may select Interest Periods shorter than they would otherwise be allowed, in order to ensure that Loans of the necessary size mature on the relevant repayment or reduction dates.

The notice period required for a Selection Notice for Term Facility Loans is usually the same as the notice period required for a Utilisation Request (see Clause 5.1 (*Delivery of a Utilisation Request*)). Where the Borrower does not deliver a Selection Notice, the Agreement determines the length of the Interest Period. This is optionally one Month; longer periods may be chosen.

Borrower Notes

The range of Interest Periods permitted is often 1, 3, and 6 Months. Periods not specified in the facility agreement will require the approval of all the Lenders. Borrowers need to ensure that Interest Periods, along with all the other provisions dealing with interest in the facility agreement, match the provisions of their hedging arrangements.

Borrowers may wish to discuss the length of the default Interest Period with the Agent.

Clause 10.2: Changes to Interest Periods

This is an extension to the provision explained above. If a Facility reduces in instalments, and a Borrower fails to select Interest Periods to coincide with repayment dates, the Agent will make the necessary adjustments to the Interest Periods. This means that the Agent selects which Loans are to be repaid, so that Borrowers will wish not to overlook this point.

Clause 10.3: Non-Business Days

If an Interest Period would otherwise end on a non-Business Day, it will instead end on the next Business Day in the calendar month in question, if there is one, or on the preceding Business Day, if there is not.

Clause 10.4: Consolidation and division of Term Facility Loans

Unless the Borrower specifies otherwise in a Selection Notice, the Agent will consolidate into a single Loan any Term Facility Loans in the same currency with the same Interest Period and same Borrower.

The Borrower is permitted to request the division of a Term Facility Loan in a Selection Notice, subject to the constraints set out in Clauses 4.4 (*Maximum number of loans*) and 5.3 (*Currency and amount*).

CLAUSE 11: CHANGES TO THE CALCULATION OF INTEREST

Clause 11 sets out the so-called “market disruption” provisions, which are intended to allow the Lenders to charge their actual cost of funds in the event of significant market difficulties. They have been the subject of some scrutiny and debate as a result of the financial crisis. In the autumn of 2008, lack of liquidity in the inter-bank market and widespread criticism of BBA LIBOR as not accurately reflecting Lenders’ cost of funds led many syndicates to consider whether the circumstances constituted a Market Disruption Event. There were, however, no reported instances of actual cost of funds being charged in the London market.

As a result of these debates, the LMA Market Conditions Provisions include a new market disruption regime. We discuss both the pre-existing provisions and the LMA Market Conditions Provisions below.

Market Disruption Event: the pre-existing Investment Grade provisions

As discussed under Clause 9 (*Interest*), LIBOR is defined in the Investment Grade Agreement as the screen rate known as BBA LIBOR, and, if that rate is not available, the arithmetic mean of the rates quoted by the Reference Banks.

If one or more of the Reference Banks does not quote a rate as required, the rate will be determined on the basis of the quotations of the other Reference Banks.

There is a Market Disruption Event in either of the following circumstances:

- BBA LIBOR is not available on screen and none or only one of the Reference Banks provides a quotation; or

- more than a specified percentage of Lenders say that their cost of obtaining matched funding in the relevant market would be higher than LIBOR.

Where there is a Market Disruption Event in relation to a Loan, the rate of interest payable to each Lender is the aggregate of the Margin, the Mandatory Cost and the rate notified by that Lender as its actual cost of funding for that Loan from “whatever source it may reasonably select”.

As soon as a Market Disruption Event occurs, either the Agent or the Borrower can require the other to enter into negotiations, for up to 30 days, to try to agree another way of determining the interest rate. Any alternative basis agreed requires the consent of all the Lenders and the Borrower.

Market Disruption Event: the LMA Market Conditions Provisions

The LMA Market Conditions Provisions make extensive amendments to the pre-existing Investment Grade Agreement provisions, essentially stipulating that:

- if a Market Disruption Event occurs, the rate will be set by reference to quotations provided by “Alternative Reference Banks”; and
- only if an “Alternative Market Disruption Event” occurs (an event equivalent to the Market Disruption Event affecting “Alternative Reference Banks”) will the Lenders’ actual cost of funds apply.

Under the LMA Market Conditions Provisions, the Reference Banks are re-named “Base Reference Banks” in order to distinguish them from the “Alternative Reference Banks”. The “Alternative Reference Banks” are intended to be an additional and larger group of Lenders listed in a schedule. The quotations from the Alternative Reference Banks are obtained on the same basis as from the Base Reference Banks. These are the basis for the “Alternative Reference Bank Rate”.

The definition of “Market Disruption Event” remains the same save for an amendment to the second limb of the definition, which is designed to deal with a situation where LIBOR is available, but a significant proportion of the Lenders in the syndicate cannot obtain funding in the London inter-bank market, as happened in the case of certain banks in autumn 2008. A Market Disruption Event will occur under the LMA Market Conditions Provisions if more than a specified percentage of Lenders certify that their “cost of funding *from whatever source [they] may reasonably select*” is in excess of LIBOR (emphasis added). Under the Investment Grade Agreement, the test is whether the cost to Lenders of obtaining matching deposits in the London inter-bank market is in excess of LIBOR. The only protection provided for Borrowers in the LMA Market Conditions Provisions on this point is the requirement for Lenders to select their funding source reasonably. Borrowers may take the view that in a LIBOR-based financing, the comparison should be between LIBOR and the cost of funding in the

inter-bank market (not between LIBOR and whatever source the Lender selects, albeit reasonably).

An “Alternative Market Disruption Event” is an event effectively equivalent to the Market Disruption Event affecting Alternative Reference Banks. It is however intended that the threshold percentage of Lenders notifying the Agent that their cost of funds exceeds the Alternative Reference Bank Rate will be higher than that required to trigger a Market Disruption Event.

The LMA Market Conditions Provisions retain the right of the Borrower to try to negotiate an alternative basis for 30 days, following an Alternative Market Disruption Event.

In summary, the LMA Market Conditions Provisions require two sets of conditions (rather than one) to be satisfied before the Borrower has to pay the Lenders’ actual cost of funds, and therefore should reduce the risk of this eventuality. Effectively, the Alternative Reference Banks are used as a safety net before the Borrower is required to pay the Lenders their cost of funds.

Borrower Notes

Whether the pre-existing Investment Grade Agreement provisions or the LMA Market Conditions Provisions are applicable, the most effective protection for Borrowers against the risk of market disruption provisions being invoked is probably achieved by setting the threshold percentage for triggering a Market Disruption Event as high as possible. Historically, this was often 50% of the Loan in question for investment grade Borrowers. There has been some downward pressure on this figure recently, with several deals at 30%, but stronger Borrowers remain able to resist this.

Further protection may be achieved by restricting the circumstances in which Lenders may give notice that their funding costs exceed LIBOR, to apply only where such costs exceed LIBOR *materially* (for example by a specified percentage).

Particular issues arising for Borrowers in relation to the LMA Market Conditions Provisions include the following:

- The Agent is under no obligation to notify the Borrower that a Market Disruption Event or Alternative Market Disruption Event has occurred.
- It is proposed that a Lender which notifies a lower cost of funds than the Alternative Reference Bank Rate, or which fails to notify its cost of funds, should be deemed to have cost of funds at the Alternative Reference Bank Rate. Borrowers may wish to query this.

- Borrowers should ensure that the Agent selects Base Reference Banks and Alternative Reference Banks with great care. For example, choosing BBA panel banks for the relevant currency (or banks with similar characteristics to such BBA panel banks) might reduce the possibility that the market disruption provisions could be triggered.

Clause 11.4: Break Costs

If a Borrower makes a payment of principal on any day other than the last day of an Interest Period, the Lenders are likely to incur Break Costs. The reason for this is that, in theory at least, they arrange the funding of each Loan to coincide with the relevant Interest Period. As a result, if they are prepaid before the end of the Interest Period, they may incur costs or losses. They will re-invest the amount prepaid by the Borrower, but their return on that amount for the period to the date when the Borrower would otherwise have paid may well be smaller than their cost of funding and smaller than the amount they would otherwise have received. Rates generally may have moved down since the Quotation Date for the Interest Period, and the period for which the amount is re-invested may not be of a standard length and hence may pay a lower rate.

The Investment Grade Agreement quantifies Break Costs, in summary, as the amount by which:

- the interest which a Lender should have received, for the period from the date of receipt to the end of the Interest Period, exceeds
- the amount which it would be able to obtain by depositing the same amount for a period starting on the Business Day following receipt and ending on the last day of the Interest Period.

This approach has the merit of transparency, though the Borrower may take issue with several points, notably the inclusion of the Margin in the calculation. Details are set out below.

Borrower Notes

The main objection here is that the calculation of Break Costs includes the Margin. The Leveraged Facilities Agreement provides (optionally) for the Margin to be excluded from the calculation, and prior to the credit crunch both leveraged and investment grade Borrowers obtained this concession regularly. Sometimes it is achieved by limiting it to prepayments in circumstances involving no fault on the Borrower's part, such as under Clauses 8.1 (*Illegality*), 11.2 (*Market Disruption*), 13 (*Tax*), and 14 (*Increased costs*).

Another objection here is often that the Lenders are not expected to re-invest the funds on the same day: this amounts, in effect, to a prepayment premium of one day's interest on the amount prepaid. The Borrower may feel that it should not have to subsidise the Lenders for not acting promptly. The Lenders may reply that, however efficient they are, it is almost impossible to re-invest funds received on the same day, especially if they are received late in the day and without notice. A compromise may be to distinguish planned prepayments (where the Borrower has given notice) from involuntary ones (such as acceleration following an Event of Default). In the case of planned prepayments, the Borrower should not be penalised, but it may be difficult to justify the absence of a prepayment premium where there is an involuntary prepayment.

Another objection to the LMA's quantification of Break Costs is that the amount taken to be re-invested by the Lenders is only the principal sum prepaid, although the Borrower will have paid interest as well. There is no logical justification for Lenders excluding the interest paid from the amount taken to be re-invested for the purposes of the second paragraph of the definition of Break Costs.

A concession won by very strong Borrowers in limited circumstances is that Break Costs should be discounted, to reflect the early payment by the Borrower. Very strong Borrowers have also argued that if the Lenders realise a profit following a prepayment on a day other than the last day of an Interest Period, this should be paid back to the Borrower.

The Borrower will want to see the calculation of the Break Costs, not just the amount (paragraph (b)).

CLAUSE 12: FEES

Clause 12.1: Commitment fee

This is a market standard provision for the payment of the commitment fee.

Under the LMA Market Conditions Provisions, no Commitment Fee is payable to a Defaulting Lender. This is an optional provision which is being taken up in the market. It is difficult to envisage a scenario in which a Borrower would not want to include it. For an introduction to the LMA Market Conditions Provisions, please see section 6 of Part I.

CLAUSE 13: TAX GROSS UP AND INDEMNITIES

Introduction

Borrowers need to turn their attention at the earliest possible opportunity to the tax issues arising in relation to any planned loan facility, preferably before the Term Sheet is signed. Specialist tax advice should always be obtained.

In general, market expectation is that the Borrower will pay gross (ie without withholding tax). The Borrower's first need therefore is for comfort that it does not have to deduct tax from interest payments to any member of the initial syndicate. Once satisfied on this point, it can go on to consider the terms on which it would be prepared to gross up, if there were changes in law which required it to withhold tax.

It is market practice for the Borrower to take the risk of change of law, and it usually agrees to gross up payments to those Lenders whom it is satisfied it can pay without deduction at the outset. These Lenders are conventionally known as "Qualifying Lenders". The main points for the Borrower to consider in relation to the initial syndicate therefore are how it satisfies itself in the first place that it can pay gross, and which criteria have to be met for a Lender to be a Qualifying Lender.

The Borrower then needs to bear in mind that Lenders may transfer their participations. Under the terms of most loan facilities, transferees need not be Qualifying Lenders, though in certain circumstances very strong Borrowers are able to require transferees to be Qualifying Lenders. Investment grade Borrowers however traditionally enjoy a measure of protection from two other provisions:

- Usually an investment grade Borrower has a right (albeit limited) to veto transfers (see Clause 24 (*Changes to the Lenders*)).
- In addition, though it may have to withhold tax, the Borrower is not obliged to gross up payments to a transferee unless payments to the transferor were also grossed up (see Clause 24.2(f)).

At the earliest opportunity, Borrowers need to consider which types of Lender should be included in the definition of a Qualifying Lender. The first point here is that, depending on the circumstances (for example, if it is a UK Borrower in a strong position and not trying to raise a very large facility amount), it might be able to ensure that only UK banks are permitted, thus excluding non-banks and lenders from outside the UK from the definition of a Qualifying Lender. The reason it is desirable to limit UK Qualifying Lenders to banks is that it is more likely that a payment to a non-bank lender might be subject to withholding tax than is the case where the payment is made to a bank. The Investment Grade Agreement presents the inclusion of building societies and certain other UK entities ("UK Non-Bank Lenders") within the definition of Qualifying Lenders as optional, and some Borrowers exclude them.

Borrowers then need to consider whether overseas Lenders should be included in the Qualifying Lender definition. In the case of a UK Borrower, Lenders which are resident outside the UK may receive payments free of withholding tax, but only if they qualify under a double tax treaty with the UK (in which case the Investment Grade Agreement calls them “Treaty Lenders”). As well as satisfying the conditions in the applicable treaty, the Lender also has to obtain directions from HMRC telling the Borrower to pay interest without deducting tax. There is, accordingly, a much greater risk of withholding tax arising in the case of Treaty Lenders than in the case of UK Lenders. However, Treaty Lenders are now routinely included in syndicates as Qualifying Lenders. A very strong Borrower might, in appropriate circumstances, such as a small club deal, consider excluding Treaty Lenders. However, the tax risks arising from their inclusion may be outweighed in other cases by the pricing and liquidity concerns which could arise from their exclusion.

Clause 13.1(a): Qualifying Lenders

Clause 13.1(a) provides the definition of a Qualifying Lender. The function of the definition is essentially to identify those Lenders which the Borrower would have to gross up, if there were a change in law which required it to withhold tax. As a result, in broad terms, it reflects the criteria which have to be satisfied for the Borrower to be able to make interest payments without withholding tax at the outset.

In this context it is important to note that the tax provisions of the Investment Grade Agreement are designed for English corporate Borrowers, despite representations from the ACT that they should, at least in outline, cater for international groups. Adaptation is therefore needed where the Borrower group comprises or includes overseas obligors.

There are four categories of Qualifying Lender in the Investment Grade Agreement:

- (a) UK banks and UK branches of overseas banks;
- (b) UK companies, or “UK Non-Bank Lenders”;
- (c) Treaty Lenders; and
- (d) building societies.

Borrower Notes

(a) UK BANKS AND UK BRANCHES OF OVERSEAS BANKS

The first category of Qualifying Lender is defined by reference to the so-called “banking exemption” from the requirement to deduct tax.

The background here is section 874 of the Income Tax Act 2007, which requires any company paying yearly interest to deduct withholding tax (currently at 20%). “Yearly interest” is generally considered to mean interest on a loan which is capable of being outstanding for a year or more: this will catch not only term loans outstanding for a year or more, but generally also revolving facilities where, although advances may be made for periods of less than a year, they may be rolled over, so that the economic nature of the arrangement is a loan capable of being outstanding for a year or more. Interest on advances made under a 364-day (or shorter) facility is not subject to withholding.

However, there is an exemption from the requirement to deduct withholding tax on yearly interest, provided by section 879 of the Income Tax Act 2007. This applies to interest paid on an advance made by a bank, if at the time when the interest is paid, the person beneficially entitled to the interest is within the charge to corporation tax in respect of it. The Borrower will therefore want to satisfy itself, in order to be able to pay gross, on two points: the advance in question must have been made by a bank, and the person beneficially entitled to the interest must be within the charge to corporation tax in respect of it.

The definition of a “bank” for these purposes cross-refers to the Financial Services and Markets Act 2000. Broadly speaking, it means UK banks and UK branches of overseas banks.

The second point takes into account the possibility of beneficial ownership of the interest being transferred. Following a loan sale by way of novation or assignment, the person beneficially entitled to the interest will be the purchaser and so for the banking exemption to apply following the sale, the purchaser must be liable to UK corporation tax on the interest. Note that novation is regarded as involving a repayment to the seller and a fresh advance by the purchaser, so that, in order for the banking exemption to apply following novation, the purchaser must qualify as a bank (as defined) in addition to being liable to UK corporation tax on the interest.

The Borrower needs to know whether or not a Lender meets these criteria, because if it pays gross on the basis that no deduction is required, and it subsequently transpires that deduction was indeed required, it will have to pay the tax it should have withheld. So how does the Borrower know whether or not a Lender meets these criteria?

Borrowers might reasonably expect Lenders to give a confirmation (at signing and on transfer) as to their status, and to inform the Borrower if the position changes. Under the terms of the Investment Grade Agreement, the Borrower is offered only limited assistance.

All Lenders are obliged to notify the Agent if a deduction is required (see Clause 13.2(b)), but that obligation is triggered only when the Lender becomes aware that withholding tax is applicable. Lenders joining the syndicate after signing are also required by a new provision inserted by the LMA in April 2009 to confirm whether or not they have Qualifying Lender status (Clause 13.5 (*Lender status confirmation*)). That confirmation is however given expressly on terms which prevent the Borrower from relying on it. Nonetheless, a Lender which fails to give the confirmation is to be treated by the Borrower as if it were not a Qualifying Lender. As a result, although the provision may relieve the Borrower of the need to gross up, it will not assist it with the primary question as to the applicability of withholding tax.

Strong Borrowers therefore often obtain a confirmation from all the original Lenders in the syndicate that they are Qualifying Lenders; sometimes this confirmation can be required from secondary market purchasers too, but this is achieved less regularly. The confirmation can be given by changing the definition of a Tax Confirmation in Clause 13.1 (so that the Lender confirms that the person beneficially entitled to the interest is a Qualifying Lender), and by amending Clauses 13.2(h) and (i) (so that they apply to all original Lenders (and not just UK Non-Bank Lenders) and (if agreed) to subsequent purchasers).

Another approach might be to get the Lenders to accept a provision to the effect that, if the Borrower pays interest gross where it should have withheld income tax, then the recipient of the interest concerned should refund to the Borrower the amount that should have been withheld. In the absence of such a tax rebate clause, the Investment Grade Agreement gives the Borrower no right to recover the amount of the tax from the Lender, unless it can show that the Lender was in breach of Clause 13.2(b), mentioned above.

(b) UK COMPANIES, OR "UK NON-BANK LENDERS"

This category broadly comprises UK tax-paying companies and partnerships, known as "UK Non-Bank Lenders". It is optional, since not all investment grade Borrowers wish to include this type of Lender in their syndicates.

Following a campaign by the LMA, withholding tax was abolished in the UK in 2001 on interest payments made to UK resident companies and to overseas companies where the recipient is within the charge to UK corporation tax as respects that income. The imposition of withholding tax had been one of the main obstacles to the inclusion of non-banks in lending syndicates.

The criteria for there being no withholding tax are set out in sections 929 to 938 of the Income Tax Act 2007. A company is not required to deduct withholding tax if one of the following conditions is satisfied:

- the person beneficially entitled to the interest is either a company resident in the UK or a partnership, each member of which is a company resident in the UK; or
- the person beneficially entitled to the interest is either (a) a company not resident in the UK which carries on a trade here through a branch or agency, and the payment falls to be brought into account in computing the company's chargeable profits; or (b) a partnership in which a UK branch of a non UK company as mentioned in (a) (together with other such branches, or UK resident companies) participates (and no one else does).

Unlike banks (discussed above), these Lenders are expected to give a representation, known as a "Tax Confirmation", to assure the Borrower that they meet the criteria for payment gross. This is because the relevant statutory exemption from withholding tax requires that the Borrower must have reasonable grounds for believing that the person beneficially entitled to the interest is within the categories described above. The representation is given at signing (under Clause 13.2(h)) and, in the case of a secondary market purchaser, in the transfer documentation.

A Borrower which is in a strong negotiating position may want to ask Lenders for a tax rebate clause, to refund any amount which should have been withheld if a Tax Confirmation proved incorrect or ceased to be true, and it paid gross mistakenly, as under (a) above.

(c) TREATY LENDERS

Market practice has changed over the last decade, so that Treaty Lenders, which rely on a double tax treaty to receive interest free of withholding tax, are often included in syndicates.

Borrowers however need to focus carefully on the contractual provisions dealing with Treaty Lenders. Market practice varies considerably in this area. Withholding tax is more likely to arise on payments to Treaty Lenders than to other Lenders and therefore there is a greater risk of the Borrower having to gross up payments to Treaty Lenders. In the absence of a direction from HMRC for the Borrower to pay interest gross, the Borrower must withhold tax. The procedure for obtaining a direction to pay gross is slow, and the conditions for the availability of relief from withholding tax not always easily satisfied, so that it is quite possible that the Borrower will have to withhold tax, at least on the first interest payment, and therefore the gross up may be triggered.

Other risks presented by Treaty Lenders are change of law risk (likely to be greater than in the case of other Lenders), and the difficulties which arise from the multiplicity of Treaties, with varying provisions.

Ideally, a Borrower in a strong negotiating position would exclude Treaty Lenders from the Qualifying Lender definition, but, as explained above, this is not market practice.

Treaty Lender definition – criteria for eligibility for grossing up

Negotiation invariably focuses on the definition of a Treaty Lender, as this determines the circumstances in which a Lender counts as a Qualifying Lender and hence is eligible for grossing up payments. The parties need to decide on the allocation of risk between them in relation to the fulfilment of conditions for the availability of relief.

The approach taken by the LMA in the Investment Grade Agreement is to invite the parties to settle a list of conditions that a Lender must meet in order to count as a Qualifying Lender. The LMA set out the first two conditions, on the ground that Treaties generally require them to be satisfied:

- The first condition requires the Lender to be treated as a resident of a state which has a treaty with the UK providing full exemption from tax on interest.
- The second condition is that the Lender must not have a permanent establishment in the UK with which the loan is connected.

These two conditions do not cover the specific requirements which will need to be satisfied (including by the Lender) if there is to be no withholding tax. There is therefore provision in the Investment Grade Agreement for a third condition to address these requirements. The LMA however leave the third condition blank, so that it is up to the parties to determine the other requirements which may apply. The parties therefore have to settle the terms of this third condition on a case-by-case basis.

Surprising though it may sound, the existence of the third, blank, condition in the Investment Grade Agreement is vitally important for Borrowers. It represents an acknowledgment that the conditions for Treaty Lenders being entitled to a gross up have to be discussed on a case-by-case basis, and additional criteria inserted. The omission of the third condition from many signed facilities agreements means that Lenders under those facilities are readily entitled to grossed up payments, even though Treaty relief allowing the Borrower to pay without withholding may never become available.

Treasurers should note that unless they receive a mark-up showing the changes made to the Investment Grade Agreement (as the LMA recommend), they may be unaware of the omission of the third condition. They should make sure that this additional condition is included in their facilities agreements where Treaty Lenders are permitted.

What should the third condition be? There is no single correct answer to this question. The LMA note that this is a complex area and that “if appropriate” additional wording should be inserted “to apportion risk as agreed by the Parties”. Often however Lenders and/or their advisers disregard the fact that the definition of “Treaty Lender” is incomplete, and put forward a definition incorporating only the first two sub-paragraphs with a claim that this is the LMA or market standard. That claim should be resisted; and appropriate wording should be inserted for the third sub-paragraph of the definition.

The suggestion in the LMA note to the definition is that “relevant treaties should be reviewed”. The difficulty with that, of course, is that the treaties that are “relevant” can be identified only if the agreement limits the jurisdictions in which all original and future lenders can be found. In the absence of such a provision more general wording is appropriate to ensure that risks that are properly Lender risks are apportioned to them. Possible wording is set out below (although each Borrower will need to address its own circumstances):

“(iii) meets all other conditions in the Treaty for full exemption from tax imposed by the United Kingdom on interest relating to:

- (a) the identity or status of the Lender (including its status for tax purposes);*
- (b) the circumstances which are particular to the manner in which it holds its rights and obligations under the Facilities;*
- (c) the length of the period during which the Lender holds its rights or obligations under the Facilities;*
- (d) the reasons for its acquisition of rights or obligations under the Facilities, except where it became a Lender on the date of the Agreement; and*
- (e) the nature of any arrangements by which the Lender turns to account its rights under the Facilities.”*

A shorter alternative is as follows:

“(iii) meets all other conditions in the Treaty for full exemption from United Kingdom taxation on interest which relate to the Lender (including its tax or other status, the manner in which or the period for which it holds any rights under this Agreement, the reasons or purposes for its acquisition of such rights and the nature of any arrangements by which it disposes of or otherwise turns to account such rights).”

Treaty Lender: procedure for obtaining direction to pay gross

Even where a Lender is entitled to relief under a Treaty, it is necessary for procedural formalities to be completed before payment may be made gross. Application has to be made to both the foreign taxing authority and HMRC, and the process is usually slow (though HMRC is conducting a review of these procedures with a view to speeding up the process, and the LMA has made a proposal for “passporting” lenders to try to improve the position). Borrowers should be aware that they cannot pay interest free of withholding tax in reliance upon a Treaty until HMRC has processed the application and issued a direction to the Borrower for the payment of interest gross. HMRC’s practice is to impose interest and possibly penalties on Borrowers who pay interest free of withholding tax in reliance upon a Treaty before HMRC has issued such a direction to the Borrower, even if the direction is subsequently issued.

The Borrower is therefore exposed where an interest payment is required before the direction has been obtained. This difficulty may be circumvented to an extent if the first Interest Payment Date is fixed at a date not sooner than (say) 6 months after signing; but even if that is possible, there remains the risk of transfers to Lenders for whom clearance is not obtained settling shortly before an Interest Payment Date. In those circumstances tax would need to be withheld and the Lender grossed up, assuming it met the agreed criteria for a Treaty Lender. The Borrower may feel that it should not take this risk, especially as the Lender will ultimately be able to recover the tax withheld from HMRC if it is eligible for relief under a Treaty. However, in practice it is unusual for Borrowers to obtain more comfort from a Lender than an undertaking of some kind to seek to obtain the direction as soon as reasonably practicable. Please see comments on Clause 13.2(g) below.

Treaty Lender: confirmation of eligibility for relief

As discussed in (a) above in relation to UK banks, Borrowers will also want to focus on the limitations of the confirmations given by Treaty Lenders, which will depend partly on the definition of a Treaty Lender which is settled. As mentioned above, the Lenders' notification obligation relating to the applicability of withholding tax in Clause 13.2(b) is qualified by awareness, and the confirmation given in Clause 13.5 (*Lender status confirmation*) by a secondary market purchaser that it is a Treaty Lender is made without liability to the Borrower, although the Borrower is entitled to treat a Lender which does not give this confirmation as not being a Qualifying Lender.

Borrowers usually want Treaty Lenders to confirm, at signing and on transfer, that they are a Qualifying Lender, to identify the relevant Treaty, and to undertake to inform the Borrower if the position changes. Borrowers can emphasise that it may be impossible for them to ascertain whether or not a Lender is eligible for payment gross: often this question cannot be answered merely by reference to the terms of the Treaty - knowledge of the Lender's particular circumstances is necessary. Depending on how procedural formalities are dealt with, the Borrower may, in some circumstances, not even know which Treaty is relevant to a Lender. Usually, a Lender is generally best placed to monitor changes to the relevant Treaty.

Accordingly, as discussed under (a) above, strong Borrowers are often able to obtain a confirmation from all Treaty Lenders (and all other Lenders) in the original syndicate that they are Qualifying Lenders; and sometimes this confirmation can be required from secondary market purchasers too. For more detail please see (a) above.

(d) BUILDING SOCIETIES

Building societies (as defined in section 989 of the Income Tax Act 2007) have been included as a category of Qualifying Lender in the Investment Grade Agreement since 2004. The background is section 880 of the Income Tax Act 2007, which provides an exemption from UK withholding tax for interest paid on advances from a building society.

Clause 13.2: Tax gross-up

Clause 13.2(a) provides that the Borrower is required to pay without deduction, unless deduction is required by law.

Under Clause 13.2(b), upon becoming aware that withholding tax is applicable, both Borrower and Lender must notify each other.

Clause 13.2(c) provides that if deduction is required by law, the Borrower must:

- withhold the tax (including on the gross up) and pay it to the relevant taxing authority, and
- gross up the payment to the Lender, so the Lender receives the intended payment in full.

Circumstances in which gross up is not required are set out in Clause 13.2(d). These are now fairly standard.

Under paragraph (i), the Borrower does not have to gross up if the Lender is not a Qualifying Lender, or has ceased to be one, unless (in summary):

- the reason why the Lender is not or has ceased to be a Qualifying Lender is a change in law, or
- the Tax Deduction would need to be made even if it were a Qualifying Lender.

In other words, the Borrower will be required to gross up:

- if the Lender is a Qualifying Lender, or has ceased to be a Qualifying Lender due to a change in law, or
- the deduction would be required even if it were a Qualifying Lender.

Paragraph (ii) deals with the case of a UK Non-Bank Lender where HMRC issues a notice under section 931 of the Income Tax Act 2007 stating that interest cannot be paid free of withholding tax notwithstanding that the Lender may claim to be a UK corporation taxpayer. Experience suggests that it is very rare for such notices to be issued.

Paragraph (iii) also deals with UK Non-Bank Lenders. It is based on the requirement mentioned above that, in order for the Borrower to pay interest free of withholding tax under the exemption in sections 929 to 938 of the Income Tax Act 2007, it must have reasonable grounds for believing that the person beneficially entitled to the interest falls within the categories of person mentioned in those provisions (see above).

Paragraph (iv) is a necessary link to any Treaty Lender's (somewhat weak) obligations set out in Clause 13.2(g) relating to obtaining a direction for gross payment (see below).

Under Clause 13.2(f), where withholding tax is applicable, Borrowers must provide appropriate evidence that they have paid it.

Under Clause 13.2(g), in relation to procedural formalities for obtaining Treaty clearance, Treaty Lenders and Borrowers are required to co-operate.

Borrower Notes

Clause 13.2(g) is a weak obligation from the Borrower's point of view. It essentially requires Treaty Lenders merely to co-operate with the Borrower in completing any Treaty application forms and similar procedural requirements. Read strictly, it does not require Lenders to initiate the completion of any procedural requirements or otherwise to be pro-active, possibly implying that it is incumbent on Borrowers to identify the relevant Treaties and to provide the relevant forms to Lenders for completion. Strong Borrowers often ask for a clearer undertaking from Treaty Lenders. Sometimes Treaty Lenders will be required to complete the procedural formalities for obtaining a direction for the Borrower to pay gross "as soon as reasonably practicable" or "promptly".

Clause 13.3: Tax indemnity

A tax indemnity of this kind is standard. Broadly speaking, it covers any tax cost, liability or loss suffered in relation to the facilities, other than tax on net income. There is a carve-out for amounts addressed by the gross up provisions of Clause 13.2 (*Tax gross up*).

Borrower Notes

The justification for the tax indemnity is chiefly the view among banks that tax liabilities suffered by them in connection with their lending - except for their general corporate taxes on net income - should be for the account of the Borrower: the gross-up provisions cater only for withholding tax, so, the banks' argument continues, the risk of other tax liabilities needs to be covered by an indemnity. The basis for this view is the banks' "cost plus" approach to lending: costs which might erode their profit should not be for their account.

Lenders regard Clause 13.3 as very important protection, and Arrangers can argue that, as its omission is liable to cause problems in syndication and subsequently in the secondary market, the overall balance of advantage to Borrowers may be in giving it. However, where Lenders and Borrowers are resident in the same jurisdiction, it is hard for Lenders to justify their need for it. Strong Borrowers may therefore sometimes be able to refuse to give it, or limit it to losses arising from a change in law.

Clause 13.4: Tax Credit

This Clause provides, in broad terms, that if a Lender receives a benefit for withholding tax payments made by the Borrower, credit should be given to the Borrower. Specifically, if a Lender decides that a Tax Credit is attributable to a payment made by an Obligor, and that it has received and used that Tax Credit, it will pass it back to the Obligor.

This provision is now fairly standard, although in practice Borrowers rarely obtain any benefit from it.

Borrower Notes

The Borrower also needs to beware of Clause 27 (*Conduct of business by the Finance Parties*), which provides very significant protection for the Lenders: in particular, they are not obliged to make a claim for a Tax Credit or relief, or make any changes to the way they arrange their tax affairs, or disclose any information about them. The Lenders are unlikely to be willing to make any changes to Clause 27.

Clause 13.5: Lender status confirmation

This is a new provision, introduced by the LMA in April 2009. It requires any Lender acquiring a participation after signing (whether in primary syndication or in the secondary market) to indicate in its transfer documentation whether or not it is a Qualifying Lender, and if it is, whether or not it is a Treaty Lender. If it fails to do so, it is to be treated by the Borrower as if it is not a Qualifying Lender.

Borrower Notes

Although potentially helpful on a practical level, this provision does not give much assistance to the Borrower from a legal perspective, as the status confirmation is given expressly without liability. As explained in the discussion under Clause 13.1 (*Tax definitions*), what the Borrower particularly needs the Lender to confirm is that the Borrower can pay that Lender gross.

The Borrower is however expressly entitled to treat a Lender which fails to give the confirmation as if it is not a Qualifying Lender. As a result, the Borrower would not, generally speaking, be required to gross up payments to a purchasing Lender which had failed to indicate its status.

CLAUSE 14: INCREASED COSTS

Clause 14.1: Increased costs

The essence of this provision is that if a Lender suffers a cost or loss in relation to the Facilities as a result of a change in law or regulation, the Borrower should indemnify it. The Lenders' reasoning here is based on the "cost plus" approach to lending discussed above under Clause 13.3 (*Tax indemnity*).

The chief topical issue in relation to increased costs provisions in loan facilities is the potential impact of the new regulatory capital requirements which are likely to be imposed on Lenders following the financial crisis. Although at this early stage it is not clear exactly what the changes will be, common ground among the various authorities suggests that they will include requirements for higher capital ratios and higher quality bank capital. Other measures which are widely anticipated and potentially relevant to bank lending include tighter liquidity requirements, and a maximum leverage ratio for banks.

It remains to be seen how, and to what extent, the various proposals will be implemented. In the meantime, Borrowers will scarcely need to be advised that the costs of these changes are likely to be passed on to them, if not by means of provisions such as increased costs clauses, then by increases in pricing.

Borrower Notes

The 1988 Basel Capital Accord ("Basel I") was replaced by the International Convergence of Capital Measurements and Capital Standards published by the Basel Committee on Banking Supervision in June 2004 ("Basel II"). Basel II forms the basis for the EU Capital Requirements Directive (2006/48/EC and 2006/49/EC) and its implementation in the UK by the FSA.

Under Basel II (as under Basel I), banks must meet a solvency ratio (capital to risk-weighted assets) of a minimum of 8%. Total Tier 1 capital may not be less than 4%. Tier 1 capital includes ordinary shares and disclosed reserves ("Core Tier 1") and preference shares and "innovative securities" ("Non-Core Tier 1"). Core Tier 1 may not be less than 2%. Under Basel II, bank regulators are, however, obliged to consider if a higher capital ratio should be required, and the FSA has applied higher benchmarks for the purposes of stress tests used as part of its ongoing supervisory regime (for example 4% Core Tier 1).

Over the next few years, a series of changes may be expected to bank regulatory capital requirements from the various authorities, in the UK, the EU and internationally. Future regulatory change is however expected to build on the existing regime, so that the principles and structure of existing regulation will remain relevant. The extent of the future changes cannot currently be predicted with any degree of certainty.

Proposed higher capital requirements

As mentioned above, it is widely anticipated that the quantity and quality of banks' regulatory capital will increase significantly from the Basel II minimum.

Could increases of this kind be recovered by banks from Borrowers under Clause 14 (*Increased costs*) of the Investment Grade Agreement? In outline, Clause 14 allows a Finance Party to recover the amount of any Increased Cost (as defined) incurred as a result of compliance with a change in law or regulation which occurs after the date of the facilities agreement. An increase in capital required as a result of the regulatory changes which are anticipated may be expected to fall within the scope of Clause 14, to the extent that it is attributable to the Finance Party's having entered into its Commitment or funding or performing its obligations.

Historically, the purpose of the increased costs provisions in loan facilities has been to protect lenders against costs arising from changes in law or regulation which are unforeseen. This has sometimes been expressly acknowledged in loan documentation, but was most clearly evidenced by the agreement of lenders generally, in the years immediately preceding the implementation of both Basel I and Basel II, that the costs arising from those changes should not be recoverable under the increased costs provisions. Once the scope of the rule changes became clear, lenders were able to agree to their exclusion from increased costs provisions, because they could then factor the anticipated costs into the pricing of the loan facilities. The LMA acknowledged this prior to the implementation of Basel II by the provision of optional language excluding costs arising from Basel II from the scope of Clause 14.

As a result, once there is some clarity as to the nature of the changes that will be required as a result of the financial crisis, Borrowers may seek to ensure that the costs arising from those changes are expressly excluded from increased costs provisions. Although the scale of the proposed increases in capital requirements might preclude such an exclusion, Borrowers may find it helpful to bear in mind that, if a bank were to claim under the increased costs provision, it could be removed from the syndicate under Clause 8.6 (*Right of replacement or repayment and cancellation of a single Lender*).

Basel II

Basel II brought in significant changes to the risk-weighting of assets. Under Basel I, the risk-weighting applied to each asset depended simply on the category it fell into. A loan to a corporate Borrower was 100% weighted, regardless of its credit rating, so that £8 of capital was required for every £100 lent, unless secured with recognised collateral. The capital cost attributable to a loan to a Borrower was constant over the life of a loan facility, and the same for all banks.

Under Basel II, lenders can opt to use external credit assessments (the “Standardised Approach”), while banks with advanced risk management capabilities may be permitted to use an internal ratings-based approach (the “IRB Approach”), using their own models. Thus, under Basel II, assessments of the Borrower’s creditworthiness may vary from bank to bank, depending on which of the approaches is used. The capital cost attributable to a loan may also vary over the life of the facility if the Borrower’s creditworthiness alters. In addition, during the life of the facility a bank’s assessment techniques can change, for example if it changes the parameters of its internal model.

As mentioned above, the LMA provide optionally for the exclusion of Basel II costs from the scope of the increased costs clause, and investment grade Borrowers have been continuing to agree this exclusion with their syndicates (including since the onset of the credit crunch). There are two reasons for this, which Borrowers should continue to consider, in order to assess the level of risk involved. The first concerns claims for the costs of initial implementation of Basel II. The likelihood of claims of this kind would appear to be diminishing, since Basel II has now been widely (though not yet universally) implemented. The second concerns the ongoing implementation of Basel II, and arises because Clause 14 is very broadly drafted, covering not only changes in law and regulation, but also changes in the application, administration and interpretation of law and regulation. For example, a change in the Borrower’s credit rating, or a change in a Lender’s methodology, could be categorised as a change in the interpretation or administration or application of the Basel II regime. Borrowers may feel that where the facility includes a margin ratchet triggered by a change in credit rating, Lenders would not need to make an increased costs claim. Changes in methodology may be less likely than was the case when Basel II was first being implemented, but cannot be ruled out. Against this background, Borrowers should consider whether it is appropriate in the circumstances of their transaction to seek to exclude Basel II costs.

Clause 14: other points for Borrowers

Clause 14.1(a): As mentioned above, the purpose of the increased costs provision has always been to protect Lenders against changes in law and regulation. The expansion of the indemnity, some years ago, to cover changes in the interpretation, application and administration of law and regulation, was not originally intended to cover “unofficial” change, made voluntarily and unilaterally by an individual bank. This might occur, for example, if there were a change in the opinion of in-house counsel on the interpretation of a legislative provision applicable to the bank in question. As a result, Borrowers have historically been able to restrict the scope of the indemnity to changes made officially, for example *by any governmental or regulatory authority*. This means that, for example, changes imposed by the FSA are covered, while changes made voluntarily by the Lender to its credit assessment approach are not.

Clause 14.1(b): “Increased Costs”: Borrowers can reasonably insist that the reduction or cost in question must be material for the Lender to be able to claim on the indemnity. They may also want to suggest that the Lender cannot make a claim unless it has notified the Borrower in advance that the cost will be incurred.

Clause 14.2: Increased cost claims: Borrowers will want the Lender’s certificate to show the calculation as well as the amount. Borrowers may also want to suggest that there should be a limited period during which the Lender could claim for Increased Costs, such as six months from the date the cost is incurred.

CLAUSE 15: OTHER INDEMNITIES

Clause 15.1: Currency indemnity

This type of indemnity is market standard. A sum due in one currency may need to be converted into another currency in order to make a claim or enforce a judgment, thus exposing the Lenders to exchange rate fluctuations.

Clause 15.2: Other indemnities

The indemnities set out here are intended to cover costs and losses incurred, broadly speaking, as a result of some fault on the part of the Borrower.

Paragraph (a), an indemnity for costs incurred as a result of an Event of Default, is standard.

Paragraph (b), an indemnity for costs resulting from a failure to pay on the due date, is justified on the grounds that paragraph (a) does not cover costs incurred during a grace period.

Paragraph (c) is an indemnity for costs resulting from an advance not being made, although requested by a Borrower. The Borrower is liable unless the fault is a Lender's.

Borrower Notes

Borrowers may seek to limit the costs and losses indemnified here to those reasonably incurred, though this may be difficult as these indemnities are intended to cover costs and losses incurred as a result of some fault on their part. Borrowers may also seek to restrict the costs and losses indemnified to those incurred as a *direct* result of the events specified.

Clause 15.3: Indemnity to the Agent

These are indemnities given to the Agent.

Paragraph (a) covers the costs of the Agent in investigating any event which it reasonably believes is a Default.

Paragraph (b) covers the Agent's costs in any foreign currency sale or purchase that it needs to make for the purposes of currency-switching under Clause 6.3 (*Change of currency*).

Paragraph (c) covers the Agent's liabilities incurred as a result of acting on any notice, request or instruction which it believes to be genuine and appropriately authorised.

Borrower Notes

In relation to this provision generally, Borrowers may want to ensure that the causal link between the cost and the event is direct, not just indirect.

Borrowers might also want to restrict paragraph (c) to situations where the notice, request or instruction turns out not to be genuine or properly authorised, on the basis that if it is, any costs should be covered by the agency fee.

CLAUSE 16: MITIGATION BY THE LENDERS

Here the Lenders undertake that in certain circumstances, such as if an Obligor has to gross up, the Lender will take all reasonable steps to mitigate the circumstances causing this. Mitigation is often achieved by a transfer of the Loans to an Affiliate, or a different Facility Office.

Borrower Notes

Borrowers may want the Lenders to be obliged to notify them if any of these circumstances arise.

Clause 16.2(b) protects a Lender by excusing it from mitigating in any way which would, in its opinion (acting reasonably), be prejudicial to it. Borrowers should note that the Lenders are given very substantial similar protection by Clause 27 (*Conduct of business by the Finance Parties*). They may therefore argue that the Lenders do not need both Clauses. Borrowers should note that Clause 27 does not require the Lenders to act reasonably.

CLAUSE 17: COSTS AND EXPENSES

This Clause sets out the customary costs indemnities.

Borrower Notes

Clause 17.1: Borrowers may be able to replace the obligation to pay transaction expenses promptly on demand with an obligation to pay within a fixed period, such as 21 days.

Clause 17.2: Borrowers may take the view that 3 Business Days is too short a time-frame for payment of amendment costs.

In relation to all these provisions, Borrowers sometimes seek to require that claims should be accompanied by reasonable supporting evidence explaining how the costs have been incurred.

CLAUSE 18: GUARANTEE AND INDEMNITY

Technical alterations made to this Clause in April 2009 did not alter the substance of these provisions, which are market standard.

Borrower Notes

Guarantors should note that the guarantee payment obligation is, “whenever a Borrower does not pay any amount when due”, to pay “immediately on demand”. Very strong Guarantors are occasionally able to adjust this obligation so that the guarantee payment is due within a fixed number of Business Days of demand.

CLAUSE 19: REPRESENTATIONS

The representations included in Clause 19, each to be given by each Obligor, cover a variety of legal and factual issues. The significance of the representations is as follows:

- If any of these representations is untrue or misleading in any material respect on the date upon which it is expressed to be given, the misrepresentation will be an Event of Default (see Clause 23.4 (*Misrepresentation*)).
- In addition, it is a condition precedent to any Utilisation that the Repeating Representations (see Clause 19.14 (*Repetition*)) are true in all material respects.

It is therefore important for Borrowers not only to take great care in settling the text of these representations at the outset but also to have in place systems which ensure that the accuracy of each representation is checked before it is made or deemed repeated.

Lenders seek representations in order to address particular risks in relation to the transaction. The representations set out in the Investment Grade Agreement will be relevant for most transactions, and further representations (or carve-outs or additions to representations) specific to the transaction in question may be required. Materiality qualifications and other restrictions are commonly agreed, for example limiting the application of certain representations to certain entities and qualifying the scope of certain representations by reference to the knowledge of the representor.

Borrower Notes

Scope of representations

Some of the representations are expressed to be given by each Obligor in relation only to itself, while others are given in relation to itself and each of its Subsidiaries, and others are given in relation to itself and all other members of the Group.

Borrowers will need to agree with the Lenders the extent to which particular Obligors can give representations with application beyond themselves. Whilst it may be reasonable for Obligors to give some representations in relation to themselves and their Subsidiaries, on the basis that they should have relevant knowledge of their own Group, some Obligors may not feel it is reasonable that they should be required to give representations in relation to the activities of each member of the wider Group. Obligors may also seek to limit the scope of the representations or particular representations in other ways. For example, where representations extend to Subsidiaries or other members of the Group, Obligors might seek to limit their application to those entities which are Material Companies (a defined term in the Leveraged Facilities Agreement which is commonly also used in investment grade facilities). The extent to which this is appropriate and reasonable will depend on the circumstances.

Qualifications by reference to materiality

In the Investment Grade Agreement, some of the representations are qualified by reference to materiality and most Borrowers will negotiate further qualifications. When negotiating these types of qualification, Obligors should consider whether the qualifications in question are sufficiently certain: on each date on which the representation has to be given, they will need to be able to satisfy themselves as to whether the representation is true or not.

The term “material” and the defined term “*Material Adverse Effect*” are both used in Clause 19. The definition of “*Material Adverse Effect*” is left blank in the Investment Grade Agreement, to be settled in the context of the particular transaction, and is discussed below. Whilst the operation of any qualification must be considered in context, Borrowers may find it helpful to use the concept of a Material Adverse Effect, rather than just inserting the word “material”, as the precision of the definition provides greater certainty of meaning. In appropriate cases, monetary thresholds can be a helpful measure of materiality.

The scope of the definition of a “Material Adverse Effect” in the Leveraged Facilities Agreement is very wide: it is subjectively determined by the opinion of the Lenders, and extends, for example, to the prospects for the Group. This is not appropriate for investment grade Borrowers, which even since the onset of the financial crisis have been negotiating more restricted definitions. While strong Borrowers usually seek to limit the scope of the term to the Group’s financial condition, or possibly just to the ability of the Obligors to perform their payment obligations, Lenders usually want to cover material effects on all the Obligors’ obligations (not just payment obligations), and factors material in the business, operations, property and financial condition of the Group. A balance may need to be struck between whether it is preferable to have a definition which is wider, but which is agreed to qualify many of the representations and undertakings, or a very narrow definition which does not qualify many obligations.

Qualifications by reference to knowledge

None of the representations set out in the Investment Grade Agreement is qualified by reference to the knowledge of any Obligor, other than Clause 19.13 (*No proceedings*). The Borrower often seeks to amend representations so that they are given “so far as it is aware”. It is important however to appreciate the potential difficulties here. The first is the issue of the individuals whose knowledge may be taken in this context to constitute that of the company. Directors may be taken to fall into this category, and also possibly other senior personnel, and in some cases the company’s advisers. If possible, therefore, it may be preferable to express an awareness qualification by reference to named individuals. Another issue may be imputed knowledge, fixing the company with knowledge of, for example, documents in its possession. Accordingly, Borrowers may seek to limit the awareness qualification to actual awareness.

Qualification by reference to matters disclosed

Borrowers commonly need to carve out from representations matters which they have disclosed to the Lenders.

When are the representations given?

Representations are made on the date the facilities agreement is signed, and in addition, specified representations will be classified in the agreement as Repeating Representations. These will be deemed repeated on certain dates.

The dates on which representations are deemed repeated are the date of each Utilisation Request, the first day of each Interest Period and the date on which any new Obligor is accepted. Clause 4.2 (*Further conditions precedent*) makes it clear that, in addition, on the date of each Utilisation the Repeating Representations must be true in all material respects in order for the Utilisation to be made. Please see the comments below on the question of which representations should be Repeating Representations.

Clause 19.1: Status

This is a customary representation which confirms the legal status and capacity of the Obligors and their Subsidiaries and their power to own their assets and carry on business. It is given by each Obligor in relation to itself and each of its Subsidiaries. This representation is usually agreed to be a Repeating Representation.

Clause 19.2: Binding obligations

Clause 19.2 confirms that each Obligor's obligations under the Finance Documents are legal, valid, binding and enforceable. It is given by each Obligor in relation to its own obligations.

Borrower Notes

A legal opinion will usually be required to be delivered as a condition precedent. This will confirm that the Finance Documents are valid, binding and enforceable. It will, however, contain a number of reservations which operate to qualify the opinion as to the enforceability of the Finance Documents. Accordingly, the representation is qualified by the reservations in the legal opinion.

This representation is often agreed to be a Repeating Representation. Borrowers should appreciate that this involves some (albeit limited) legal risk. The opinion will speak at the date at which it is given. As a result, when the representation is repeated, it will only be qualified by reference to the legal position as at the date of delivery of the opinion. If there were a relevant change in law after the date of the opinion, the representation might no longer be accurate. It is however customary for the parties to agree that this legal risk will be borne by the Borrower.

Clause 19.3: Non-conflict with other obligations

This representation confirms that implementation of the transaction does not conflict with other legal or contractual obligations. It is widely drafted to cover non-conflict with:

- any law or regulation applicable to the relevant Obligor;
- its constitutional documents and those of its Subsidiaries; and
- any agreement or instrument binding upon it or any Subsidiary or its assets or those of any Subsidiary.

This provision requires the co-operation of lawyers and the personnel of the Obligors to check that by entering into the transaction, they will not be in breach of any law, constitutional document or contract binding on them or any Subsidiary. The first point to check is that the borrowing will not breach any borrowing limits in the company's constitutional documents, or any other relevant contract.

Borrower Notes

The Borrower will usually want to limit the application of this representation to Obligors only, and qualify paragraph (c) by reference to a Material Adverse Effect. This is usually a Repeating Representation.

Clause 19.4: Power and authority

Each Obligor represents here that it has the requisite power and authority to enter the transaction. This is usually a Repeating Representation.

Clause 19.5: Validity and admissibility in evidence

In paragraph (a), the Obligors confirm they have complied with any applicable consent and filing requirements.

The LMA Users' Guide acknowledges that paragraph (b), in which each Obligor represents that all steps have been taken to ensure that the facilities agreement can be produced as evidence in court, is not required to be given by companies incorporated in England and Wales.

This representation is usually repeated.

Clause 19.6: Governing law and enforcement

The Obligors here represent that the choice of English law will be effective, and that a judgment obtained in England will be enforced in their home jurisdiction. As the LMA Users' Guide acknowledges, the Lenders do not need these statements from Obligors which are English companies.

Borrower Notes

All Obligors (whether or not English companies) are likely to argue that these topics are not suitable material for representations: they are technical legal points which are usually dealt with in a legal opinion. If the Lenders insist on obtaining these representations in addition to a legal opinion, Obligors should ensure that they are qualified by reference to the reservations in the legal opinion, which should set out any necessary qualifications.

Where these representations are to be given, Obligors will want to resist repeating them, as the legal opinion will not be updated. However, as mentioned under Clause 19.2 (*Binding obligations*), this type of legal risk is customarily borne by the Borrower.

Clause 19.7: Deduction of Tax

Here each Obligor represents that it is not required to withhold tax from Qualifying Lenders, subject to certain conditions. The text was modified by the LMA in April 2009 so that it does not constitute more than a statement that the Obligor is not required to deduct withholding tax from payments to Qualifying Lenders (as defined).

Borrower Notes

Prior to the April 2009 amendment, Clause 19.7 contained a much wider statement that withholding tax is not applicable, which amounted to another gross up provision, but with none of the exceptions set out in Clause 13.2(d). UK Obligors were warned not to give such a representation and to argue that the Lenders have all the protection they need in Clause 13 (*Tax*). Lenders should no longer seek the older version of this representation. It does not provide any protection to the Borrower in the context of, for example, the difficult issues surrounding Treaty Lenders where, as discussed under Clause 13 (*Tax*), the avoidance of withholding tax depends on action taken by the Lenders.

Borrowers should not repeat this representation: the allocation of tax risks is set out in detail in Clause 13 (*Tax*), and a repetition of this representation is liable to cut across that provision.

Where the Obligors include any non-English companies, amendment to this representation may be required, as to Clause 13 (*Tax*).

Clause 19.8: No filing or stamp taxes

Here the Obligors provide reassurance as to filing and stamp taxes in their jurisdiction.

Borrower Notes

As the LMA Users' Guide comments, this is not needed from English corporate Obligors. In addition, all Obligors can take the view that the stamp duty indemnity set out in Clause 13.6 (*Stamp taxes*) means that the Lenders do not need reassurance on this point, and that concerns about filing requirements and so on are covered by Clause 19.5 (*Validity and admissibility*).

The Lenders should not insist on the repetition of this representation (if it is included).

Clause 19.9: No default

In paragraph (a), each Obligor represents that no Event of Default is continuing or might reasonably be expected to result from the making of a Utilisation.

In paragraph (b), each Obligor represents that no default is outstanding under any contract (including contracts made by its Subsidiaries) which might have a Material Adverse Effect.

Borrower Notes

In paragraph (a), note the meaning of “continuing”, discussed under Clause 1.1 (*Definitions*): if it has the narrow meaning of “not waived”, then if an Event of Default has been remedied but not waived, it will qualify as “continuing”. This means that if the representation were later repeated, and the Event of Default remained unwaived, there would be a further Event of Default.

Note that paragraph (a) is correctly limited to Events of Default (ie actual Events of Default). If it were amended to cover Defaults (ie to include potential Events of Default), the process of repetition on drawdown could turn a potential Event of Default into an actual Event of Default. The Lenders would then be able to accelerate on the basis of a potential Event of Default, a situation which would not be acceptable.

Borrowers may object to the forward-looking second part of this statement (“might reasonably be expected to result”), on the grounds that prediction of this kind is very uncertain.

The language of paragraph (b) is not easy. The Lenders want reassurance that the Obligors are not in breach of any other agreement, whether another financing agreement or business purchase agreement or ordinary trading contract, where that breach might have a Material Adverse Effect.

Obligors often object to the range of this representation, in applying to all contracts, even though it applies only to a breach that might have a Material Adverse Effect. The Lenders’ concerns about breaches of contract are also addressed, in different ways, by Clause 19.13 (*No proceedings threatened or pending*), Clause 23.12 (*Material adverse change*) (if included) and Clause 23.5 (*Cross-default*).

Please see the introductory comments to Clause 19 in relation to a Material Adverse Effect.

Clause 19.10: No misleading information

In paragraph (a), the Finance Parties look for confirmation as to the accuracy of the factual information provided.

In paragraph (b), they look for confirmation as to the quality of the information and assumptions on which the financial projections are based.

In paragraph (c), they seek broadly worded comfort that the information provided is not untrue or misleading.

These statements are key, and usually heavily negotiated. The focus of the Borrower needs to be on verification. This process is assisted if the representations are limited to written and factual information, and only authorised personnel provide this and keep a record as they do so.

These representations are usually not repeated.

Borrower Notes

These statements are often made by the Company alone, and limited to its knowledge (a topic discussed in the introduction to the comments on Clause 19).

Borrowers usually seek to limit paragraph (a) to information contained in the Information Memorandum.

Paragraph (b) warrants that the assumptions on which the financial projections are based are reasonable. The focus of discussion here is often the objectivity of the standard. Borrowers often seek to confirm that the directors consider the assumptions reasonable.

Paragraph (c), while objectively expressed, requires judgment. Although qualified by materiality, the statement focuses on omissions from the Information Memorandum, as well as its contents. Borrowers usually seek to restrict it.

Clause 19.11: Financial statements

Paragraph (a) is a key representation about the financial statements provided at signing (the “Original Financial Statements”), to the effect that they were prepared in accordance with GAAP consistently applied.

Paragraph (b) is another key representation about the Original Financial Statements: that they “fairly represent” the Obligor’s financial condition and operations during the relevant financial year.

Paragraph (c) is the “No material adverse change” representation.

Borrower Notes

The LMA definition of GAAP is “generally accepted accounting principles in []”, with an option to continue “including IFRS”, if any of the Original Financial Statements are IFRS-compliant. Thus, whether the Original Financial Statements are prepared under IFRS or a national GAAP, the representation as to the method of preparation reflects proper practice: preparation is usually in accordance with not only the applicable legal requirements but also with the body of principles and guidelines peripheral to the core legal requirements which are accepted as guidance as to good practice in the relevant jurisdiction.

Paragraph (b) reflects the requirement applicable to IFRS financial statements, that they must “present fairly” the financial position of an entity. The requirement applicable to UK-GAAP financial statements is that they must give “a true and fair view” of the company’s state of affairs. Although there has been some debate as to the possible difference in meaning of the two phrases, it is widely believed that, notwithstanding the differences between the requirements of IFRS and the CA 06 for the format and content of company accounts, there is no substantive difference, in the context of a representation of this kind in a loan agreement, between the two standards.

If paragraphs (a) and (b) are to be repeated, it needs to be clear that in the future this will be with reference to the financial statements most recently delivered.

The “no material adverse change” representation in paragraph (c) can sometimes be restricted so as to catch only an adverse change which is material in the context of the operations of the Group as a whole, and/or which has or will have a Material Adverse Effect (see introductory comments to Clause 19).

The inclusion of a “no material adverse change” representation is fairly standard, and is given at signing, measured against the most recent set of audited accounts. Investment grade Borrowers are not usually required to repeat this representation, as the Lenders may have the protection of the “material adverse change” Event of Default (discussed under Clause 23.12 (*Material adverse change*)). If the “no material adverse change” representation were to be repeated, focus would be needed on the date against which change is measured.

Clause 19.12: Pari Passu Ranking

This statement provides the essential comfort for unsecured Lenders that their claims rank equally with the claims of all other unsecured and unsubordinated creditors, other than those mandatorily preferred by law.

Clause 19.13: No proceedings pending or threatened

This representation applies (in summary) to actual or threatened litigation about which the Obligors are aware. Litigation is not caught by the representation unless it might reasonably be expected - if the counterparty sued successfully - to have a Material Adverse Effect.

This representation is not usually repeated, as the issues are covered by the information undertaking set out in Clause 20.4 (*Information*).

Borrower Notes

Borrowers usually seek to change this representation so that it looks to the reasonably likely outcome of the litigation, rather than the worst case scenario. Also, Borrowers may prefer to specify a threshold amount for the reasonably likely outcome, to avoid the uncertainty of the concept of Material Adverse Effect.

Clause 19.14: Repetition

Please see the discussion of this topic in the introduction to Clause 19. Care is needed in considering which representations will be the Repeating Representations. The Lenders' view as to which these should be varies considerably from one Borrower and deal to another, but usually starts from the position that they should all be Repeating Representations. The Obligors can usually argue successfully that representations will not be repeated if they are specific to the circumstances of signing (dealing with for example the Information Memorandum) or they address a concern also covered by an undertaking or an Event of Default, so that there is an overlap (for example, Material Adverse Change).

CLAUSE 20: INFORMATION UNDERTAKINGS

Introduction

These undertakings set out the requirements for information to be delivered to the Lenders during the life of the Facilities.

Borrower Notes

Borrowers will be concerned to protect the confidentiality of much of the information that is required to be delivered, though some of it will be publicly available. Confidential information is protected by the express confidentiality undertakings which the LMA included in the Investment Grade Agreement in April 2009 (Clause 36 (*Confidentiality*)).

A separate but related concern, which has received some press coverage, has been the possibility of market abuse by non-bank institutions such as hedge funds which hold loan participations and also deal in regulated investments such as equities. The concern arises particularly where there may not be information barriers segregating the staff dealing in regulated investments (on the “public side”) from those on the “private side” (such as the agency and loan trading desks) receiving information which may include inside information from the Borrower.

The LMA has issued guidance for loan participants on these issues. It has also amended the Investment Grade Agreement to cater for Lenders who wish, in order not to receive any inside information, to remain “public side” only. In April 2009, it introduced a new paragraph (c) to Clause 26.13 (*Relationship with the Lenders*) to enable such Lenders to appoint a third party to receive all communications on their behalf, and a new paragraph (c) of Clause 26.8 (*Responsibility for documentation*) to make clear that neither the Arranger nor the Agent is responsible for any determination as to whether information provided to any other Finance Party is non-public information.

These changes may be a useful response to requests (chiefly from participants in the leveraged loan market) for sanitised information packages, “scrubbed” of private-side information. The internal requirements of a Lender in relation to the provision of confidential and inside information are a matter for that Lender to manage, and the appointment of a representative to receive information on their behalf is a practical solution. Borrowers should resist any suggestion that they might police the information flow on behalf of such Lenders, in view of the potential cost and liability implications.

For comments on the potential impact of Lenders not receiving all the information delivered by the Borrower to the Agent, please see Clauses 26.13 (*Relationship with the Lenders*) and 35 (*Amendments and waivers*).

Clause 20.1: Financial Statements

Clause 20.1 provides for the delivery of annual and half-yearly accounts to the Lenders.

Borrower Notes

The period allowed by the Lenders for delivery of accounts varies. However, audited accounts are commonly required within 4 to 6 months of the end of the financial year, and half-yearly accounts within 3 to 4 months of the end of the half-year.

Clause 20.2: Compliance Certificate

Compliance Certificates are required to be delivered with each set of annual and half-yearly accounts, confirming compliance with the financial covenants.

Borrower Notes

Compliance Certificates are required to be signed by two directors. The Investment Grade Agreement allows the parties to provide that in addition the Certificate provided with the audited accounts will be signed by the auditors, or reported on by them in an agreed form.

The background here includes a guidance statement issued by the Institute of Chartered Accountants in 2000, which advises accountants that Compliance Certificates should be signed only by the Borrower, and that a firm of accountants should not report to Lenders on the Borrower's covenant compliance without first entering a separate engagement letter with the Lenders. They are advised to report only on the extraction of figures by the Borrower in the Certificate, the accuracy of the arithmetic, and compliance with the relevant definitions. As a result, if it is agreed that the auditors will report on Compliance Certificates, they should be involved at an early stage, to ensure that the exact nature of their remit is settled before signing. The form of their report needs to be settled too.

Borrowers may take issue with the statement in paragraph 3 of the form of Compliance Certificate set out in Schedule 8 that no Default is continuing. The statement covers Default on any point, not just the financial covenants, and the Lenders are already protected by Clause 20.5 (*Notification of Default*) which requires the Obligors to notify the Agent of any Default promptly. Also, it is not clear whether the confirmation is intended to be as at the testing date or the date of the Certificate.

Clause 20.3: Requirements as to financial statements

This Clause sets out the requirements of the Lenders in relation to the financial statements delivered. The detail requires some consideration.

Borrower Notes

Paragraph (a) provides that each set of financial statements delivered shall be certified by a director of the relevant company as fairly representing its financial condition. Where the representations regarding financial statements (Clause 19.11 (a) and (b)) are repeated, Borrowers may object that the Lenders do not need in addition a director's certificate. However, where (as is often the case) the director's certificate is to be given, care is needed to ensure that the text of the confirmation conforms to the text of Clause 19.11 (*Financial statements*). For example, Clause 19.11 contemplates the disclosure of exceptions.

The parties have to agree here whether the financial statements will be prepared on the basis of "frozen GAAP" or "non-frozen GAAP" (adopting either paragraph (b) or paragraph (c)).

Paragraph (b) obliges the Borrower simply to ensure that each set of financial statements is prepared using GAAP (ie as it changes from time to time).

Under the "frozen GAAP" provision, each set of financial statements has to be prepared on the same basis as the Original Financial Statements, unless there has been a change in GAAP. In that case, they are required to reflect the changes in GAAP, but in addition the auditors must provide a description of the changes necessary for them to reflect the principles and practices on which the Original Financial Statements were prepared, and sufficient information to enable the Lenders to determine whether the financial covenants have been met on the basis on which they were set. In relation to loan facilities including financial covenants, all parties will want the "frozen GAAP" provision, for the convenience and certainty it provides in enabling the covenants to be measured on a consistent basis.

As a result, since it is possible that the accounting practices or principles on which financial covenants are set may change during the life of the loan facility, it will usually be advisable to include an additional Clause, under which the parties agree to negotiate in good faith to settle the amendments which may be required to the facilities agreement as a result. In the context of the switch to IFRS, the LMA and ACT agreed the following wording:

"If the Company notifies the Agent of a change in accordance with [paragraph ()] of Clause [] (Requirements as to financial statements)] the Company and the Agent shall enter into negotiations in good faith with a view to agreeing any amendments to this Agreement which are necessary as a result of the change. To the extent practicable these amendments will be such as to ensure that the change does not result in any material alteration in the commercial effect of the obligations in this Agreement. If any amendments are agreed they shall take effect and be binding on each of the Parties in accordance with their terms."

Borrowers may wish to provide additionally that the parties will negotiate for a minimum period, such as 30 days. A provision of this kind should provide the necessary basis for dialogue between the parties, though it should be appreciated that, as an agreement to agree, its meaning is not sufficiently certain for it to be enforceable.

The LMA definition of GAAP is discussed under Clause 19.11 (*Financial Statements*).

Clause 20.4: Information: miscellaneous

This provision contains a number of information requirements, including notification of any material litigation and a general requirement to supply the Agent with any information reasonably requested.

Borrower Notes

Certain aspects of this provision may be objectionable from a Borrower perspective. For example, the general requirement in paragraph (c) to provide further information might be limited to such information as can be provided without material cost to the Group (at least prior to the occurrence of an Event of Default).

Additionally, Borrowers may prefer the materiality threshold for notification of litigation and claims in paragraph (b) to be expressed as a fixed minimum amount, consistent with any agreed in the related representation (Clause 19.13 (*No proceedings*)).

Listed Borrowers may wish to limit the material which can be requested to information which is publicly available.

Clause 20.5: Notification of Default

This is a customary provision obliging each Obligor to notify the Agent promptly upon becoming aware of the existence of any Default.

Borrower Notes

Borrowers may wish to provide that the notification requirement is triggered promptly upon the Parent becoming aware of any Default. As drafted, each Obligor is required individually to notify the Agent of any Default (unless it is aware that another Obligor has already done so).

Clause 20.6: Use of websites

This provision means that, if the Agent and the Borrower agree, the Borrower can post any information required to be delivered on a website.

Borrower Notes

The Lenders are not obliged to agree to the use of the website: Borrowers should note that posting information on the website satisfies their obligations only in relation to those Lenders who have individually agreed to receive it electronically. However, technological development since this provision was first formulated may now mean that it would be appropriate for Borrowers to discuss with their Arranger whether the consent of the Lenders remains necessary on an individual basis. Ideally, all Lenders would be required to receive website information, though with a continuing right to call for paper copies. Borrowers can point to similar developments, in the new rules set out in the CA 06 and the Disclosure and Transparency Rules, which are designed to facilitate electronic communication.

Borrowers may want to negotiate some relaxation of the requirement in paragraph (a)(iii) that the information must be in a format previously agreed with the Agent.

The Borrower needs to reflect carefully on its obligations under paragraph (c) to notify the Agent. It may wish to resist the obligation to notify the Agent upon becoming aware that the website is infected by a virus, given the potential consequences of a failure to do so. The Borrower may also wish to consider inserting an express exclusion of all liability arising out of a virus infecting the website.

Clause 20.7: “Know Your Customer” checks

These provisions require the Obligor to provide information to the Agent for the purpose of satisfying applicable “know your customer” or “KYC” requirements.

KYC checks on each Obligor will need to be carried out by the Original Lenders prior to signing. Clause 20.7 requires the Obligor to provide KYC information in any of three situations:

- a change in law or regulation after signing;
- a change in the status of an Obligor after signing; or
- a proposed secondary market purchase.

This obligation is limited in that a Lender or prospective Lender is entitled to request the information only where it is obliged to carry out KYC checks. The request may not be made where the information is already available to the Lender or prospective Lender, as would be the case if the Agent were willing to pass on information already in its possession. In addition, the information may only be requested in order for the Lender to satisfy itself that it has complied with applicable law. Finally, the Obligor is not obliged to comply unless the request is reasonable.

Background

The information which follows describes in outline the regime applicable to a Lender with a UK facility office. Lenders with facility offices elsewhere will be subject to different regimes, though those in EEA jurisdictions should be similar.

The wording in Clause 20.7 ("*Know your customer*") was originally based on the Money Laundering Regulations 2003. These have now been replaced by the Money Laundering Regulations 2007 (the "Regulations"), but their effect is very similar.

In summary, any Lender with a UK facility office which is proposing to lend to a Borrower is expressly required by the Regulations to apply, on a risk-sensitive basis, "customer due diligence" (or CDD) measures. In practice this entails identifying the Borrower and then verifying the Borrower's identity on the basis of documents, data or information obtained from a reliable and independent source. In the case of unlisted corporate Borrowers, it also means identifying any individual beneficial owners (defined as individuals who own or control more than 25% of the shares or voting rights in the Borrower or otherwise exercise control over the management of the Borrower).

The Regulations have also introduced:

- a simplified due diligence regime which will apply to certain limited categories of Borrowers, including a Borrower which is a company whose securities are listed on a regulated market and which is subject to specified disclosure obligations. In practice this means that Lenders should not require detailed information in order to verify the identity of a listed Borrower for KYC purposes;
- a requirement for Lenders to carry out "ongoing monitoring" of a business relationship, which can include updating CDD information; and
- a formal reliance regime which enables financial institutions to place reliance on customer due diligence carried out by certain other persons, and in particular by banks which are authorised or are otherwise subject to the Regulations or equivalent legislation in other EEA (and some non-EEA) jurisdictions.

Any Lender with a UK facility office is also required by generally applicable proceeds of crime legislation to know its Borrower and its Borrower's business.

The initial CDD measures are required to be carried out before the Lender enters a business relationship or one-off transaction with the Borrower. Ongoing monitoring must then follow that initial identification and verification exercise. Non-compliance is potentially a criminal offence.

In 2007, when the Regulations came into force, the Joint Money Laundering Steering Group updated its guidance (the "JMLSG Guidance") on how financial sector firms should seek to comply with these and other anti-money laundering requirements. The JMLSG Guidance sets out industry best practice for financial sector firms in relation to both the Regulations and the generally applicable proceeds of crime legislation. It includes in particular sector-specific guidance on syndicated lending. The secondary debt market is specifically addressed, noting that a lender purchasing debt in the secondary market, whether by novation, assignment or sub-participation, must consider the extent of its obligations to identify, and verify the identity of, the Borrower.

When carrying out customer due diligence, the JMLSG suggests that each Lender should have regard for the 'risk-based approach' required by the Regulations and further advocated in the JMLSG Guidance. Moreover, the JMLSG Guidance confirms that Lenders may wish to take account of or rely on the due diligence carried out on the Borrower by the Arranger or the Agent.

The JMLSG Guidance helpfully goes on to say that simplified due diligence as provided for in the Regulations may be applied not only to a listed Borrower but also to any Borrower which is a majority-owned and consolidated subsidiary of a listed company, or a Borrower which is subject to the licensing and prudential regulatory regime of a statutory regulator (eg the FSA).

Borrower Notes

An unlisted Borrower may find that its Lenders want to have the right to request KYC information in addition following a change in the composition of the Borrower's shareholders. A change of significant (ie 25%+) shareholdings may require a Lender to carry out further KYC checks after a loan agreement has been signed, though not necessarily in all cases (the beneficial owner test relates only to *individuals* owning or controlling more than 25% of a corporate borrower).

The combined effect of the regulatory regime, JMLSG Guidance and LMA provisions is therefore expected to be as follows:

- Listed Borrowers should not need (before or after signing) to provide UK-based Lenders with KYC information beyond confirming basic details, unless after signing there is a change in law or regulation, or the Borrower's status changes (eg a de-listing).
- Unlisted Borrowers would be likely to be subject to KYC checks from UK-based Lenders before signing; this would be due to the Lenders' statutory and regulatory duties rather than any contractual obligation. After signing, an unlisted Borrower would be required by the terms of the LMA documentation to provide KYC information for any prospective Lender which is required to perform KYC checks, or if there were a change in law or in the Borrower's status or, in some cases, if there were a change in the composition of its shareholders.

Borrowers wishing to restrict the impact of this provision may like to consider the following suggestions:

- Some Agents and Arrangers may be prepared to act as a distributor of KYC material, and a channel for KYC requests. As mentioned above, in addition to the JMLSG Guidance clearly contemplating the utility of Lenders relying on checks carried out by an Agent or Arranger, the Regulations now provide a statutory regime under which reliance between banks can be effective. Borrowers will prefer to deal with a single organisation, if possible, rather than receiving requests for KYC information from a range of Lenders and prospective Lenders.
- Borrowers may be concerned that they may be asked for information which they cannot provide, such as about the beneficial ownership of shares. Although obliged only to provide information in response to requests which are reasonable, Borrowers may feel more comfortable if the information for which they can be asked is expressly limited to information which is within their possession or control or which can be obtained using reasonable endeavours. If it is impossible for a Borrower to supply certain information, but the Lender cannot lawfully become or remain a Lender without it, the illegality provisions of Clause 8.1 (*Illegality*) should be triggered, rather than the Borrower being held to be in breach for failure to do the impossible. An alternative approach could be to require the Borrower merely "to deal in good faith" or "co-operate with" reasonable requests, though this may not satisfy Lenders to the extent that they are obliged as a matter of law to carry out KYC checks.

- The information which the Borrowers are obliged to provide is expressed to be in order for the Lender or prospective Lender “to carry out and be satisfied it has complied with all necessary KYC or other similar checks”. Borrowers will prefer the purpose to be expressed objectively (“in order for the Lender... to comply . . .”); the word “satisfactory” was used in earlier versions of the Regulations but is now no longer a feature of the statutory text, which refers to due diligence measures being “risk-sensitive” and “appropriate”. Lenders may be prepared to concede that the aim is for them to be satisfied “acting reasonably”.
- Borrowers may wish to clarify that all requests for KYC information should be sent via the Agent.

CLAUSE 21: FINANCIAL COVENANTS

This Clause is left blank, since financial covenants – if there are to be any – have to be tailored to the circumstances of the Borrower. Historically, not all investment grade facilities have included financial covenants, although Lenders have become more likely to require them since the credit crunch.

The Leveraged Facilities Agreement contains model form financial covenants designed, as the name suggests, for use in a leveraged financing. These assume a cashflow based financing and therefore deal with cashflow cover, interest cover, leverage and capital expenditure, though not net worth or other asset-focussed ratios. While some aspects of the LMA drafting may be helpful in settling financial covenants in a deal which is not leveraged, care will be needed to ensure appropriate provision for the circumstances of each case. As a result, there will in most cases need to be significant change to the LMA language. For borrower-friendly guidance, see the ACT Borrower’s Guide to the Leveraged Facilities Agreement.

CLAUSE 22: GENERAL UNDERTAKINGS

The general undertakings set out in Clause 22 constitute a set of basic, albeit stringent, restrictions on the operations of the Borrower group. Though usually supplemented by a number of deal- and Borrower-specific undertakings, they are also usually heavily negotiated. Negotiations tend to focus on:

- The list of companies caught by the restrictions: for example, some of the undertakings include every member of the Group: depending on the circumstances, it is possible that some undertakings should be limited to only certain Group members, such as Material Companies.
- Materiality: it is common to limit the scope of the undertakings by reference to materiality, for example by reference to a Material Adverse Effect, and/or by

permitting transactions which would otherwise be prohibited up to a certain amount per annum.

- Specific exclusions justified by the type of business and plans of the Group. Care is needed to consider the scope of the undertakings being sought, so that appropriate exceptions are settled in advance of signing, to avoid the need for requests for amendments.

In contrast to a representation, an undertaking remains in force continuously for the life of the Facilities. Breach at any time will therefore be an Event of Default.

Clause 22.1: Authorisations

This covenant requires each Obligor to obtain and supply copies to the Agent of all Authorisations (for example any regulatory consents and approvals) required to enable it to perform its obligations under the Finance Documents, and to ensure their legality, validity and enforceability and admissibility in evidence.

Borrower Notes

Borrowers may seek to qualify this covenant, limiting the obligation to Authorisations whose absence would be materially prejudicial to the Finance Parties.

Clause 22.2: Compliance with laws

This is a customary undertaking on the part of the Obligors to comply with all laws, to the extent that failure to comply would materially affect their ability to comply with the Agreement.

Clause 22.3: Negative pledge

In an unsecured loan facility, the purpose of the negative pledge is to prevent the Borrower from creating any security over its assets – save for listed exceptions – and thus to preserve the pool of assets available for unsecured creditors. Negotiations usually focus on the categories of security which are to be permitted: the Borrower needs to ensure at the outset that it will be able to trade and to carry on business on the basis contemplated with its Lenders without the need to obtain their consent for routine funding arrangements.

Changes made to the negative pledge at the request of the ACT in April 2009 have extended the list of exceptions to include categories regularly approved by Lenders, notably set-off and netting for hedging purposes, and retention of title arrangements.

Clause 22.3(a): Security

Clause 22.3(a) sets out the basic, broad covenant on the part of each Obligor not to create Security, and not to allow any Security to exist, over its assets. Note that the prohibition applies whether or not the amount secured is financial indebtedness: security granted in favour of, for example, trade creditors is prohibited as well.

Note that the Borrower is also obliged to ensure that no other member of the Group will do this. Depending on the nature of the Group, the Borrower may argue that only certain material Subsidiaries, or only the Obligors, should be caught by this restriction.

Note also the very wide definition of Security given in Clause 1.1 (*Definitions*), which covers not only the classic forms of security such as mortgages and charges, but also “any other agreement or arrangement having a similar effect”. This last phrase may catch a wide range of arrangements, such as set-off, sale and leaseback, debt factoring, retention of title and so on. Borrowers will be very concerned by the breadth of this definition, and want to restrict it. They will also wish to delete some of the provisions of Clause 22.3(b) which effectively duplicate it, although these apply only where the purpose of the transaction is to raise Financial Indebtedness or to finance the acquisition of an asset. Where it is not possible both to restrict the definition of Security and to delete the duplication in Clause 22.3(b), Borrowers will prefer the former, as the scope of Clause 22.3(b) is limited by reference to Financial Indebtedness and the financing of the acquisition of an asset.

Clause 22.3(b): Quasi-Security

Clause 22.3(b) imposes further restrictions on all members of the Group, and the list of companies caught by these restrictions needs to be limited as mentioned above.

This Clause lists transactions which may not fall within the definition of Security but which are usually regarded by banks in that light, such as sale and repurchase or leaseback, debt factoring on recourse terms, and set-off arrangements, including intra-group netting and set-off of bank accounts. There is a final and very broad category catching any other arrangement that has a preferential effect. In each case the arrangement is not caught unless the primary aim is to raise Financial Indebtedness or finance the acquisition of an asset. Transactions of this kind have been defined as “Quasi-Security” since April 2009, for convenience and in line with the Leveraged Facilities Agreement.

Clause 22.3(c): Exceptions

Borrowers are well advised to devote time to ensuring that the exceptions to the negative pledge set out in paragraph (c) will permit them to arrange their future funding requirements in the ways that they are envisaging, and to ensure that their Lenders understand their plans and expectations. Detailed discussion is often

necessary. Lenders are usually reluctant to make general exceptions, such as for security granted “in the ordinary course of business”.

Borrower Notes

Existing Security

Sub-paragraph (i): it is envisaged that all Security existing at the time the facilities agreement is signed can be exempted by being listed in Schedule 9, though Lenders may allow only certain forms of existing Security to be permitted in this way. Borrowers should note that the exemption will not apply if the amount of the debt exceeds the limit stated in Schedule 9.

Netting and set-off in the ordinary course of banking arrangements

Sub-paragraph (ii): Clause 22.3(b)(iii) (in its full form) and a wide definition of Security will prohibit a broad range of set-off and netting arrangements with banks, finance houses, suppliers and others. The exception set out in paragraph (c)(ii) for set-off and netting permits only arrangements made “in the ordinary course” of the company’s “banking arrangements”, and only if they are made “for the purpose of netting debit and credit balances”. Borrowers usually need this exception to be relaxed further. In particular, Borrowers usually need to refer instead to the ordinary course of their financing arrangements. Often the exception needs to cover expressly netting and setting-off arrangements under derivatives contracts and cash management arrangements. Sometimes it may be helpful to refer to a bank’s standard terms of business and ISDA terms.

Other netting and set-off in hedging transactions

Sub-paragraph (iii) is an additional exception inserted in April 2009. It is now clear that set-off and close out netting arrangements in hedging transactions are permitted where they are entered for the purpose of:

- hedging any risk to which a Group member is exposed in its ordinary course of trading; or
- the company’s interest rate or currency management operations in the ordinary course of business and for non-speculative purposes.

Collateral provided by way of credit support for hedging is excluded from this permission.

Liens

Sub-paragraph (iv): under English law, a lien is a form of security which arises by operation of law to allow an unpaid creditor to retain possession of an asset until he is paid. Borrowers are sometimes able to alter this exception so that it permits liens and rights of set-off arising by operation of law and in the ordinary course of business.

Assets acquired after signing

Sub-paragraph (v) permits Security over assets acquired after signing, but only subject to conditions: the Security must not be provided in order to finance the acquisition, the amount secured must not be increased, and the Security must be discharged within a fixed period, such as 6 months. Effectively therefore this permission does not permit, for example, Security being granted over an asset in order to finance its acquisition.

Historically, in the case of strong credits, Lenders have agreed in some cases to permit security for funding acquisitions, but only (for example) if the asset is purchased at a fair market value and on an arm's length basis, and the amount secured meets a loan to value ratio and is not increased after the date of the acquisition.

Sub-paragraph (vi) is similar to sub-paragraph (v), in this case relating to the assets of a company whose share capital is acquired by a Group member.

Security created pursuant to the Finance Documents

Sub-paragraph (vii) permits security created pursuant to the Finance Documents.

Retention of title etc

Sub-paragraph (viii) is a new exception, inserted in April 2009, in line with market practice and the Leveraged Facilities Agreement, for retention of title and similar arrangements, for goods supplied in the ordinary course of trading and on the supplier's standard terms.

Other

Sub-paragraph (ix) is left blank by the LMA, for the parties to settle any further exceptions that may be required, such as:

- Security for trade finance, for example pledges of goods and documents of title to a financial institution providing a letter of credit, and assignments of insurance policies.
- Security over land and buildings to secure the cost of building or improvements.
- Intra-group Security.
- Refinancings, where Security is given in substitution for any Security permitted, and over the same asset, as long as the maximum amount secured does not increase.
- Debts factored on a recourse basis as part of the Group's day-to-day cash collection procedures rather than as a means of raising finance.
- Payments into court or security for costs given in connection with legal proceedings which are being contested.
- Rent deposits for leasehold premises where a Group member is a tenant.

De minimis

Sub-paragraph (x) allows the Borrower to create security which is not permitted by the preceding sub-paragraphs, up to a certain aggregate amount of indebtedness. The Borrower will need to ensure that the amount of indebtedness which can be secured is high enough. This is often expressed either as a fixed amount or the higher of a fixed amount and a specified percentage of net worth.

Clause 22.4: Disposals

The basic prohibition here is very wide-ranging: no Obligor may sell, lease or dispose of any asset, and the Borrower must ensure that no member of the Group makes any disposals. Strong Borrowers usually succeed in negotiating substantial exceptions, and can sometimes delete the prohibition altogether.

Borrower Notes

Paragraph (b) sets out the exceptions. The first exception in paragraph (i) applies to disposals in the ordinary course of trading. Borrowers usually want to extend this to disposals in the ordinary course of business.

Paragraph (ii) covers assets exchanged for comparable or superior assets.

Paragraph (iii) is blank, anticipating further exceptions to be negotiated. For example:

- Many Borrowers ask for an additional exception for disposals “for fair value and on arm’s length terms”. This will permit many disposals, and obviate the need to extend the permission in paragraph (i) beyond disposals in the ordinary course of trading.
- Disposals of obsolete or redundant assets are conventionally permitted (for example in the Leveraged Facilities Agreement).
- Intra-group transfers of assets are also generally permitted. The Borrower can point out that the Lenders are protected by several other provisions against major changes in the business: for example, Clause 22.6 (*Change of business*), and Clause 23.9 (*Ownership of the Obligors*).
- Other exceptions may include for example disposals to which Group members are committed prior to signing, and exceptions required by the nature of the Group’s business and operations. These might include, for example, disposals of book debts in the context of factoring or discounting arrangements.

Paragraph (iv) permits other disposals of assets of a value up to a stated amount, such as a percentage of net assets, each year. The threshold needs to be set at a sufficiently high level to enable the Borrower to run the business without having to make regular requests for waivers or amendments. Borrowers may also seek to carry forward or carry back unused basket amounts from year to year.

Clause 22.5: Merger

Here the Lenders prohibit any form of merger or corporate reconstruction by any member of the Group.

Borrower Notes

Borrowers may seek to limit the application of the Clause only to Obligor, and to ensure that it permits certain kinds of reorganisation, such as solvent liquidations or reorganisations (as in the Leveraged Facilities Agreement).

Clause 22.6: Change of business

The Borrower undertakes here not to make any substantial change to the general nature of its business or that of the Group.

CLAUSE 23: EVENTS OF DEFAULT

This Clause lists the events which qualify as Events of Default.

For commentary on the consequences of an Event of Default, please see the discussion of Clause 23.13 (*Acceleration*) below.

Clause 23.1: Non-payment

This is the non-payment Event of Default, catching any payment failure on the due date.

There is an exception for failure to pay as a result of administrative or technical error, provided this is remedied within a fixed grace period to be agreed. There is also a grace period which is expressed to apply in the event of major operational disruption.

Borrower Notes

Grace periods

Practice in relation to this provision is surprisingly variable. While it is common to settle grace periods for non-payment due to administrative or technical error and a Disruption Event (discussed below), not all facilities follow the LMA pattern. For example, some Borrowers negotiate different grace periods for payments of interest and principal (for any reason), with a separate grace period applying if the non-payment is due to administrative or technical error. Other Borrowers negotiate a short general grace period, with separate grace periods applying in the case of administrative or technical error or a Disruption Event.

The grace period agreed for non-payment as a result of an administrative or technical error is usually between three and seven Business Days.

Where a short general grace period is agreed in addition, this is usually around three Business Days.

It is common for the same grace period to apply to Disruption Events as to administrative or technical errors, although Borrowers may feel that where there is a Disruption Event the grace period should last as long as the event is continuing. The use of a simple grace period of a fixed number of Business Days might not be sufficient.

Borrowers should note that the Disruption Event grace period does not apply to the cross-default Clause. See further Clause 23.5 (*Cross default*).

Major operational disruption

Following 9/11, the Government commissioned a report on the potential impact of major disruption in the financial system. The Report of the Task Force on Major Operational Disruption in the Financial System, published in 2003, concluded that market participants should ensure that their contracts cater for major operational disruption. Against this background, the LMA and the ACT settled some changes to the Investment Grade Agreement:

- A specific grace period was added for payment failure on the part of the Borrower when this is due to a Disruption Event. Please see the comments above on this grace period.
- A provision was added (Clause 29.10 (*Disruption to payment systems*)) enabling the Agent to respond pragmatically to a Disruption Event. For further information, please see the comments on that Clause.

Clause 23.2: Financial covenants

There is an Event of Default if any of the financial covenants is not satisfied.

Borrower Notes

No grace period is contemplated by the LMA, and Lenders may take the view that the financial covenants are inherently incapable of remedy, because they measure a ratio or amount in relation to a past accounting period. Nonetheless, a grace period is usually agreed, to provide time for a cure. This may be between 10 and 30 days. If (as has historically been typical in the leveraged market, though not in the investment grade context), the Borrower has equity cure rights, the grace period needs to be consistent with the time permitted for the exercise of those rights.

Clause 23.3: Other obligations

This Clause provides that there will be an Event of Default if there is a breach of any other obligation (ie other than non-payment or the financial covenants). The LMA contemplate that grace periods will be agreed.

Borrower Notes

Borrowers can usually negotiate reasonable grace periods (such as between 15 and 30 days). They may also seek to insert a materiality qualification, and to provide that time starts to run from the date on which the Agent serves notice on the Borrower.

Clause 23.4: Misrepresentation

There is an Event of Default if any representation made by an Obligor proves to have been incorrect or misleading in any material respect.

Borrower Notes

This provision is softened by a materiality qualification: a representation has to be inaccurate in a material respect for there to be an Event of Default. However Borrowers are often able also to settle a grace period equivalent to that applicable for a breach of covenant, to cure a misrepresentation which is capable of remedy.

Clause 23.5: Cross-default

Under the cross-default, a default under any other Financial Indebtedness of any Group member is an Event of Default under the facilities agreement. This is a topic on which Borrowers usually spend some time in negotiation with the Lenders.

The aim of the cross-default Clause from the Lenders' point of view is to ensure that they are on an equal footing with all the other financial creditors of the Group: if another lender is not paid and accelerates, demanding repayment at once, or if another lender has the right to accelerate, the Lenders wish also to be able to accelerate repayment of the Facilities (even if the Borrower has not otherwise defaulted under the facilities agreement), in order not to be at a disadvantage. The Borrower however needs to restrict the circumstances in which the Lenders can demand repayment under the facilities agreement on the basis of defaults under other financing arrangements.

Borrower Notes

The Clause focuses on defaults relating to Financial Indebtedness, the definition of which is discussed under Clause 1.1 (*Definitions*).

It applies to defaults by any member of the Group. Strong Borrowers have historically succeeded in restricting the cross-default provision to defaults by Obligor only, or Material Subsidiaries.

Paragraphs (a) and (b) are hard to dispute: if some other Financial Indebtedness is not paid when due, or is accelerated, there will be an Event of Default under the facilities agreement.

Paragraph (c) provides for cross-default if another lender cancels its commitment as a result of a default. Only a very strong Borrower will usually be able to argue successfully that the cancellation of an undrawn commitment should not be a cross-default.

Paragraph (d) provides for cross-default if another lender is merely entitled to accelerate. The Borrower will say the Lenders do not need to be able to accelerate under the facilities agreement unless the other creditor also actually accelerates (as in paragraph (b)) or is not paid (as in paragraph (a)). The inclusion of paragraph (d) makes the clause a “cross-default” clause; if it were deleted, the clause would be a “cross-acceleration” clause. (Very strong Borrowers have historically been able to restrict Clause 23.5 to cross-acceleration. In current market conditions, this is more difficult.)

Paragraph (e) is a useful carve-out: there is no default under this Clause 23.5 if the amount of the Financial Indebtedness owing to other creditors which is in default is less than a specified figure. This can provide a reasonable degree of comfort if the threshold amount is satisfactory.

Some Borrowers argue that non-payment of other Financial Indebtedness should not constitute a cross-default under the Investment Grade Agreement until the end of the longer of any applicable grace period under that other indebtedness and the grace period applicable for payment defaults under the Investment Grade Agreement. Without such a provision, the Lenders under the Investment Grade Agreement might be able to accelerate on the basis of a grace period which is shorter than the grace period they have agreed with the Borrower for payment defaults under the Investment Grade Agreement.

There is no grace period under this Clause 23.5 for defaults under other contracts due to a Disruption Event, although there is a grace period in Clause 23.1 (*Non-payment*) for payment default under the Investment Grade Agreement due to a Disruption Event. As a result, where there is no grace period under another contract for payment default due to a Disruption Event, the cross-default Clause under the Investment Grade Agreement can be triggered by a payment default due to a Disruption Event under the other contract. If a Borrower is not able to convince its banks that the cross-default provision in the Investment Grade Agreement should have a Disruption Event grace period, it will need to consider other ways of preventing chains of cross-defaults arising by virtue of a Disruption Event. One solution is to insert a Disruption Event grace period for payment default in all new facilities (or refinancings) so that, over time, all the Borrower's debt documentation (including bilaterals and financial instruments) will include this grace period.

Clause 23.6: Insolvency

The essence of this Event of Default is the insolvency of any member of the Group, on either a cashflow basis (where it is unable to pay its debts as they fall due) or a balance sheet basis (the value of its assets is less than the amount of its liabilities, taking into account contingent and prospective liabilities). However, the Event of Default is drafted in such a way as to be applicable in a wider range of circumstances: attention to the detail of the drafting is therefore required.

Borrower Notes

This Event of Default will be triggered by the insolvency (or other stated events) of any member of the Group. Historically, strong credits have been able to limit its application, for example to Obligors and Material Companies.

Paragraph (a) can be triggered if a Group member suspends payment on any one of its debts, or, by reason of actual or anticipated financial difficulties, commences negotiation with a single creditor with a view to rescheduling. These triggers need to be restricted to suspension of payments to or negotiation with a class or category of creditors, to avoid an Event of Default arising from dealings with a single creditor. Borrowers also often seek to exclude negotiations with the Finance Parties from this provision.

Clause 23.7: Insolvency proceedings

This Event of Default is triggered essentially by insolvency proceedings in relation to any member of the Group, in any jurisdiction. Borrowers often seek to amend the drafting, which is unacceptably broad.

Borrower Notes

Without amendment, this Event of Default is liable to be triggered very early. The opening of Clause 23.7 is unsatisfactorily vague: “Any . . . procedure or step is taken in relation to . . .”.

This Event of Default is also problematic in two of the ways mentioned in the case of Clause 23.6 (*Insolvency*): it can be triggered by the relevant proceedings being initiated in any member of the Group, and in some cases by reference to a single creditor or single debt.

The reference to a moratorium in paragraph (a) is duplicative of the trigger in Clause 23.6(c).

Enforcement of any Security over any assets in paragraph (d) is often subject to a minimum value or qualified in some other way by reference to materiality.

Since April 2009, this provision has included a carve-out for vexatious or frivolous winding-up petitions, in line with the Leveraged Facilities Agreement and market practice. In the Leveraged Facilities Agreement, the petition has to be dismissed within 14 days of commencement. In the Investment Grade Agreement, the period is left blank to be settled between the parties. Borrowers often seek a much longer period, such as 30 or even 60 days.

Clause 23.8: Creditors' process

This Event of Default is triggered where any asset of any Group member with a value in excess of a stated minimum becomes subject to a creditor's process such as execution, which is not discharged within a fixed period.

In order that it should apply only in appropriate circumstances, it is important to ensure that the materiality threshold is fixed at a sensible level. Borrowers often obtain 21 days to discharge the process.

Clause 23.9: Ownership of the Obligors

There is an Event of Default if any Obligor ceases to be a Subsidiary of the Company.

Change of control of the Company is addressed in Clause 8.2 (*Change of control*).

Clause 23.10: Unlawfulness

There is an Event of Default if it becomes unlawful for an Obligor to perform any of its obligations.

Clause 23.11: Repudiation

There is an Event of Default if an Obligor repudiates a Finance Document or shows an intention to do so.

Borrower Notes

A party to a contract repudiates it by indicating that it does not intend to perform its obligations. If, therefore, an Obligor repudiates the facilities agreement, the Lenders will have the right to accelerate.

Clause 23.12: Material Adverse Change

Inclusion of this Event of Default (the “**MAC**”) is fairly standard, though Borrowers can argue persuasively that the Lenders are adequately protected by all the other representations, covenants and Events of Default, and do not need in addition the ability to accelerate or stop a drawing on the grounds that there has simply been a material adverse change. On the other hand, although Borrowers often feel that that this Event of Default is too vague to be acceptable, its lack of certainty may make it difficult for the Lenders to rely on.

It is important to consider the MAC Event of Default in conjunction with the related representation, Clause 19.11(c). Please see the comments on that Clause.

Borrower Notes

The precise wording of the MAC Event of Default is left blank in the Investment Grade Agreement for the parties to negotiate. There is a range of possibilities. In the Leveraged Facilities Agreement, for example, the wording is triggered on the occurrence of an event or circumstance which in the reasonable view of Majority Lenders has or may be reasonably likely to have a Material Adverse Effect. Where this is proposed, Borrowers usually seek to ensure that the wording is changed so that the test is objective, and not dependent on the Majority Lender view. They also seek to restrict the definition of a Material Adverse Effect as discussed in the introductory comments to Clause 19 (*Representations*).

Clause 23.13: Acceleration

The essence of this provision is that if an Event of Default occurs, the Lenders are entitled to demand immediate repayment, and/or declare that the Loans are repayable on demand, and/or cancel their Commitments.

Borrower Notes

Note that in the template the Lenders' right to accelerate is triggered by the occurrence of an Event of Default "[which is continuing]". Use of square brackets in the Investment Grade Agreement indicates optional language. In this instance, however, the Investment Grade Agreement may be out of line with market practice, as these words are almost invariably included in loan facilities for sub-investment grade Borrowers as well as investment grade Borrowers. If these words were not included, the Lenders would be able to accelerate once an Event of Default had occurred, even if it were no longer continuing.

In this context, please see the comments on "continuing", under Clause 1.1 (*Definitions*): the Borrower will want it to be defined as "not remedied or waived", otherwise an Event of Default will count as continuing even after it has in fact been remedied, unless and until formally waived.

CLAUSE 24: CHANGES TO THE LENDERS

This Clause sets out the procedure and conditions applicable to the assignment and/or transfer of participations in the Facilities by the Lenders.

Trading in the secondary loan market usually takes one of three possible legal forms:

- novation (commonly referred to as a transfer);
- assignment; and
- sub-participation.

Following a novation, the purchaser assumes the rights and obligations of the seller, and thus enters a contractual relationship with the Borrower. An assignment transfers rights only, but gives the purchaser a claim directly against the Borrower. A sub-participation, by contrast, is a back-to-back contract between seller and purchaser, under which the purchaser has no direct relationship with the Borrower. As a result, while transferees and assignees become Lenders of record, a sub-participant does not.

Loan documentation has conventionally imposed restrictions only in relation to transfers and assignments, as sub-participants do not become Lenders of record with a direct relationship with the Borrower. The LMA documentation follows this approach. The focus of the guidance below is therefore on the Lenders of record, who acquire interests through transfer or assignment. However, the powerful economic influence of transactions "behind the scenes", such as sub-participations and credit derivatives, should not be overlooked. This is discussed further at the end of the comments on Clause 24 below.

Clause 24.1: Assignments and transfers by the Lenders

This Clause provides that, subject to the specified conditions (see Clause 24.2 (*Conditions of assignment or transfer*) below), a Lender may assign its rights or transfer by novation its rights and obligations to a very wide class of permitted assignees and transferees. These include not just banks and financial institutions but also any type of entity which is “regularly engaged in or established for the purpose of making, purchasing or investing in loans, securities or other financial assets”. The class of permitted transferees is thus very broad, and includes for example CLOs, hedge funds and distressed debt specialists, as well as insurance companies and pension funds.

Borrower Notes

A 2006 decision of the UK Court of Appeal made it clear that in order to qualify as a financial institution, in the context of a loan facility, an organisation need only be a “*legally recognised form or being, which carries on its business in accordance with the laws of its place of creation and whose business concerns commercial finance*”. In particular, it is not necessary that an organisation’s business should include “bank-like activities”. Thus, even if the class of permitted Lenders is restricted to banks and financial institutions, it will remain very broad.

Issues raised by the question of syndicate composition are discussed in Part 1, section 7.

Strong Borrowers often seek to restrict the class of permitted transferees by, for example:

- requiring transferees to be Qualifying Lenders. Please see comments on Clause 13 (*Tax*) for more guidance on this topic; and/or
- requiring transferees to have a single A long term credit rating.

Some Borrowers negotiate specific exclusions from the class of permitted transferees. For example, a list of institutions which are not acceptable may be settled, or industry competitors may be excluded, by name or by reference to a sector.

The recent popularity of debt buy-backs in the leveraged market has focussed attention on the question of whether a Borrower (or a Group member) could itself qualify as a permitted transferee if it wished to purchase the debt. This possibility might make a broad definition of a permitted transferee advantageous for Borrowers. For more guidance on this issue, please see the ACT Borrower’s Guide to the Leveraged Facilities Agreement.

In general, in this context, it is worth bearing in mind the relationship between the class of permitted Lender and the requirement for the Borrower's consent to transfers (see Clause 24.2 (*Conditions of assignment or transfer*)). A very broad class of permitted Lender will be more acceptable where the Borrower has a right to veto transfers which is not restricted. Where however the right to veto transfers is more restricted, it may be appropriate to seek to limit the class of permitted Lenders, for example to Qualifying Lenders.

Clause 24.2: Conditions of assignment or transfer

This Clause sets out the conditions applicable to assignments and transfers. The most important feature is the requirement for the Borrower's consent in Clause 24.2(a). Limitations on this right are set out in Clause 24.2(b)-(c).

Clause 24.2(f) includes important protection for Borrowers from an increase in tax and capital adequacy costs following an assignment or transfer.

Borrower Notes

Paragraph (a)

This provides that the Borrower's consent is required for an assignment or transfer.

The requirement for the Borrower's consent to a transfer or assignment, other than to another Lender or an Affiliate, is standard for investment grade Borrowers. There is no such requirement in the Leveraged Facilities Agreement, which merely requires consultation with the Borrower, though not after an Event of Default has occurred. The right to be consulted is of course much less valuable to the Borrower than a right of veto. However Lenders will point out that restrictions on trading are liable to have a negative effect on liquidity in the secondary market, and also on the credit derivatives markets, where a loan participation may be required to be transferred to a third party.

Nonetheless, the Borrower's right of veto in relation to a loan transfer has generally held up well in the Investment Grade market since the credit crunch. Borrowers should be aware however that, typically, Lenders are seeking to restrict Borrowers' consent rights further in the current climate.

The Borrower's consent is not required for a transfer or assignment to another Lender or an Affiliate of a Lender. This is conventional. Lenders usually explain that they need to be able to transfer to Affiliates, for example in order to carry out their obligations to mitigate under Clause 16 (*Mitigation*).

In addition, classically, Lenders seek to disapply the consent right when an Event of Default has occurred and is continuing, although strong Borrowers will try to resist this.

Where the Borrower's consent right is restricted, other mechanisms for controlling syndicate composition become more important. For example, restricting the scope of the gross up entitlement may deter some potential purchasers of syndicate participations.

Paragraph (b)

This provides that when the Borrower's consent is required, it must not be unreasonably withheld or delayed. Furthermore, if it is not expressly refused in five Business Days, it is deemed given.

A reasonableness requirement is standard practice. Where reasonableness is required, it may be qualified by defining some of the circumstances where it would not be unreasonable to refuse consent. Examples include where the institution has previously been in a minority of Lenders refusing consent to a request.

In relation to timing issues here, the LMA's aim is to make it practicable to settle trades ten Business Days after the trade date. The Borrower may however argue that it should be allowed more than five Business Days before its consent is deemed given, especially where the prospective Lender may be a Treaty Lender.

Paragraph (c)

The Borrower may not withhold consent on the grounds of an anticipated increase in Mandatory Costs.

Paragraph (f)

The Borrower is not obliged to gross up a transferee Lender, or make payments to a transferee Lender under the tax indemnity or Increased Costs Clause, if, at the date of transfer, the transferor would not have had an entitlement to receive a payment under Clause 13 (*Tax gross-up and indemnities*) or Clause 14 (*Increased Costs*) had the transfer not occurred.

However, since the amendments made to the Investment Grade Agreement in April 2009, this protection for Borrowers has been disappplied in relation to transfers during the course of primary syndication.

Historically, the protection for Borrowers provided here was based on market acceptance of the view that Borrowers should not suffer greater tax or capital adequacy costs as a result of transfers, at any time, and some Borrowers continue to achieve this protection at all times (during and after primary syndication). The protection provided for Borrowers by this provision is generally most useful in relation to transfers to Treaty Lenders, who may have to be grossed up until a direction is made to the Borrower to pay without withholding tax. This may be particularly valuable in circumstances where primary syndication may not close quickly, and there is a risk of transfers during that period to Treaty Lenders which may need to be grossed up.

The LMA has removed the protection for Borrowers from greater tax costs in the Leveraged Facilities Agreement, in relation to transfers made at any time.

Clauses 24.5 and 24.6: procedure for transfers and assignments

Clause 24.5 sets out the procedure which Lenders are required to follow on a transfer of their participation.

Clause 24.6 was inserted by the LMA in April 2009, in response to market demand for a procedure for Lenders to use on assignment, although the procedure set out is not mandatory.

Clause 24.7: copy of transfer and assignment documentation to the Company

The Borrower is entitled to a copy of transfer and assignment documentation from the Agent.

See Clause 26.2 (*Duties of the Agent*), in relation to the new clause included in the LMA Market Conditions Provisions, entitling the Borrower to a list of the names and participations of the Lenders.

Clause 24.8: Security over Lenders' rights

This is a new and optional provision introduced by the LMA in April 2009. In outline, it provides that a Lender may use its rights under the Finance Documents as security for its own indebtedness. Examples could be security granted to a central bank or to investors in a securitisation.

Borrower Notes

The Borrower is protected by provisions which prohibit the security from being granted on terms which involve a change in the Lender of record or a release of the Lender from its obligations to the Borrower. In addition, the Borrower cannot be required to make payments to any person other than the Lender, nor to make any greater payment than would otherwise be required to the Lender. On the basis of this protection, the Borrower does not have any consent or consultation rights where security is granted by the Lender. The chief risk to the Borrower arising from security being granted by a Lender would therefore appear to be the same as that arising where the Lender uses a sub-participation or credit derivative to offset its credit risk: the possibility of an unknown third party influencing the Lender's voting behaviour.

Clause 24.9: Pro rata interest settlement

This is a new and optional provision introduced by the LMA in April 2009 in order to facilitate transfers of loan participations mid-Interest Period. Where the Agent is willing, the payment of interest and fees at the end of the Interest Period will be split between transferor and transferee pro rata to the time they have been a Lender during that period. Without this arrangement, the Borrower's obligation is only to pay the Lender of record at the end of the Interest Period, so that either the transferee has to pay a proportion of the amount received at the end of the Interest Period on to the transferor, or it has to pay an amount in respect of the prospective payment of interest and fees when the trade settles.

Borrower Notes

Borrowers will want to ensure that the Agent is required to notify it as well as the Lenders if it is able to distribute interest payments on a pro rata basis.

Transactions "behind the scenes": sub-participations and credit derivatives

In the context of secondary market transactions, it is important not to overlook the economic influence of counterparties to transactions such as sub-participations and credit derivatives.

As mentioned above, the Investment Grade Agreement is silent on the subject of transactions behind the scenes. From a Lender's point of view, one of the most attractive features of a sub-participation or a credit derivative is that it usually enables the Lender to transfer credit risk without regard to the transfer restrictions in the loan agreement, and without reference to the Borrower. Lenders are not usually under any legal obligation to provide Borrowers with any information about these transactions, and typically take the view that it is commercially in their best interests not to. As a matter of law, these transactions do not generally give the counterparties direct rights against the Borrowers, so, the argument goes, they need not be a concern to them.

While there may be potential benefits for Borrowers from these transactions, for example in relation to pricing and liquidity, there may also be problems. Where the Borrower is untroubled by financial difficulties, these problems may not materialise. At the point at which the Borrower needs a waiver or an amendment to its facility, or faces insolvency, however, they may become critical. There is a risk that a Lender's voting behaviour may be influenced, or even in some cases determined, by an unknown third party. In some cases, ultimately, the third party may also acquire the Lender's loan participation and become a Lender of record.

In the light of these concerns, pre-credit crunch, some Borrowers sought limited information rights in relation to "single name" credit derivatives and sub-participations. The difficulties of securing a corporate rescue without information about the "behind the scenes" transactions are well documented.

There may also sometimes be circumstances in which it might be justifiable for a Borrower to restrict the Lenders' ability to enter into these transactions, so that its prior consent is required. Although not common, this has been achieved in some pre-credit crunch cases.

An alternative strategy for a strong Borrower might be to request a provision which requires Lenders to retain control of voting rights in relation to the Facilities.

CLAUSE 25: CHANGES TO THE OBLIGORS

Clause 25 sets out provisions for changes to the Obligors.

Clause 25.2 contains a general prohibition on the assignment or transfer by any Obligor of any of its rights or obligations.

Clauses 25.2 and 25.3 provide a mechanism for the accession and resignation of Borrowers.

Clauses 25.4-6 provide a mechanism for the accession and resignation of Guarantors.

Borrower Notes

Clause 25.2: Additional Borrowers

Depending on which of the options is selected here by the Agent, the Borrower will need to obtain the approval either of all Lenders or Majority Lenders for a Subsidiary to become an Additional Borrower, and the Subsidiary may need to be wholly-owned. What is appropriate here will depend very much on the circumstances of the Borrower and the transaction. Borrowers may need to bear in mind that Lenders may be subject to country and sector limits that affect their decision-making process.

Clause 25.4: Additional Guarantors

A Subsidiary may have to be wholly-owned to become an Additional Guarantor.

CLAUSE 26: THE ROLE OF THE AGENT AND THE ARRANGER

Clause 26 makes provision for the Agent and the Arranger.

Clause 26.2: Duties of the Agent

The LMA Market Conditions Provisions include a new clause, which will be helpful to Borrowers, in paragraph (f), requiring the Agent to provide the Borrower with a list of the names and participations of the Lenders, either on a monthly basis or in response to requests. This is a provision that many Borrowers seek in any event, to enable them to keep track of who is in their syndicate. This could be critical if a Borrower gets into financial difficulty.

Clause 26.13: Relationship with Lenders

This provision was altered in April 2009 to cater for Lenders wishing to receive only public information about the Borrower, a development which arose from the increasing volume of loan participations taken by non-bank institutions, such as hedge funds, in the years leading up to the credit crunch (see Clauses 20 (*Information Undertakings*) and 36 (*Confidentiality*)). Under paragraph (c) a Lender may notify the Agent of its appointment of a third party to receive all communications on its behalf.

Borrower Notes

Borrowers may wish to consider how they may be affected by a Lender's appointment of a third party to receive all communications on its behalf. The LMA provision does not give the Borrower the right to be notified as to the appointment of a third party for this purpose, so it will not know of the arrangement.

The main concern here is the potential impact on voting and requests for amendments and waivers. Borrowers may want to ensure they are appropriately protected against the risk posed by Lenders which may well not respond to requests or which may vote in a minority against proposals because they do not have the necessary background information. For more on this topic please see Clause 35 (*Amendments and Waivers*).

Clause 26.16: Agent's Management Time

Under this provision, claims by the Agent under Clause 15.3 (*Indemnity to the Agent*) and Clause 17 (*Costs and expenses*) will be increased to cover the costs of the Agent's management time.

Borrower Notes

Borrowers are likely to view these costs as overheads, which should be treated as such, and point out that the Agent is paid a fee for its role. The provision is not commonly included in an investment grade facility.

CLAUSE 27: CONDUCT OF BUSINESS BY THE FINANCE PARTIES

This Clause is most commonly discussed in the context of Clauses 13.4 (*Tax Credit*) and 16 (*Mitigation*). It provides, in outline, that nothing in the facilities agreement will interfere with a Lender's right to arrange its affairs as it sees fit, or oblige a Lender to make a claim for tax relief or a tax credit.

Borrower Notes

This Clause amounts to very significant protection for the Lenders, and means in effect that the Borrower will obtain the benefit of a Tax Credit enjoyed by a Lender after the Borrower has grossed up a payment only if the Lender is able and willing to co-operate. Likewise, the obligation of a Lender in Clause 16.1 (*Mitigation*) to take all reasonable steps to mitigate has to be read in the context of Clause 27. It is however likely to be difficult for a Borrower to persuade the Lenders to make concessions in this area.

CLAUSE 29: PAYMENT MECHANICS

Clause 29 makes provision for payment mechanics.

Clause 29.1: Payments to the Agent

The Agent will notify the Borrower of the details of the account to which payment must be made.

Clause 29.2: Distributions by the Agent

The Borrower must give the Agent not less than five Business Days' notice of the details of the account to which it wants payment to be made.

Clause 29.3: Distributions to an Obligor

This Clause provides that the Agent can set off funds received by it from the Lenders for the Borrower against an amount due from the Borrower; where the amounts are in different currencies it can use the funds received from the Lenders to make the necessary foreign currency purchase to set off against the amount due from the Borrower. The Agent is entitled to do this if it obtains the Borrower's consent, or under Clause 30 (*Set-off*), discussed below.

Clause 29.6: No set-off by Obligors

The Borrower must make all its payments free of set-off.

Borrower Notes

A particular issue arises here in the context of a Defaulting Lender. (For an introduction to the LMA Market Conditions Provisions, please see section 6 of Part I). If a Borrower achieves the right to prepay a Defaulting Lender (limited under the LMA Market Conditions Provisions to termed out Revolving Facility advances), it may also wish to exercise set-off rights against that Lender. The Borrower may not wish to make a payment to a Defaulting Lender free of set-off if it is then left to prove in the Defaulting Lender's insolvency for the balance of any amount owed to it by that Defaulting Lender (for example, under a hedging arrangement). Borrowers may therefore wish to insert an exception to the restriction on set-off with regard to Defaulting Lenders, or at least provide for the ability to exercise set-off rights against a Defaulting Lender with the consent of those Lenders who are not Defaulting Lenders.

Clause 29.7: Business Days

The Modified Following Business Day convention applies, so that if a payment is due on a day which is not a Business Day, it will instead be due on the next Business Day in the same calendar month (if there is one) or the preceding Business Day (if not).

Clause 29.10: Disruption to payment systems

This Clause was added in 2005, as a consequence of 9/11: for background information, please see the comments on Clause 23.1 (*Non-payment*).

This Clause provides that if a Disruption Event occurs, the Agent and the Borrower may confer, with a view to agreeing any changes to the operation or administration of the Facilities as the Agent may deem necessary. Any changes actually agreed by the Agent and the Borrower are binding on the parties.

Borrower Notes

The Agent is not obliged to consult with the Borrower or the Lenders, if, in its opinion, it is not practicable to do so in the circumstances. In this case, no changes can be made. Borrowers might seek to specify that the Agent's view as to whether consultation is practicable should be a reasonable one.

CLAUSE 30: SET-OFF

This permits a Finance Party to set off a matured obligation due to it by an Obligor under the facilities agreement against a matured obligation due by it to that Obligor, whether or not under that agreement. The Lender is entitled to set off even if the obligations are owing in different currencies, using a market rate of exchange.

Borrower Notes

The Borrower needs to check that it is not prohibited from giving the Lenders this right, because of the terms of the negative pledges it has given to other lenders. If it has to accept set-off to some extent, as is often the case, it will want to ensure that it is permitted only if there is an Event of Default continuing. The Lender should be required to notify the Borrower promptly after any set-off.

CLAUSE 31: NOTICES

All communications are to be made by fax or letter. Communications to the Agent must be actually received by it and addressed to the correct officer or department. The onus is on the sender of a fax to ensure that it is received in legible form.

Borrower Notes

Clause 31.5 (*Electronic communication*) allows the Agent and Lenders to agree to email communication, on a bank-by-bank basis. Note that this provision does not extend to communication with the Borrower.

CLAUSE 32: CALCULATIONS AND CERTIFICATES

Interest, commission and fees accrue from day to day, and are calculated on the basis of the actual number of days elapsed and a 360-day year, or market practice, if that is different. (For example, the day-count fraction for sterling and Hong Kong dollars is 365).

CLAUSE 35: AMENDMENTS AND WAIVERS

This Clause provides that all parties will be bound by amendments or waivers to which Majority Lenders and the Obligors consent. The majority required is usually fixed at 66.6% of Total Commitments. Changes to certain key provisions, such as the Margin, however require the consent of all Lenders. These are listed in Clause 35.2.

LMA Market Conditions Provisions

Particular concerns for a Borrower arise where there is a Defaulting Lender, and these are addressed by the LMA Market Conditions Provisions. (For an introduction to the LMA Market Conditions Provisions, please see section 6 of Part I). Where these provisions are adopted, Clause 35 provides for:

- the disenfranchisement of a Defaulting Lender; and
- the replacement of a Defaulting Lender (“yank the bank”).

The LMA Market Conditions Provisions articulate the principle (which has been widely adopted in the market) that a Defaulting Lender should not be able to vote on the basis of any undrawn Commitment. The corollary of this is that it is generally accepted that a Defaulting Lender should not be disenfranchised in relation to its outstanding amounts, and the new provisions also reflect this position.

Also under the LMA Market Conditions Provisions, a Defaulting Lender can be replaced at par by a new or existing Lender if the Borrower is able to arrange this. This provision is largely the same as the existing right to “yank” a single Lender following a tax gross up claim or (in the context of the Leveraged Agreement only) a Lender becoming a Non-Consenting Lender, discussed under Clause 8.6 (*Cancellation and repayment or replacement of a single Lender*) above. The main difference between the new provision and the existing “Replacement of Lender” mechanics is that the new

provision permits the Defaulting Lender's rights and obligations under the Revolving Facility only (or its undrawn Revolving Facility Commitments only) to be transferred.

Borrower Notes

Voting

Borrowers should bear in mind the limitations inherent in the principle that a Defaulting Lender's undrawn Commitments should be discounted for voting purposes: this will be effective only to the extent that the Defaulting Lender's Commitment remains uncanceled and undrawn.

There are two drafting issues here:

- As mentioned under Clause 7.2 (*Repayment of Facility B Loans*), the disenfranchisement provision is designed for use with the definition of Majority Lenders found in the Leveraged Facilities Agreement; the definition of Majority Lenders in the Investment Grade Agreement operates differently. As a result, it will be necessary, in the Investment Grade Agreement, to adopt the Majority Lender definition from the Leveraged Facilities Agreement.
- Where unanimity is required, should a Defaulting Lender have a vote? The drafting is somewhat unclear, but the LMA's position seems to be that a Defaulting Lender does have a vote. A strong Borrower might take a different view.

Where a Defaulting Lender does have voting rights, Borrowers should be aware that an insolvency practitioner may be unable or unwilling to vote. "Snooze and lose" protection could therefore be helpful.

A "snooze and lose" provision means that the Defaulting Lender's Commitment is taken out of the total if it fails to respond within a fixed period (usually between 5 and 15 Business Days). This has the effect of treating the Defaulting Lender as not existing in the syndicate (thus making it easier to achieve the necessary majority). A more aggressive variation is "delay and it's ok": failure to respond with the fixed period is deemed consent.

Borrowers should beware however that the existence of these rights may prompt a swift negative response to consent requests from Defaulting Lenders or their representatives. However, they can be useful in conjunction with "Yank the bank" provisions. They could also make it easier for the Lenders to obtain the necessary majority to accelerate the debt. The Leveraged Facilities Agreement includes a "snooze and lose" provision at Clause 41.2(d).

To date, “snooze and lose” provisions have not routinely been a feature of investment grade facility documentation. Now however, where the LMA Market Conditions Provisions are inserted, Borrowers will want to consider including them, irrespective of the Borrower’s creditworthiness.

“Yank the bank”

A “*yank the bank*” provision permits the Borrower to replace a Lender in certain circumstances.

The first set of circumstances is where the Lender has made a claim for increased costs, a tax gross up or under the tax indemnity. See Clause 8.6 (*Cancellation and repayment or replacement of a single Lender*).

The second set of circumstances is where the Lender does not consent to a request for a waiver or amendment, but the requisite majority of other Lenders have done so. This type of provision is included in the Leveraged Facilities Agreement (Clause 41.3), but not the Investment Grade Agreement. While investment grade Borrowers may wish to discuss the inclusion of such a provision, they should be aware of the limitations on its usefulness in practice. Under the Leveraged Facilities Agreement, the Lender has to be taken out at par, so that if the debt is trading below par, it will be difficult to find a replacement. The Borrower may also incur fees in finding a replacement. If this type of provision is to be included, please see the comments on Clause 41.3 in the ACT Borrower’s Guide to the Leveraged Facilities Agreement.

The third set of circumstances is where the Lender is a Defaulting Lender. This type of provision is included in the LMA Market Conditions Provisions. There are two issues of note to Borrowers here:

- The replacement Lender must be acceptable to the Agent (this provision is optional). This seems unjustified. Please see comments on Clause 2.2 (*Increase*).
- The requirement for a Defaulting Lender to be replaced at par is presented as optional, but it is difficult to envisage how an alternative provision might be framed. Providing for the replacement of a Defaulting Lender at market value is one possibility, but an objective means of determining market value at the time of transfer would need to be identified. An alternative might be a price agreed by seller, buyer and Borrower. Replacement at par may not be operable in practice. Following the collapse of Lehman Brothers, it proved impossible to find buyers to purchase its loan participations at par.

CLAUSE 36: CONFIDENTIALITY

Clause 36 contains undertakings given by each Finance Party to keep Confidential Information confidential, and not to disclose it save as specified. Each Finance Party also agrees to protect all Confidential Information with security measures and a degree of care that would apply to its own confidential information.

The definition of “*Confidential Information*” is in a form familiar to the market, which is based on the definition used in the LMA stand-alone forms of Confidentiality Undertaking for use in primary syndication and in the secondary market. It covers all information relating to the Company, any Obligor, the Group, the Finance Documents or a Facility which a Finance Party becomes aware of in that capacity or which is received by it in relation to the Finance Documents or a Facility from any member of the Group or any of its advisers including via another Finance Party.

It excludes information which:

- is or becomes public (other than as a result of a breach of Clause 36),
- is identified at the time of delivery as non-confidential by any member of the Group or its advisers, or
- is information either already known by the relevant Finance Party or obtained by it later from a source which is (as far as the Finance Party is aware) unconnected with the Group, and which has not (as far as the Finance Party is aware) been obtained in breach of any obligation of confidentiality.

This express confidentiality undertaking given by all the Finance Parties is one of the most important features of the new version of the Investment Grade Agreement published in April 2009. An almost identical undertaking was included in the version of the Leveraged Facilities Agreement published in September 2008. At the same time, the LMA also updated their stand-alone forms of Confidentiality Undertakings for use in primary syndication and the secondary market, which are discussed in Part III below.

The background here was the immense growth in the number of non-bank lenders in lending syndicates in the years leading up to the financial crisis which began in autumn 2008. This focussed attention on two related topics:

- Increasingly, the Lenders include institutions which may hold both loan participations and debt securities, but which may not have information barriers in place internally to deal with the receipt of inside information from the Borrower pursuant to its obligations under a loan agreement. Many Lenders rely on information barriers to segregate staff who work on the “private side” of the barrier, such as those engaged in loan arrangement, agency and trading, from

those on the “public side”, who trade in regulated investments. Other Lenders, however, without information barriers in place, need to be “public side only”, in order not to restrict their trading in regulated investments. In the light of increasing sensitivity about the potential for market abuse, the LMA, along with other trade associations, published a number of papers on the issues arising for Lenders in relation to inside information.

- It is not clear that the common law duty of confidentiality owed by a bank to its customer extends to non-banks, and the scope of any implied duty is uncertain. Accordingly, the LMA agreed to insert an express confidentiality undertaking in their loan documentation.

While in general the new confidentiality undertaking is a welcome development for the protection of the information provided to syndicates, there are some concerns which Borrowers may want to address, which are highlighted below.

Borrower Notes

The two main topics for Borrower focus are the duration of the confidentiality undertaking, and the carve-outs.

Duration

The confidentiality undertaking given by each Finance Party falls away 12 months after the earlier of the date when it ceases to be a Finance Party and the date of final repayment.

Although the market is familiar with a 12 month period, as it has featured in the LMA stand-alone forms of Confidentiality Undertaking for some time now, Borrowers may be concerned that it may not be long enough to protect all types of Confidential Information. The LMA acknowledge by the use of square brackets that the reference to 12 months is subject to negotiation. Borrowers should remember that neither the banks' common law duty of confidentiality nor the implied duty of confidentiality on which Borrowers had to rely had an end date.

Carve-outs

The list of circumstances in which disclosure of Confidential Information by the Lenders is permitted is much longer than that familiar to the market from the LMA stand-alone Confidentiality Undertakings (discussed in Part III below).

Some of the changes made by the LMA are modernising, catering for past and future developments in the markets. Other carve-outs permit disclosure of Confidential Information on terms on which Borrowers may want to consider carefully, and in some cases improve. Much of the devil is in the detail. For example:

- *Disclosure to Affiliates.* This category has been updated to include Related Funds, and extended to include officers, directors, employees, professional advisers, auditors, partners and Representatives (broadly defined and discussed below). It permits disclosure on condition simply that the recipient is informed that the information is confidential and may be price sensitive. However there is no requirement to inform where the recipient is subject to professional or other confidentiality obligations. Borrowers may conclude that notice of confidentiality is not necessary where the recipient is in any event subject to confidentiality obligations. However, they may wish to note that, in the previous LMA stand-alone forms of Confidentiality Undertaking, the signatory was obliged to use all reasonable endeavours to ensure that any person (ie including an Affiliate) to whom it passed any Confidential Information acknowledged and complied with the provisions of the undertaking as if that person were also a party to it. Borrowers may therefore wish to argue that Lenders should give an undertaking along these lines, on the basis that they were able to do so previously under the terms of the LMA stand-alone Confidentiality Undertakings. Borrowers should however be aware that in the previous versions of the Investment Grade Agreement no conditions were attached to disclosure to Affiliates.
- *Disclosure to actual and potential secondary market purchasers, including sub-participants and credit derivative counterparties, and their Affiliates, Related Funds, Representatives and professional advisers.* A Confidentiality Undertaking must be provided by the recipient of the information unless the recipient is a professional adviser who is subject to confidentiality obligations. Normally, a purchaser or counterparty will not be a professional adviser, and so will be required to provide a Confidentiality Undertaking.
- *Lenders' Representatives.* The LMA have inserted a new provision in the Investment Grade Agreement (Clause 26.13(c) (*Relationship with the Lenders*)) permitting a Lender to appoint a Representative to receive all communications in relation to the Finance Documents. This could be appropriate in the case of a Lender wishing to receive public-side information only, in order not to receive any inside information. Under the terms of Clause 36, a Representative would be permitted to receive Confidential Information if it signs a Confidentiality Undertaking, although this requirement does not apply where it is a professional adviser subject to confidentiality obligations.

- *Disclosure to secondary market investors and financiers.* Investors and financiers of secondary market purchases are a new category of permitted recipient. A Confidentiality Undertaking must be provided, unless the recipient is otherwise bound by confidentiality requirements and is informed that the information may be price sensitive. Similar concerns arise here to those mentioned above.
- *Disclosure to Lenders' chargees.* The Investment Grade Agreement newly includes an optional provision, Clause 24.8 (*Security over Lenders' rights*), setting out terms protecting the Borrower where a Lender creates Security over its rights under any Finance Document. In these circumstances, Confidential Information can be disclosed to the chargee. The protection offered is that the chargee must be informed that the information is confidential and possibly price-sensitive, unless it is impracticable to inform the chargee, in the opinion of the Lender. Borrowers may wish to ask Lenders about the circumstances in which they envisage creating Security over their rights under the Finance Documents, and the protection of Confidential Information disclosed to a chargee.
- *Litigation.* This category permits any disclosure "required" in connection with and for the purposes of any litigation or similar proceedings. The Finance Party must notify the recipient that the information is confidential and may be price sensitive, unless this is impracticable, in the opinion of the Finance Party. Borrowers may want to restrict this category to proceedings concerning the Finance Documents, and require the recipient to be notified as to the confidentiality of the information in all circumstances. They may also want to be notified of any disclosure in this category.
- *Disclosure "as appropriate".* The categories above permit disclosure of such Confidential Information as the Finance Party considers appropriate. Although this subjective assessment of appropriateness has been the criterion in the LMA documentation for some time, the increase in the number and breadth of categories of permitted disclosure may invite fresh consideration of this question. Arguably, for example, information should be disclosed to Affiliates, Related Funds, and their staff and advisers on a "need to know" basis.
- *All disclosure categories above.* Clause 36 does not entitle the Borrower to any information regarding disclosures, whether or not subject to a Confidentiality Undertaking. Lenders will argue that this is impracticable, but it could make it difficult for the Borrower to enforce its confidentiality rights as a result, as it simply may not be aware who is in possession of its Confidential Information. Borrowers may seek to find a balance here between administrative burden and risk, by discussing with the Finance Parties how they might most easily meet the Borrower's reasonable need for information.

- *Disclosure by Lender to rating agency.* In another new, albeit optional, category of permitted disclosure, Lenders would be able to disclose Confidential Information to a rating agency, to enable it to carry out its normal rating activities in relation to the Finance Documents and/or the Obligors. Borrowers may want to insist on the inclusion of the optional provision that requires the rating agency to be informed that the information is confidential and may be price sensitive. They may also feel that they should be informed of any disclosure in this category.
- *Numbering service providers.* Disclosure of specified items of information, such as the currency, amount and type of the Facilities, would be permitted to a numbering service provider appointed by the Agent to facilitate secondary market trading. This is an optional provision which will need to be included where a numbering service provider is to be appointed. The information to be disclosed would not remain confidential but would not normally be price-sensitive, with the possible exception of items (vi) and (xii) – the date of any amendment or restatement and changes to any of the information previously supplied. The Borrower is required to represent (Clause 36.3(c)) that none of the information disclosed is, or will be, unpublished price sensitive information, so it will need to seek to exclude items (vi) and (xii) from that representation. Also, it should not agree to extend the list of information which may be disclosed without careful consideration.
- *Confidentiality Undertaking.* Borrowers should ensure that the form of Confidentiality Undertaking (to be set out in Schedule 11) for use under the terms of Clause 36 is in a form acceptable to them. Please see Part III for comments on the LMA secondary market forms of confidentiality undertaking.
- *Excluded recipients?* Borrowers should consider whether there are any classes of recipient to whom disclosure should be expressly prohibited, such as competitors.

SCHEDULE 4: MANDATORY COSTS

The LMA Mandatory Costs Schedule provides a mechanism for institutions to recover certain regulatory costs which are levied on their lending function. Though widely used in the market without negotiation, Borrowers will want to bear in mind that the FSA announced a sharp increase in supervisory fees for deposit-takers in May 2009, a change which may be repeated in future years.

Borrower Notes

The calculation of the amount payable by the Borrower

The Investment Grade Agreement requires the Agent to calculate the Mandatory Cost for each Loan, and notify the Borrower as soon as possible at the start of each Interest Period.

The Mandatory Cost is the average of the Lenders' Additional Cost Rates, weighted in proportion to their participation in the relevant Loan. The Additional Cost Rate for any Lender whose Facility Office is in the UK is calculated by reference to different formulae, according to whether the Loan is in sterling or not. The Additional Cost Rate for any Lender whose Facility Office is in the euro-zone is the percentage notified by that Lender as its cost of complying with ECB requirements in respect of Loans made from that Facility Office.

UK mandatory costs: Lender with Facility Office in the UK

There are two categories of costs applicable to Lenders with a Facility Office in the UK: reserve asset costs and supervisory fees.

Reserve asset costs

UK reserve asset costs apply to all Eligible Institutions. A Lender will qualify as an Eligible Institution if, broadly speaking, it has permission under Part 4 of the Financial Services and Markets Act 2000 to accept deposits, or if it is an "EEA firm" with permission to accept deposits in the UK.

Eligible Institutions are required to make non-interest bearing cash ratio deposits with the Bank of England if their Eligible Liabilities exceed a threshold of £500 million. The amount of the deposits required is 0.11% of Eligible Liabilities in excess of the threshold. Eligible Liabilities are, broadly speaking, short term (ie less than 2 years) sterling liabilities, net of sterling loans made to other banks in the UK banking sector.

Supervisory fees

While the Bank of England remained banking supervisor, there was no specific charge for banking supervision. The transfer of banking supervision to the FSA in 1998 however triggered the introduction of supervisory fees. Although these fees decreased significantly in the decade which followed, after the financial crisis the FSA announced a sharp increase in supervisory fees for deposit-takers in May 2009. It had commented that it had been doing supervision "on the cheap" (FT, 17 October 2008).

Supervisory fees are calculated chiefly by reference to Modified Eligible Liabilities (“MELs”), which are (broadly speaking) the total of Eligible Liabilities (explained above) and 33.3% of foreign currency liabilities; foreign currency liabilities exceeding £1 billion are discounted to zero if offset by intra-group lending. There is a scale of rates applicable to different tranches of MELs: each bank can be subject to several different rates, depending on the amount of its MELs.

Until 2001, supervisory fees were, in outline, £51 per £1 million of MELs for UK banks. Rates then decreased annually, with the average for the year 2008-9 being roughly £24 per £1 million MELs. Rates for 2009-10 range from £32 to £47 per £1 million MELs for the biggest banks.

The rates for “Incoming firms”, whether “EEA firms” or “Treaty firms”, are 20% of the rates applicable to UK banks.

Since the introduction of supervisory fees by the FSA, the LMA has recommended that banks should charge Borrowers for them, and included them in the formulae in their Mandatory Costs Schedule, as item E. The formulae ensure that, where the advance is denominated in a foreign currency, the Borrower pays 33.3% of the rate applicable on a sterling advance. The amount payable by the Borrower is calculated on the basis of the rates applicable to the Reference Banks. Each Reference Bank is required to quote its average supervisory fee rate, so that the Agent can compute the average of those quotations.

In practice, however, it is not clear whether or not banks have in fact been routinely charging Borrowers for these fees, at least on non-sterling loans.

Banks have often taken the view that the costs incurred in recovering these fees are disproportionate to the amounts involved. From a Borrower perspective, supervisory fees are an overhead of the bank. In addition, given the disparity between the charges for UK and Incoming firms, the averaging process used by the LMA means that some Lenders are significantly over-compensated, and others significantly under-compensated. As a result, some Lenders have historically conceded the right to recover these fees, on bilateral facilities in particular. It has been more difficult (though not unknown) for Lenders to agree to omit item E from the formula on syndicated facilities, partly for reasons of transferability in the secondary market and partly because of the approach taken to the issue by the LMA. It remains to be seen whether market practice will change in the light of the increases in supervisory fees which have now been announced.

Borrowers may like to note the potential impact which the selection of the Reference Banks may have on item E. For the reasons explained above, Reference Banks which are “incoming firms” with large MELs are likely to quote a lower rate than UK Reference Banks with smaller MELs.

ECB costs: Lender with Facility Office in the euro-zone

ECB reserve requirements apply to all euro-zone branches of banks, wherever incorporated. They are calculated, broadly speaking, by reference to the bank's short term liabilities (ie less than 2 years) in all currencies, not just the euro. Liabilities owed to other banks within the ECB regime are excluded. The impact of these reserve requirements is that Lenders which are euro-zone branches of banks will incur a cost in respect of their funding of a loan made to a Borrower, unless (as commonly happens) they obtain the funding from another euro-zone bank branch.

Where ECB reserve requirements apply, a sum equal to 2% of the bank's short term liabilities must be put on deposit with its local national central bank ("NCB"). Even in that case, however, the Lender is unlikely to suffer a significant loss, because the deposit bears interest at a commercial rate (the ECB's open market refinancing rate for euro from time to time). As a result, the only loss that a euro-zone Lender could suffer is the difference between the rate it is paying to fund the deposit and the rate paid by the NCB.

Historically, Lenders have not generally passed on ECB costs to Borrowers. Market practice may however change.

Lenders are obliged effectively to try to ensure that ECB costs are not charged, under Clause 16 (*Mitigation*). Although in the form of the Investment Grade Agreement published in May 2004, the LMA deleted the right (which existed previously) for a Borrower to prepay a Lender which charges ECB costs and cancel its Commitment, it is expected that banks will not object to the reinstatement of that right in practice. Borrowers may want to negotiate that concession.

A warning: unilateral changes to the Mandatory Costs Schedule

Borrowers should beware of paragraph 13, which permits the Agent unilaterally to make any amendments which are "required to be made to this Schedule in order to comply with any change in law or regulation" imposed by the Bank of England, the FSA or the ECB. The Agent is required merely to consult the Borrower. The Borrower can however argue that in most cases this situation is covered by Clause 14 (*Increased Costs*): any Lender suffering a loss should use that procedure to recover (thus allowing the Borrower to cancel and prepay, or replace the Lender); and if many or all of the Lenders are affected, the Schedule should be re-negotiated, but not amended unilaterally by the Agent.

Part III: LMA Ancillary Documentation

LMA CONFIDENTIALITY LETTERS FOR PRIMARY SYNDICATION AND THE SECONDARY MARKET

The forms of these letters do not carry the ACT's endorsement.

LMA confidentiality and front running letter for primary syndication

This letter is designed to be sent out by the Arranger to potential syndicate members. As its title suggests, it has a dual purpose: to obtain a confidentiality undertaking from each potential syndicate member, and to record the front running undertakings given by the Arranger and each potential syndicate member to each other.

Borrowers will be well advised to check with the Arranger that this letter will be sent to all potential syndicate members, and that none of them receives any confidential information until it has signed and returned the copy provided. While the Borrower's interest in protecting the confidentiality of its information is self-evident, it will also support the LMA's recommendation that underwriters and arrangers should undertake not to engage in front running.

Front running takes place for example where an underwriter actively encourages an institution which is considering a primary participation to await the secondary market, or actually makes a price on a loan, before allocations have been notified to the initial syndicate. No trade needs to take place, as making a price or simply discouraging a bank from participating in the initial syndicate is liable to distort the process of primary syndication. As well as undermining the primary process and preventing the market from operating in an open and orderly manner, front running can result in the underwriters being left with more than their anticipated hold level. It can also have negative consequences for Borrowers, such as a lesser facility amount than is required.

Borrower Notes

Duration. The signatory of the letter may or may not become a Finance Party. If it becomes a Finance Party in primary syndication, it becomes subject to the terms of the confidentiality undertaking in the Agreement (Clause 36 (*Confidentiality*)) – assuming the transaction documentation is LMA-based – which falls away 12 months after the earlier of the date on which it ceases to be a Finance Party and the date of final repayment. Where it does not become a Finance Party, the confidentiality undertaking falls away 12 months from the date of the letter.

Borrowers may be concerned that a 12-month undertaking may not be long enough to protect at least some of their Confidential Information. As is explained in the commentary on Clause 36, although the market is familiar with a 12-month period, as it has featured in LMA documentation for some time now, sensitive long term business plans and projections, for example, may need protection for a much longer period. The LMA acknowledge by the use of square brackets that this period is subject to negotiation.

Information and enforceability. Although this letter states that the confidentiality undertaking is given for the benefit of the Borrower, it is not entirely clear, as a practical matter, that it would necessarily be able to enforce it. The copy to be signed by the potential syndicate member and returned to the Arranger is addressed also to the Borrower. Borrowers do not, however, usually receive a copy. They may therefore want to ask the Arranger to ensure that they either receive a copy, or are notified of the names of all signatories. Ideally also the letter will not be distributed by the Arranger until the Borrower has been given the opportunity to comment on it, and suggest any changes it feels are necessary. (Strong Borrowers may insist that they should send out the forms of confidentiality undertaking to prospective lenders, to maximise the effectiveness of the undertakings.)

Borrower consent to amendment. The letter expressly states that it may be varied or rescinded without the Borrower's consent. This provision is not usually acceptable to the Borrower.

Disclosure permitted to Affiliates. Disclosure in this category is permitted provided that the recipient is informed that the information is confidential and may be price sensitive. However there is no requirement to inform where the recipient is subject to confidentiality obligations. Borrowers may conclude that notice of confidentiality is not necessary where the recipient is in any event subject to confidentiality obligations. However, they may wish to note that, in the previous LMA stand-alone form of Confidentiality Undertaking for use in primary syndication, the signatory was obliged to use all reasonable endeavours to ensure that any person (including an Affiliate) to whom it passed any Confidential Information acknowledged and complied with the provisions of the undertaking as if that person were also a party to it. Borrowers may therefore wish to argue that signatories should give an undertaking along these lines, on the basis that they were able to do so under the terms of the previous LMA stand-alone Confidentiality Undertaking.

The Arranger. Borrowers should ensure that an express confidentiality undertaking is provided to them by the Arranger.

Enquiries of group members. The LMA used to include an undertaking not to make enquiries of any Group member or any of their officers, directors or employees or professional advisers relating to the Facilities. This undertaking was deleted some years ago. Borrowers will however want to ensure they have procedures in place which restrict the flow of information from any Group member or its professional advisers to one office or department, which can control the material that is passed over. In particular Borrowers should ensure that that office or department deals only with the Arranger or Agent, not individual Lenders or prospective Lenders.

LMA secondary market confidentiality letter

The form of this letter is designed to be given by the potential purchaser of a loan participation or credit derivative counterparty. The LMA intend it to be inserted as Schedule 11 of the Investment Grade Agreement, as the basis of the defined term Confidentiality Undertaking. Please see Clause 36 (*Confidentiality*) for discussion of the circumstances in which disclosure is permitted subject to provision of a Confidentiality Undertaking.

Although this letter is widely used, it does not provide Borrowers with as much protection as they may require or expect, and so consideration should, where possible, be given to amending it in the light of the points made below.

Borrower Notes

Duration. The signatory of the letter may or may not become a Finance Party. If it becomes a Finance Party in the secondary market by novation, it becomes subject to the terms of the confidentiality undertaking in the Agreement (Clause 36 (*Confidentiality*)) – assuming the transaction documentation is LMA-based – which falls away 12 months after the earlier of the date on which it ceases to be a Finance Party and the date of final repayment. Where it does not become a Finance Party (for example where it takes a sub-participation or acquires an interest in the Facility through a credit derivative or no deal is concluded), the confidentiality undertaking falls away 12 months from the termination of the transaction or date of the letter. (For an explanation of the differences between novation, assignment and sub-participation, please see the commentary on Clause 24.1 (*Assignments and transfers*)).

Borrowers may be concerned that a 12 month undertaking given by institutions which do not become syndicate members may not be long enough to protect at least some of their Confidential Information. As is explained in the commentary on Clause 36, although the market is familiar with a 12 month period, sensitive long term business plans and projections may need protection for a much longer period than a year from the date of the letter. The LMA acknowledge by the use of square brackets that this period is subject to negotiation.

Information and enforceability. Although this letter states that it is given for the benefit of the Borrower, it is not entirely clear that, as a practical matter, it would necessarily be able to enforce it. The undertaking is addressed to the Borrower. However, as discussed in the context of Clause 36, the Borrower is not entitled to any information regarding disclosures, even where a Confidentiality Undertaking is provided. Lenders will argue that this is impracticable, but it could make it difficult for the Borrower to enforce its confidentiality rights as a result, as it simply may not be aware who is in possession of its Confidential Information. Borrowers may seek to find a balance here between administrative burden and risk, by discussing with the Finance Parties how they might most easily meet the Borrower's reasonable need for information.

Borrower consent to amendment. The letter expressly states that it may be varied or rescinded without the Borrower's consent, a provision which will not usually be acceptable.

Disclosure permitted to Affiliates. The same point arises here as is explained above in the context of the LMA confidentiality letter for use in primary syndication. In the previous LMA form of confidentiality undertaking for use in the secondary market, the signatory was obliged to use all reasonable endeavours to ensure that any person to whom it passed any Confidential Information acknowledged and complied with the provisions of the undertaking as if that person were also a party to it. Borrowers may therefore wish to argue that signatories should give an undertaking along these lines, as they were able to do so previously.

Disclosure permitted additionally to all recipients permitted under Clause 36 (Confidentiality). Please see the commentary on Clause 36 for the wide range of recipients to whom disclosure is permitted by this device. Borrowers should consider whether it is acceptable for their Confidential Information to be disclosed to this greatly extended category of recipients.

Glossary

Terms defined in the Investment Grade Agreement have the same meanings in this guide. Comments on some of these terms are to be found in the comments on Clause 1.1 (*Definitions*) in Part II of this guide.

Capitalised terms used in this guide have the following meanings:

ACT Borrower's Guide to the LMA Leveraged Facilities Agreement	The ACT Borrower's Guide to the LMA Facilities Agreement for Leveraged Transactions, produced by Slaughter and May, available at http://www.slaughterandmay.com/what-we-do/publications-and-seminars/publications/client-publications-and-articles/t/the-act-borrowers-guide-to-the-lma-facilities-agreement.aspx .
Investment Grade Agreement	LMA recommended form of multi-currency term and revolving facilities agreement for multiple borrowers and guarantors, April 2009
Leveraged Facilities Agreement	LMA senior multi-currency term and revolving facilities agreement for leveraged acquisition finance transactions, November 2009
LMA confidentiality and front running letter for primary syndication	LMA confidentiality and front running letter for primary syndication, January 2010
LMA Market Conditions Provisions	The Users' Guide to LMA Finance Party Default and Market Disruption Clauses in conjunction with the recommended form of primary documents, June 2009
LMA secondary market confidentiality letter	LMA confidentiality letter (seller) for use with LMA secondary loan documentation, January 2010

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The Dutch perspective on LMA Loan Documentation for Investment Grade Borrowers

Produced by

**DE BRAUW
BLACKSTONE
WESTBROEK**

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This guide has been produced by De Brauw Blackstone Westbroek N.V., to provide assistance for corporate treasurers reviewing draft facility agreements based on the LMA documentation for investment grade borrowers which are governed by Dutch law or entered into by Dutch Borrowers.

The Dutch perspective on LMA Loan Documentation for Investment Grade Borrowers

This commentary gives specific guidance to Borrowers entering into LMA style loan documentation to which Obligors incorporated in the Netherlands are a party or which is chosen to be governed by Dutch law. This commentary proceeds from the LMA Primary Investment Grade Multi-Currency Term and Revolving Facilities Agreement, version dated April 2009 (the “**LMA Agreement**”). The commentary is intended as a supplement to the ACT Borrower’s Guide to LMA Loan Documentation for Investment Grade Borrowers produced by Slaughter and May, version dated February 2010.

Unless otherwise stated, capitalised terms defined in the LMA Agreement have the same meaning in this commentary.

In this commentary, a Dutch Obligor is assumed to be a Dutch company in the form of a limited liability company (*naamloze vennootschap*; “N.V.”) or a private company with limited liability (*besloten vennootschap met beperkte aansprakelijkheid*; “B.V.”).

GOVERNING LAW

The LMA Agreement has been drafted for use under English law. However, the LMA Agreement can be used also as the basis for a Facility Agreement governed by Dutch law. Although some amendments are required for this purpose, these amendments are limited and predominantly technical.

Facility Agreements based on the LMA Agreement will typically be governed by English law. English law is widely accepted in the financial markets and Lenders will often argue that using any law other than English law as the governing law of a Facility Agreement will hamper syndication. For a Dutch corporate borrower, the obvious advantages of using Dutch law rather than English law as the governing law of its Facility Agreement are that (i) the Facility Agreement is then governed by a law with which it (including, probably, its internal legal counsel) is familiar, (ii) it can negotiate the Facility Agreement without a need to engage English external legal advisers, and (iii) if ever there is litigation about the Facility Agreement, that litigation can be conducted in the Dutch courts rather than the English courts. It is perfectly acceptable for a Dutch borrower to require that its Facility Agreement should be governed by Dutch law. Although Dutch law may not be achievable for borrowers which need to rely on international syndication to achieve an appropriate Lender group, banks should often be willing to accommodate Dutch law for borrowers whose syndicate is generally limited to Dutch banks, borrowers entering into a club deal with selected banks without a need for further syndication, and strong Dutch borrowers with a

credit profile which makes the governing law of the documentation less of a concern to the banks.

REGULATORY CONSTRAINTS TO BORROWING

Under Section 3:5 of the Dutch Financial Markets Supervision Act (*Wet op het financieel toezicht*, the “**FMSA**”), Dutch borrowers may (to the extent relevant here) borrow funds only from parties that qualify as “professional market parties” (*professionele marktpartijen*). Violation of Section 3:5 FMSA may, among other things, lead to fines or administrative measures being imposed on the borrower by the Dutch Central Bank.

“Professional market parties” (“**PMP**”) include banks and other regulated institutions and corporate entities of a certain size. In addition, any Lender that lends at least EUR 50,000 (or its equivalent in other currencies) to a Borrower qualifies as a PMP in relation to that Borrower. The EUR 50,000 requirement implies that participation in the first Loan or Loans made to the Borrower by each Lender which does not otherwise qualify as a PMP, must be at least EUR 50,000.

If a Lender transfers (part of) its participation to a New Lender which does not otherwise qualify as a PMP, that (part of the) participation in any outstanding Loans must be at least EUR 50,000. If there are no Loans outstanding, the size of the (part of the) participation must be such that the New Lenders participation in the first Loan or Loans made by it must be at least EUR 50,000.

In practice, the Original Lenders generally are banks and therefore PMPs. It is customary for Facility Agreements for a Dutch Borrower or Borrowers to include provisions aimed at ensuring that any New Lender also qualifies as a PMP. See comments to Clause 24 (*Changes to Lenders*).

DUTCH SECURITY; PARALLEL DEBTS

This comment is relevant only for Facility Agreements under which the Obligors must grant Dutch law security (pledges (*pandrechten*) or mortgages (*hypotheken*)) to the Lenders.

If a Facility Agreement requires the Obligors to create security in favour of the Lenders, in practice the facility and security documentation will provide for appointment of a security agent or security trustee (the “**Security Trustee**”). The security is then provided to the Security Trustee (and not to the group of Lenders or Finance Parties as a whole). The Security Trustee is charged with administering the security and, if the unfortunate occasion arises, with enforcing the security and distributing the proceeds of enforcement among the Lenders and the other Finance Parties.

However, under Dutch law it is debatable whether security can be granted in favour of a person that is not the creditor of the claims secured by the security. Obviously, the Security Trustee is not the creditor of the claims of the Lenders or the other Finance Parties. To work around this complication, in practice facility and security documentation requiring the creation of Dutch law security will provide for a “parallel debt structure”. Under that structure, each Obligor creating Dutch law security agrees that it shall pay to the Security Trustee amounts (the “**Parallel Debts**”) equal to the amounts from time to time payable by the Obligor to the Lenders and the other Finance Parties (the “**Underlying Debts**”). The Dutch law security is then created to secure the Parallel Debts rather than the Underlying Debts.

To ensure that a parallel debt structure works flawlessly, attention must be given to the following details:

- Under the parallel debt structure, in relation to each amount owing under the Finance Documents, each Obligor has two payment obligations: one to the relevant Finance Party (the Underlying Debt) and one to the Security Trustee (the Parallel Debt). In order to avoid the Obligor having to pay double, the parallel debt provision must stipulate that every payment of a Parallel Debt to the Security Trustee will reduce the Underlying Debt owed to the relevant Finance Party correspondingly.
- There may be a debate about the time at which payment of a Parallel Debt reduces the relevant Underlying Debt, either (i) at the time when the relevant Obligor makes that payment to the Security Trustee, or (ii) at the time when the Security Trustee pays on that amount to the relevant Lender or other Finance Party. The Finance Parties may opt for option (ii), thereby burdening the Obligors with a credit risk on the Security Trustee: if the Security Trustee becomes insolvent after it has received payment from the Obligor but before it can make the subsequent payment to the relevant Finance Party, the Underlying Debt will not be discharged and the relevant Obligor will be obliged to pay again. It is not unreasonable for Obligors to require that the parallel debt provision must provide for option (i).
- The parallel debt provision should be drafted in such a way that each Obligor’s Parallel Debts correspond with the Underlying Debts owed by that Obligor, and not with Underlying Debts owed by any other Obligor. If an Obligor’s Parallel Debt were to correspond with the Underlying Debt of any other Obligor, that Obligor would through the Parallel Debt become liable for those other debts. If it is the intention that an Obligor is liable for another Obligor’s debts, this should be achieved through the guarantee provisions in the Facility Agreement, or another appropriate means, and not through the backdoor of the parallel debt structure.
- To ensure that the Parallel Debts are an exact mirror of the Underlying Debts, the parallel debt provision should provide that each Parallel Debt falls due only at the

time when the relevant Underlying Debt falls due, and that it is payable in the same currency and in the same manner as that Underlying Debt.

As a starting point, it is appropriate for the parallel debt provision to be governed by the law applicable to the Underlying Debts, *i.e.*, in practice, the governing law of the Facility Agreement. This avoids the risk that, as a result of differences between two applicable legal systems, the Parallel Debts and the Underlying Debts do not mirror each other perfectly. However, under some legal systems (but not under English or Dutch law), parallel debt structures may not be legal. In that case, it is inevitable and acceptable that the parallel debt structure is governed by a law other than the law of the Facility Agreement. The proper solution then is for the parallel debt structure to be set out in a separate Parallel Debt Agreement. If the parallel debt structure is set up to ensure the effectiveness of Dutch law security, it is logical for the Parallel Debt Agreement to be governed by Dutch law.

CLAUSE 1 – DEFINITIONS AND INTERPRETATION

Clause 1.1: Definitions

“Business Day”

If the Facility Agreement provides for a Euro facility without a possibility to take out Loans in other currencies, the reference to “London” can be deleted (unless the Agent is located in London).

“Confidentiality Undertaking”

If the Facility Agreement is to be governed by Dutch law, it is appropriate to replace the reference to “a recommended form of the LMA” by a reference to a form attached to the Facility Agreement, without any reference to the LMA (so that the definition of “LMA” in Clause 1.1 can be deleted). The standard form LMA confidentiality agreement set out in Schedule 11 (*LMA Form of Confidentiality Undertaking*) can then be transformed to a Dutch law confidentiality agreement. Also see the comment on Schedule 11: Form of LMA Confidentiality Undertaking.

“GAAP”

Dutch Obligors will generally prepare their financial statements in accordance with Dutch GAAP, so the definition of “GAAP” generally should be: “GAAP” means generally accepted accounting principles in the Netherlands. If an Obligor applies IFRS, the definition should be: “GAAP” means generally accepted accounting principles in the Netherlands, including IFRS. As in most cases Dutch Obligors which apply IFRS are also bound by Dutch GAAP, which imposes disclosure requirements in addition to IFRS, a simple definition reading “GAAP” means “IFRS” would be technically incorrect.

Obviously, if different Obligor apply different GAAPs, the definition of GAAP needs to be tailored accordingly. Tailoring is required only to the extent that Obligor are required to supply their financial statement to the Finance Parties. For Obligor which are not required to supply financial statements, the "GAAP" definition is generally irrelevant.

"Insolvency Event"

An "Insolvency Event" definition is not included in the LMA Agreement, but will be added if the Facility Agreement includes "Defaulting Lender" provisions (and "Impaired Agent" provisions). Such provisions are customary in the current market and aim to provide solutions if a Lender (or the Agent) fails to comply with its obligations under the Finance Documents or becomes insolvent. In the Dutch market, two matters may require the Borrower's attention.

First, Dutch Lenders will typically require that an "Undisclosed Administration" should not qualify as an Insolvency Event. This requirement aims to ensure that the appointment of a "silent trustee" (*stille curator*) under the FMSA (or similar actions under foreign law) is excluded from the Insolvency Event definition. Such exclusion is not objectionable.

Secondly, Dutch Lenders may propose that the opening of bankruptcy and similar proceedings should not qualify as an Insolvency Event. As the Defaulting Lender provisions are designed particularly to cater for the risk that a Lender goes bankrupt, such proposal should be fiercely resisted.

"Mandatory Cost"

The substance of the definition of "Mandatory Cost" is set out in Schedule 4 (*Mandatory Cost formulas*). There, "Mandatory Cost" is defined as the costs of complying with the regulatory requirements of (i) the European Central Bank ("ECB"), and (ii) the Bank of England and the UK Financial Services Authority ("FSA"). In general terms, these costs result from requirements for Lenders to maintain certain deposits with the relevant authorities. At the time when this commentary was written, the costs of complying with the requirements of the ECB were zero.

If a Facility Agreement is set up as a club deal between a number of Dutch banks, perhaps with one or two banks elsewhere on the European continent, or if it is otherwise unlikely that UK banks will want to participate in a Facility Agreement, the Borrower may want to suggest that the Mandatory Cost should be limited to ECB costs, and not extend to Bank of England and FSA costs. As a starting point, banks will not be enthusiastic about such suggestion, as it may limit the tradeability of the Facility Agreement in the secondary market. A strong Borrower may, however, be successful in this regard.

“Security”

The LMA Agreement definition of “Security” refers to forms of security which are common under English law but do not necessarily have a clear meaning under Dutch law. If the Facility Agreement is to be governed by Dutch law, it is appropriate for the definition to be replaced by a definition which uses Dutch law concepts. The text could be: “Security” means a mortgage (*hypotheek*), pledge (*pandrecht*), right of retention (*recht van retentie*) and any similar right created for the purpose of granting security, whether under Dutch law or any other law. Sometimes, Finance Parties may propose adding “retention of title arrangement (*eigendomsvoorbehouden*)” and “privileges (*voorrechten*)” to this definition. A retention of title or privilege, however, at least arguably is not “Security” within the meaning of the English law definition under the LMA Agreement, and such additions can therefore be rightfully opposed by the Borrower.

If the Facility Agreement is governed by English law, also see the comment on Clause 1.2: Construction – Other Dutch terms.

“Subsidiary”

The LMA Agreement definition uses an English law definition of “Subsidiary” by reference to the Companies Act 2006. This is not appropriate if the Facility Agreement is to be governed by Dutch law, and may not be appropriate if the “Company”, *i.e.* the top holding company of the Borrower group and which is a party to the Facility Agreement as the “Company”, is a Dutch company.

If the Facility Agreement is governed by Dutch law, it seems logical to opt for a definition of “Subsidiary” which refers back to the definition of “subsidiary” (*dochtermaatschappij*) in Section 2:24a of the Dutch Civil Code (“CC”). The definition would then read: “Subsidiary” means a subsidiary (*dochtermaatschappij*) as defined in Section 2:24a CC. In general terms, a “subsidiary” as defined in Section 2:24a CC is an entity in which the parent company (directly or through its subsidiaries) can exercise more than 50% of the votes in the general meeting of shareholders, or can appoint more than 50% of the managing or supervisory directors. However, see below.

The concept of “Subsidiary” is particularly relevant for two types of provisions in the LMA Agreement: (i) the provisions imposing obligations on “members of the Group”, which generally include the “Company” and “its Subsidiaries”, and (ii) the provisions relating to consolidated annual accounts, which are generally assumed to apply to the “Group” as a whole.

Where the LMA Agreement imposes obligations on Subsidiaries, the Company needs to be able to ensure that its Subsidiaries comply with those obligations. For that purpose, the Company needs to have control over those Subsidiaries. In practice, the Company would generally have control over its subsidiaries within the meaning of

Section 2:24a CC. However, for certain Companies exceptions may apply, for instance if the Group has entered into joint ventures in which it has a majority participation, but over which it does not exercise (sole) control. In those cases, it is appropriate not to define “Subsidiary” by reference to Section 2:24a CC, but to use a more general concept of “control”: “Subsidiary” means, in relation to a company, another company over which it exercises control. To complete this definition, an appropriate definition of “control” should be added. Often, “control” will be defined to include (i) ownership of more than 50% of the Subsidiary’s issued share capital and the voting rights attaching to that, (ii) the right to appoint more than 50% of the Subsidiary’s managing and supervisory directors, and (iii) the right to direct the policies and affairs of the Subsidiary.

As the LMA Agreement refers to the consolidated annual accounts of the “Group”, it is important for the Company to ensure that the group of companies which qualify as “Subsidiaries” is identical to the group of companies which it consolidates. In most cases, this will be the case. However, exceptions may apply. Dutch GAAP and IFRS do not require consolidation of “subsidiaries” (as defined in Section 2:24a CC) but of group companies and other legal entities over which the consolidating company exercises control (Dutch GAAP) or entities over which the consolidating company can exercise control (IFRS). The concepts of “control” under Dutch GAAP and IFRS are not identical and do not necessarily coincide with the criteria used to define “Subsidiary”. In addition, the consolidating company may have entered into joint ventures which are proportionally consolidated. In these cases, a separate definition of “Subsidiary” for the purpose of the relevant annual accounts may be required.

“VAT”

The LMA Agreement definition refers to the English Value Added Tax Act 1994. For a Facility Agreement governed by Dutch law, it is appropriate to replace that reference by a reference to the 1968 Turnover Tax Act (*Wet op de omzetbelasting 1968*).

Clause 1.2: Construction

Directors and officers

The LMA Agreement contains numerous provisions that refer to “directors” of the Obligors. English companies have a single board which may be composed of executive and non-executive directors. Dutch companies, however, will generally have either one single managing board (composed of executive directors) or a managing board and a supervisory board (the latter being composed of non-executive directors with no responsibilities for the company’s day-to-day management). In most cases, the references to “director” in the LMA Agreement would not include supervisory directors. For that reason, it is advisable for a Borrower to require that a provision be added to Clause 1.2 to the effect that in relation to a Dutch Obligor “director” means a managing director (*bestuurder*) and “board of directors” means the managing board

(*bestuur*). The provision can also be included in a “Dutch terms” clause; see “Other Dutch terms” below.

Occasionally, the LMA Agreement also refers to “officers” of Obligors. “Officers” has no clear meaning under Dutch law. Therefore, in relation to Dutch Obligors, any reference to “officers” is best avoided, or replaced by a concept which clarifies which persons are intended to be covered.

Other Dutch terms

It is customary for Facility Agreements with a Dutch Obligor or subject to Dutch law to include a “Dutch terms” clause. The Dutch terms clause clarifies how certain terms used in the LMA Agreement (and which stem from an English law background), should be interpreted in a Dutch context. Generally, there is no reason to object to such a clause. However, attention should be given to the following details.

The Dutch terms clause will commonly provide that any action to be taken by the Dutch Obligors to authorise their entry into the Facility Agreement includes any action required under the Dutch Works Councils Act (*Wet op de ondernemingsraden*). Compliance with the Works Councils Act is a mandatory legal requirement and it is difficult to argue that the Finance Parties cannot rightfully demand that the Works Council Act is complied with (particularly because non-compliance could, in certain circumstances, have negative consequences for the Finance Parties). However, the Finance Parties may take the compliance requirement one step further by proposing to provide that any “necessary action to authorise” also includes that an unconditional positive advice from the competent works council(s) be obtained. As the Works Councils Act provides for other ways for the Dutch Obligors to comply with the provisions of the Act, such a provision can be justifiably resisted (although the Finance Parties may argue that the only way for them to be sure that the Works Council Act has been complied with is their being supplied with an unconditional positive advice from the works council). Also see the comment on Schedule 2: Conditions precedent – Part I – Conditions precedent to initial Utilisation – Additional condition precedent: works council advice.

If the Facility Agreement is governed by English law, the Dutch terms clause will commonly also provide which Dutch security rights qualify as “Security” as defined in the LMA Agreement. There is no objection against including a mortgage (*hypotheek*), pledge (*pandrecht*), right of retention (*recht van retentie*) and any other limited right (*beperkt recht*) created for the purpose of granting security (*goederenrechtelijk zekerheidsrecht*).

Any proposal by the Finance Parties to add “retention of title arrangements (*eigendomsvoorbehouden*)” and “privileges (*voorrechten*)” can, however, be justifiably resisted; see the comment on Clause 1.1: Definitions – “Security” above.

Time of day

If both the Company and the Agent are located in the Netherlands, it is generally appropriate to replace the reference to “London time” in Clause 1.2(a)(xi) by a reference to “Central European Time” or “Amsterdam Time”. Similarly, in that case, the reference to “close of business in London” in Clause 11.2 (*Market disruption*) should be replaced by references to Amsterdam. However, if the Facility Agreement includes a definition of “LIBOR”, that definition should continue to refer to London time.

Clause 1.3: Third party rights

The LMA Agreement wording referring to the Contracts (Rights of Third Parties) Act 1999 can be used in the case of a Dutch Obligor signing an English law Facility Agreement. For a Facility Agreement governed by Dutch law, the provision should be replaced by a provision to the effect that, except where expressly provided to the contrary, a person that is not a Party to the Facility Agreement has no right under section 6:253 CC to exercise or enforce any term of the Facility Agreement. It is advisable to add that where the Facility Agreement provides that a person that is not a Party has a right to exercise or enforce a term of the Facility Agreement, the Facility Agreement (including the rights of that person) may be terminated, amended, supplemented or waived without that person’s consent.

CLAUSE 2: THE FACILITIES

No additional comments.

CLAUSE 3: PURPOSE

No additional comments.

CLAUSE 4: CONDITIONS OF UTILISATION

Clause 4.2: Further conditions precedent

In the Dutch market, it is not uncommon for (Dutch) Lenders negotiating a Facility Agreement that includes financial covenants to propose adding as a condition precedent that there is no threat that the financial covenants will be breached. Such a condition precedent may take a variety of forms, ranging from (i) the Finance Parties having received no evidence that, in their opinion, the financial covenants may be breached, to (ii) the Borrower not having given notice to the Finance Parties that it expects the financial covenants to be breached. Whether this is objectionable depends partly on the way the financial covenants are set up – see the comment on Clause 21: Financial covenants – and partly on the wording of the condition precedent. The Borrower will want to ensure that the additional condition precedent is worded objectively, so that there is a clear test whether the condition precedent has been

satisfied. From that perspective, a condition precedent that the Finance Parties have not received unspecified evidence that the financial covenants may be breached, is not a desirable result. A condition precedent that the Borrower has not delivered a certificate to the Finance Parties that the financial covenants will be breached, may be acceptable. In respect of such certificate, see the comment on Clause 20: Information Undertakings.

CLAUSE 5: UTILISATION

No additional comments.

CLAUSE 6: OPTIONAL CURRENCIES

No additional comments.

CLAUSE 7: REPAYMENT

No additional comments.

CLAUSE 8: PREPAYMENT AND CANCELLATION

Clause 8.2: Change of control

According to this Clause the Lenders may cancel the Facility if there is a change of control of the "Company", *i.e.* in practice the top holding company of the Borrower group. There is no hard and fast rule which determines how "change of control" should be defined. The precise definition will differ depending on the circumstances, including in particular the corporate structure and jurisdiction of incorporation of the Company. It is, however, critical for the Company to ensure that the change of control definition is not worded too broadly and, to avoid uncertainty about the applicability of the change of control clause to any specific case, that it is clear what constitutes a "change of control".

If the Company is a subsidiary of another company, "change of control" will usually be defined so that there is a change of control if the Company's parent company ceases to control a certain percentage of the issued shares of the Company and of the voting rights attaching to those shares. Depending on the circumstances, percentages may differ from more than 50% to 100%. In addition, or alternatively, the definition may provide that there is a change of control if the parent company ceases to be able to appoint a certain percentage (usually more than 50%) of the managing or supervisory directors of the Company, or if it ceases to be able to direct the policies and affairs of the Company.

If the Company is a listed company, "change of control" is more commonly defined to the effect that there is a change of control if a person (or two or more persons

acting in concert) acquire a certain percentage of the issued shares of the Company. Percentages typically used in this regard are 50% or more, or 30% or more (30% being the threshold percentage under Dutch law for an acquirer to make a public offer for the Company). In addition, the definition may provide that there is a change of control if a person (or two or more persons acting in concert) obtains the ability to appoint a certain percentage (usually more than 50%) of the managing or supervisory directors of the Company, or the ability to direct the policies and affairs of the Company.

If the Company is a Dutch listed Company, "change of control" can also be defined by referring to Chapter 5.3 of the FMSA for what constitutes (i) "control" (*beschikking*), (ii) a "share" (*aandeel*) and (iii) voting rights (*stemmen*). Although referring to the FMSA for the change of control definition has the advantage of better clarity as to what constitutes a change of control, the Company should, however, carefully check whether referring to Chapter 5.3 does not make the scope of the change of control definition too broad.

CLAUSE 10: INTEREST PERIODS

No additional comments.

CLAUSE 11: CHANGES TO CALCULATION OF INTEREST

No additional comments.

CLAUSE 12: FEES

No additional comments.

CLAUSE 13: TAX GROSS UP AND INDEMNITIES

Clause 13.2: Tax gross-up

The Netherlands currently does not levy withholding tax on ordinary interest payments or any other payments made under an ordinary loan and it is currently considered unlikely that an interest withholding tax will be introduced in the near future.

Only if a loan is (re)characterised as equity for Dutch corporate income tax purposes, will Dutch dividend withholding tax be due. Under current Dutch tax law, a Loan made under an LMA Agreement will only be recharacterised as equity for Dutch corporate income tax purposes if the three following conditions are cumulatively met:

- the remuneration (interest) payable in respect of the Loan is entirely or mainly dependent on the profits realised by the Borrower or on the distribution of those profits;
- the Loan is subordinated to senior obligations of the Borrower; and
- the Loan is made for an indefinite period of time, with the understanding that repayment of the loan can be demanded in case of bankruptcy or liquidation (“perpetual”). In this respect a term of more than 50 years is considered indefinite.

In practice, it is unlikely that these conditions would apply to a Loan provided by a single bank or syndicate of banks under an LMA Agreement.

As, under current Dutch tax law, there is no relevant Dutch withholding tax, the gross-up provisions in the LMA Agreement are not objectionable. The limits of the gross-up obligation provided for in the LMA Agreement (and which stem from UK tax law) are irrelevant for Dutch Obligors and if there are no other Obligors can be deleted in their entirety. As it is currently unlikely that a relevant withholding tax will be introduced in the Netherlands in the foreseeable future, it is debatable whether it is necessary to include gross-up provisions in case a withholding tax is introduced. This will depend on the circumstances (including the term of the facility) and should be determined on a case-by-case basis.

CLAUSE 14: INCREASED COSTS

No additional comments.

CLAUSE 15: OTHER INDEMNITIES

No additional comments.

CLAUSE 16: MITIGATION BY THE LENDERS

No additional comments.

CLAUSE 17: COSTS AND EXPENSES

No additional comments.

CLAUSE 18: GUARANTEE AND INDEMNITY

Effect under Dutch law

It is customary that, in a Facility Agreement governed by Dutch law, the guarantee and indemnity provisions of Clause 18 are retained with limited amendments.

Unfortunately, as the guarantee is drafted against an English law background, the effect of the guarantee is not immediately obvious under Dutch law. Probably, absent any provision to the contrary, the guarantee if subject to Dutch law is a mixture of a suretyship (*borgtocht*) (paragraph (b) of Clause 18.1) and an independent guarantee (paragraph (c) of Clause 18.1). If there is more than one Guarantor, their obligations under the suretyship are joint and several (*hoofdelijk*).

The Finance Parties will usually insist, however, that the Facility Agreement provides that the guarantee is not a suretyship or an acceptance of joint and several liability but an independent guarantee. Although for the Guarantor a suretyship has certain advantages over a guarantee, it is difficult to argue against this, as it is in line with established market practice. Once the provision has been included, it is likely (although not certain) that the guarantee provisions should be interpreted accordingly, so that the guarantee qualifies as an independent guarantee in its entirety.

Although the guarantee provision requires the Guarantors to pay the Finance Parties “on demand”, the guarantee is not an “on demand guarantee” comparable to a letter of credit or other forms of bank guarantees. Under a letter of credit, as a starting point, the bank must pay the beneficiary upon presentation of appropriate documents irrespective of whether the debt to which the letter of credit relates remains outstanding. Under the guarantee as included in the LMA Agreement, the Guarantors can only be required to pay “whenever a Borrower does not pay any amount when due”. Accordingly, once the Borrower has paid, the obligation for the Guarantors to pay falls away, irrespective of any “demand” by the Finance Parties.

Recourse

If, in a Facility Agreement governed by Dutch law, the guarantee were to take effect as a suretyship or an acceptance of joint and several liability, statutory provisions governing recourse between sureties or between joint and several debtors would apply. However, if the guarantee is not a suretyship or an acceptance of joint and several liability, there are no specific statutory rules on recourse among Obligor. To avoid a situation – which will usually only occur if the group is in distress – where a Guarantor that has not benefited from the facility but has made a payment to the Finance Parties under its guarantee, cannot take recourse against the Borrower or Borrowers whose debts it has serviced, it is advisable to create a specific arrangement on recourse between Obligor. One option is to provide in the Facility Agreement that, as between the Obligor (but not as between the Obligor and the Finance Parties), the provisions on joint and several liability will apply. In general terms, these provisions require that the payments under the guarantee must ultimately be borne by the Obligor that has benefited from the relevant Loan or other amounts. These provisions usually set out general principles and may not always provide a clear roadmap to a result. Another option is to create a separate agreement between the Obligor which governs recourse.

Whichever option is chosen, recourse claims between Obligor have limited practical relevance as long as the Finance Parties are not fully paid as Clause 18.7 (*Deferral of Guarantor's rights*) requires the Obligor to refrain from exercising any recourse rights for as long as any amount under the Facility Agreement remains outstanding.

Additional Clause: Guarantee limitations for Dutch Obligor

For a Dutch holding company of a group, it is generally not problematic to act as Guarantor for its subsidiaries.

However, if a subsidiary is to provide an upstream guarantee for its parent company (or parent companies) or cross-stream guarantees for its sister companies, the following considerations must be taken into account.

Financial assistance

Under Dutch financial assistance rules (Sections 2:98c and 2:207c CC), a Dutch Obligor may not act as Guarantor in respect of Loans advanced to finance the acquisition of shares in that Obligor's capital. (The same prohibition applies to the creation of security to secure such financing.) If there is a chance that, for certain Obligor, the guarantee in the Facility Agreement may fall foul of Dutch financial assistance rules – a typical example would be an acquisition financing where the target companies accede to the Facility Agreement at or after closing of the transaction – it is customary for the Facility Agreement to provide that Dutch Obligor have no liability under the guarantee to the extent that, if they were to have such liability, Dutch financial assistance rules would be violated.

Dutch financial assistance rules apply to Dutch companies the shares of which are acquired, but also to such companies' subsidiaries, including most likely their foreign subsidiaries. For this purpose, "subsidiaries" are subsidiaries as defined in Section 2:24a CC (see the comment on Clause 1.1: Definitions – "Subsidiary"). As consequence, the guarantee limitation for Dutch financial assistance rules should not be limited to the Guarantor the shares of which are being acquired, but should extend to any of that Guarantor's subsidiaries. It is, however, uncommon for such a carve-out to also apply to non-Dutch subsidiaries.

Corporate interest

If the guarantee as provided by a Dutch Guarantor (i) exceeds the Guarantor's objects as set out in its articles of association, or (ii) is not in the Guarantor's corporate interest (*vennootschappelijk belang*), the Guarantor (or, in practice, its trustee in bankruptcy) may nullify the guarantee if the Finance Parties knew or without any investigation should have known that this was the case.

Whether the guarantee exceeds a Guarantor's objects can be determined by reviewing the objects clause in its articles of association. In practice, the Finance Parties will generally insist, at least for subsidiary Guarantors, that the articles of association expressly provide that the Guarantor may provide guarantees for the debts of group companies or other persons generally and that, if necessary, the articles of association be amended to that effect. Ensuring that the guarantee is within the scope of the objects clause in the Guarantor's articles of association is also in the interest of the board or boards of the Guarantor, thus making such amendment in principle not problematic.

Whether the guarantee may violate a Dutch Guarantor's corporate interest is more difficult to determine. According to case law, all relevant circumstances must be taken into account and, as a result, there is no hard and fast rule to determine how this question should be answered in any specific case. However, the following may serve as general guidance:

- When determining what a Guarantor's corporate interest is, the interests of the group to which the Guarantor belongs may be taken into account. The relative weight which should be given to the Guarantor's own interest and the interest of the group will depend on a variety of circumstances, including whether the Guarantor enjoys any direct or indirect benefits from the guarantee and including whether the group is closely knit or a loose conglomerate of fairly independent entities. Indications whether or not the group is closely interlinked may be found in the group's management structure or in group arrangements, such as cash pooling or service arrangements.
- In the case of a closely knit group, although when determining what a Guarantor's corporate interest is, the interests of the group may play an important role (and may, in certain circumstances, override the Guarantor's own corporate interest), the group's interests cannot set aside the Guarantor's own corporate interest in its entirety. The Guarantor's primary interest is to ensure its continued existence and if, by entering into the guarantee, a Guarantor jeopardises that continued existence, its corporate interest may be violated. In practice, the potential liabilities incurred by a subsidiary Guarantor under a guarantee in a Facility Agreement will often (if not in most cases) vastly exceed its financial resources. As a result, if the guarantee were called, there would be a chance, if not a certainty, that the Guarantor would not survive. However, legal writings suggest that a theoretical risk that a Guarantor may not survive if the guarantee is called is insufficient to conclude that entering into the guarantee violates its corporate interest. Instead, there should be a "concrete" danger or a "foreseeable" risk. On this basis, as a rule of thumb, it seems reasonable to assume that if there is no concrete reason to expect that the Borrowers will not be able to meet their obligations under the Facility Agreement, so that there is no concrete danger that

the guarantee will be called, the guarantee should not violate the Guarantor's corporate interest.

To take account of the potential corporate interest risk, a Dutch Guarantor may want to try to include a carve-out to exclude its liability under the guarantee to the extent that its corporate interest would be violated. However, although such a carve-out is not unheard of, the Finance Parties will generally find such a carve-out unacceptable, on the basis that it is for the Guarantor's management to determine whether the Guarantor's corporate interest is violated.

Pauliana

If (i) a Dutch Guarantor enters into the guarantee under the Facility Agreement without an obligation to do so (*onverplicht*), (ii) one or more of the Guarantor's creditors (existing or future) are prejudiced as a result of the guarantee, and (iii) at the time the Guarantor entered into the guarantee both it and the Finance Parties knew or should have known that one or more creditors would be prejudiced, the creditor or creditors concerned (or, in practice the Guarantor's trustee in bankruptcy) may nullify the guarantee on the basis of Dutch "*Pauliana*" rules.

A guarantee under a Facility Agreement will usually be entered into without an obligation to do so. Furthermore, if a guarantee is called, this could result in the Guarantor becoming insolvent. In that case, the Guarantor's creditors are likely to be prejudiced as a result of the guarantee as (i) creditors must share the assets available for their recourse with the Finance Parties as beneficiaries under the guarantee, and (ii) the guarantee is unlikely to have produced tangible benefits to the Guarantor which also benefit its creditors (but exceptions may apply).

To take account of potential *Pauliana* risks, a Dutch Guarantor may want to try to include a carve-out to exclude its liability under the guarantee to the extent that *Pauliana* rules would be violated. Again, however, although such a carve-out is not unheard of, the Finance Parties will generally find such a carve-out unacceptable on the basis that it is for the Guarantor's management to determine whether the Guarantor's creditors might be prejudiced by the guarantee.

CLAUSE 19: REPRESENTATIONS

No additional comments.

CLAUSE 20: INFORMATION UNDERTAKINGS

In the Dutch market, it is not uncommon for (Dutch) Lenders negotiating a Facility Agreement that includes financial covenants to propose an obligation for the Obligors to notify the Agent if they have reason to believe that the financial covenants may not be satisfied.

Whether this is objectionable depends partly on the way the financial covenants are set up and partly on the wording of the information obligation. If the financial covenants are set up to apply “at all times” – in that regard, see the comment on Clause 21: Financial covenants – the obligation to notify the Agent of a covenant breach may require the Obligors to continuously monitor compliance with the financial covenants. This defies the purpose of limiting testing of the financial covenants to certain specified testing dates. As regards the wording of the information obligation, it is important for Borrowers to ensure that there can be no doubt as to when the obligation to notify the Agent is triggered. Ideally, the Borrower will want to be obliged to notify the Agent only after management has received financial information – usually in the form of management accounts – from which it is clear that there is a covenant breach as at a testing date. However, Finance Parties may aim for a more loosely worded requirement with wider applicability to the effect that the notification obligation applies as soon as the Borrower becomes aware that the financial covenants will be breached.

CLAUSE 21: FINANCIAL COVENANTS

In the Dutch market, it is common for (Dutch) Lenders to require that the financial covenants are tested on specified testing dates, but must be satisfied “at all times”. From a commercial perspective, it undeniably makes sense to include such a requirement (although exceptions may apply for Borrowers operating in a highly volatile environment). The financial covenants offer the Finance Parties protection in the event that their Borrower runs into financial difficulties, and usually there will be no apparent reason why that protection should be denied to the Finance Parties in between testing dates. From a legal perspective, however, the requirement has its disadvantages because it creates uncertainty. In between testing dates, the information required to calculate the financial covenants is usually not available. As a result, in between testing dates, the question whether the financial covenants are or are not satisfied can generally be answered only on the basis of estimates and, possibly, expectations. Borrowers therefore have a reasonable argument to oppose an “at all times” requirement, although practice shows that Dutch Lenders are not easily persuaded to drop it.

CLAUSE 22: GENERAL UNDERTAKINGS

Clause 22.3: Negative pledge

Clause 22.3 (*Negative Pledge*) prohibits the members of the Group from granting Security unless permitted under this Clause. In addition to other carve-outs which may be required to ensure that the Group can operate its business, for Dutch Obligors the following matters need to be considered.

General banking conditions

If an Obligor has banking relationships with one or more Dutch banks, it is likely that the General Banking Conditions (drawn up by the Netherlands Bankers' Association (*Nederlandse Vereniging van Banken*) and the Consumers Union (*Consumentenbond*), the "GBC") apply to those relationships or a part of them.

Under article 24 (*Liens*) GBC, the relevant bank has a pledge on all debts which the bank owes to its customer and on all goods, including securities and other financial instruments, which the bank holds or obtains for the customer. Under article 25 (*Right of set-off*) GBC, the bank has the right to set off any debts due by the bank to the customer against any debts due by the customer to the bank. The pledge under article 24 GBC constitutes "Security" and thereby violates the negative pledge of Clause 22.3 of the LMA Agreement. In addition, in certain circumstances, the right of set-off under article 25 GBC may constitute "Quasi-Security" as defined in Clause 22.3 of the LMA Agreement and thereby also violates the negative pledge obligations set out in that Clause.

Although in theory a bank could waive the application of articles 24 and 25 GBC, experience shows that banks will not do so in practice. For that reason, it is generally necessary for the Borrower to ensure that a carve-out for articles 24 and 25 GBC is included in Clause 22.3.

In addition to the GBC, Dutch banks customarily use other general conditions, in particular in relation to corporate borrowers. These conditions may contain provisions comparable to articles 24 and 25 GBC. Also, Dutch banks may include provisions comparable to articles 24 and 25 GBC in separate agreements with their customers. Borrowers entering into an LMA-style Facility Agreement will need to consider whether the carve-out referred to above for articles 24 and 25 GBC should extend to other general conditions or contractual arrangements entered into with Dutch banks.

Article 26 (*Collateral*) GBC requires the customer to provide additional collateral for its debts to the bank if the bank so requests. Technically, article 26 does not violate the negative pledge of Clause 22.3 of the LMA Agreement. Clause 22.3 forbids the members of the Group to create Security, but not to agree to create Security upon request. Only if a request is made does compliance with that request constitute a violation of Clause 22.3. (Sometimes, however, Clause 22.3 will be expanded to apply also to any agreement to create Security. In that case, acceptance of article 26 GBC does constitute a violation of Clause 22.3.)

In practice, the Finance Parties are unlikely to accept a carve-out from the negative pledge requirement of Clause 22.3 for article 26 GBC. This is understandable, as accepting such a carve-out would expose the Finance Parties to the risk that substantial Security is created for the benefit of another bank, breaking the equal treatment among banks which the Finance Parties generally seek. As a result, there is

no clear solution to the potential conflict between compliance with Clause 22.3 and article 26 GBC. The Borrower will need to manage its relationships with the banks using the GBC in such a way that those banks will not use their rights under article 26. If ever a bank were to use those rights, the Borrower would need to determine the most advisable course of action at the time.

Additional Clauses: No Financial Indebtedness and No Guarantees

In practice, a Facility Agreement will often contain a prohibition for members of the Group on incurring Financial Indebtedness, subject to carve-outs as set out in the Facility Agreement. Also, a Facility Agreement may contain a prohibition for members of the Group on providing guarantees for the obligations of other persons.

In Clause 1.1 of the LMA Agreement, “Financial Indebtedness” is defined to include various forms of borrowings but also guarantees in respect of borrowings. Dutch Obligor which have issued “403 declarations” in respect of one or more consolidated subsidiaries need to be aware that the liabilities covered by such declarations constitute Financial Indebtedness, so that to that extent the 403 declaration itself also qualifies as Financial Indebtedness. Accordingly, if 403 declarations have been issued (or may be issued in the future) a carve-out from any undertaking restricting the incurrence of Financial Indebtedness must be included in the Facility Agreement. (A 403 declaration is a declaration by a parent company and filed with the Trade Register that the parent company assumes joint and several liability for any liabilities arising from any agreement entered into, or other legal acts performed, by its subsidiary referred to in the declaration.)

By definition, a 403 declaration also qualifies as a “guarantee”. Consequently, if a Facility Agreement restricts members of the Group from providing guarantees, a similar carve-out as set out above is required from that prohibition.

Another Dutch law particularity to be considered if a Facility Agreement restricts members of the Group from providing guarantees, are fiscal unities (*fiscale eenheden*) which may exist between members of the Group. Fiscal unities may, if certain conditions are met and at the option of the Group, exist in respect of Dutch corporate income tax (*vennootschapsbelasting*) and Dutch turnover tax (*omzetbelasting*). By law, the participants in a fiscal unity are jointly and severally liable for the tax liabilities to which the fiscal unity applies. In practice, a prohibition on providing guarantees is likely to extend to acceptance of joint and several liabilities. Consequently, if members of the Group participate in one or more fiscal unities, a carve-out from the “no guarantees” undertaking will be required.

CLAUSE 23: EVENTS OF DEFAULT

Clause 23.6: Insolvency

It is customary for the Finance Parties to require that “a member of the Group giving notice under section 36(2) of the Dutch 1990 Tax Collection Act (*Invorderingswet 1990*)” is added as an additional limb to this Clause. Section 36(2) of the 1990 Tax Collection Act requires a person to notify the Tax Authorities if it expects not to be able to pay certain taxes when due. Adding this limb to Clause 23.6 should not be objectionable to the Obligor.

Clause 23.8: Creditors’ process

Under this Clause, an Event of Default occurs if an attachment is made on assets of a member of the Group. Under Dutch law, an attachment may be either a pre-judgment attachment (*conservatoir beslag*) or an executory attachment (*executoriaal beslag*). It is not uncommon to distinguish between these two types of attachment and to allow for a higher monetary threshold and a longer remedy period (between 2 and 4 weeks) for a pre-judgment attachment than for an executory attachment (with a limited threshold and remedy period and sometimes none at all).

Clause 23.13: Acceleration

Sometimes, the Finance Parties will propose that an extra limb be added to this Clause, to the effect that if there is an Event of Default, the Agent may require the Obligor to create Security for the benefit of the Finance Parties to secure the Obligor’s obligations under the Finance Document. If the Facility Agreement is set up as an unsecured facility, such an addition changes the nature of the facility to a secured facility. In that case, the proposal should be forcefully resisted.

CLAUSE 24: CHANGES TO THE LENDERS

Transfer and assignment mechanisms

The LMA Agreement provides for transfer by novation as one means by which Lenders can transfer their participations in whole or in part. Although novation is not impossible under Dutch law, if the Facility Agreement is governed by Dutch law, it is more appropriate to replace this transfer mechanism by a mechanism more suited to the Dutch legal system. In practice, two mechanisms are used: (i) transfer of contract (*contractoverneming*), and (ii) a combination of assignment of claims (*cessie*) and assumption of obligations (*schuldooverneming*). It is not uncommon for both mechanisms to be included, with the latter serving as a back-up in case the former does not work.

Replacing novation by one (or both) of the Dutch mechanisms requires changes to Clause 24.1 (*Assignments and transfers by the Lenders*) and Clause 24.5 (*Procedure for transfer*) and consequential changes in other provisions. These changes, although extensive, are largely technical and their negotiation is best left to the legal advisers to the Parties.

“Assignment” as a means for a Lender to assign rights has a Dutch equivalent in the form of a Dutch law assignment (*cessie*). Generally, the provisions in the LMA Agreement on assignments are effective under Dutch law, although minor technical changes are required to Clause 2.46 (*Procedure for assignment*).

Professional market party

As explained above in the comment “Regulatory constraints to borrowing”, a Dutch Borrower must ensure that the Lenders as parties to the Facility Agreement qualify as PMPs. To ensure that New Lenders meet this requirement, a provision should be added to Clause 24.2 (*Conditions of assignment or transfer*) to the effect that, if an assignment or transfer does not include an amount outstanding from each Dutch Borrower of at least EUR 50,000 (or its equivalent in other currencies), the New Lender must confirm that it is a PMP. Alternatively, the Facility Agreement could provide that assignments and transfers are permitted only if the participation retained by the Existing Lender (if any) and the participation acquired by the New Lender amount to a certain minimum amount. This amount must then be set sufficiently high – e.g. EUR 10 million – to make it likely that the EUR 50,000 test for qualification as a PMP will always be met.

CLAUSE 26: ROLE OF THE AGENT AND THE ARRANGER

Under Dutch law, the relationship between the Agent and the other Finance Parties qualifies as assignment (*opdracht*) or agency (*lastgeving*). If the Facility Agreement is to be governed by Dutch law, the Finance Parties will often require that the application of the statutory rules on assignment and agency (Sections 7:400 to 424 CC) be excluded. This is not objectionable.

CLAUSE 27: CONDUCT OF BUSINESS BY FINANCE PARTIES

No additional comments.

CLAUSE 28: SHARING AMONG THE FINANCE PARTIES

No additional comments.

CLAUSE 29: PAYMENT MECHANICS

Clause 29.6: No set-off by Obligors

The LMA Agreement provides that Obligors are not allowed to apply set-off when making payments to the Finance Parties. If, as is now customary, the Facility Agreement includes “Defaulting Lender” provisions (and “Impaired Agent” provisions), there is a fair argument that the restriction on set-off by Obligors should not apply in relation to a Finance Party which is bankrupt or in a similar state. However, in the Dutch market, experience has shown that Dutch Lenders are not willing to accept set-off by Obligors even in the case of a bankruptcy of the Lender in question.

CLAUSE 30: SET-OFF

If the Facility Agreement is governed by Dutch law, the words that Finance Parties may set off obligations “to the extent beneficially owned by that Finance Party” are better removed as beneficial ownership has no clear legal meaning under Dutch law.

CLAUSE 31: NOTICES

Clause 31.6: English language

If the Facility Agreement is entered into in a strictly Dutch environment (without the involvement of non-Dutch Finance Parties), the Borrower may want to consider whether the requirement that notices and other documents must be in English should be relaxed to also allow for documents in Dutch.

CLAUSE 32: CALCULATIONS AND CERTIFICATES

No additional comments.

CLAUSE 33: PARTIAL INVALIDITY

Section 3:42 CC provides that, if part of an agreement is invalid, the remainder of the agreement remains in full force and effect except to the extent that, taking into account the contents and purport of the agreement, it is inextricably linked to the invalid part. Generally, this provision would seem to provide an adequate solution to any issues which may arise in case the Facility Agreement is partially invalid. On that basis, it could be argued that in a Facility Agreement governed by Dutch law Clause 33 can be deleted. On the other hand, if the Finance Parties insist, the Clause is not really harmful either.

CLAUSE 34: REMEDIES AND WAIVERS

If the Facility Agreement is governed by Dutch law, it is customary for the Finance Parties to insist on the inclusion of a provision (either as part of Clause 34 or elsewhere in the agreement) to the effect that (i) the Obligors may not rescind or nullify the Facility Agreement, and (ii) the Obligors may not invoke any right of suspension against any demand to comply with their obligations. Such provisions are in line with market practice and should not be objectionable.

CLAUSE 35: AMENDMENTS AND WAIVERS

No additional comments.

CLAUSE 36: CONFIDENTIALITY

No additional comments.

CLAUSE 37: COUNTERPARTS

In a Facility Agreement governed by Dutch law, a counterparts clause is superfluous. Nonetheless, in practice, the provision is included in Facility Agreements to which Dutch law applies and that is not objectionable.

CLAUSE 38: GOVERNING LAW

If the Facility Agreement is to be governed by Dutch law, the reference in this Clause to “English law” obviously must be changed to “Dutch law”.

CLAUSE 39: ENFORCEMENT

Clause 39.1: Jurisdiction

If the Facility Agreement is to be governed by Dutch law, the reference in this Clause to “the courts of England” should be changed to reflect a submission to the jurisdiction of the Dutch courts. It is customary to designate a specific court (e.g. “the courts of Amsterdam, the Netherlands”) as the competent court.

Clause 39.2: Service of process

If the Facility Agreement is governed by English law, the Finance Parties will insist that the Dutch Obligors appoint a process agent in the United Kingdom. If there are UK entities within the group to which the Obligors belong, any such entity can serve as process agent. Otherwise, the Obligors will need to rely on one of the English service providers offering process agent services.

If the Facility Agreement is governed by Dutch law, there is no need for the appointment of a process agent by the Dutch Obligors. If there are no Obligors other than Dutch Obligors, Clause 39.2 becomes superfluous and can be deleted (unless it is necessary to take account of the possibility that there may be non-Dutch Obligors in the future).

SCHEDULE 1: THE ORIGINAL PARTIES

Dutch law requires each Dutch Obligor to state its full name and corporate seat (*statutaire zetel*) in all agreements to which it is a party. Therefore the full name and corporate seat of each Dutch Obligor must be included in Schedule 1. If the Dutch Obligors are not listed in Schedule 1, but are named only at the head of the Facility Agreement, the full name and corporate seat must then be included there.

SCHEDULE 2: CONDITIONS PRECEDENT – PART I – CONDITIONS PRECEDENT TO INITIAL UTILISATION

(a) a copy of the constitutional documents of each Original Obligor

For Dutch Obligors, this paragraph is interpreted to require delivery of (a) the deed of incorporation (*akte van oprichting*), (b) the articles of association (*statuten*) and (c) an extract from the Trade Register (*uittreksel uit het handelsregister*).

(b) a copy of a resolution of the board of directors of each Original Obligor

Under this requirement, each Dutch Obligor must deliver a copy of a resolution from its managing board. The resolution may be in the form of minutes, or an extract from minutes, of a meeting of the managing board. It is more customary, however, to supply a copy of a written resolution signed by all managing directors. It is also customary for a draft of any written resolution to be submitted to the Finance Parties' legal advisers for their approval.

If a Dutch Obligor has a supervisory board, the Finance Parties will usually require that the Obligor also delivers a copy of a supervisory board resolution. If under the Obligor's articles of association its entry into the Facility Agreement requires supervisory board approval, this is a reasonable requirement which the Obligor should not object to. If the articles of association do not require supervisory board approval and obtaining such approval is impractical or otherwise undesirable, the Obligor can justifiably resist delivering a supervisory board resolution. As with managing board resolutions, a supervisory board resolution can take the form of the minutes (or an extract from minutes) of a meeting, but a written resolution is more common.

Under Dutch practice, the Finance Parties will generally require that the board resolutions contain certain confirmations. The confirmations operate as quasi representations and there are good arguments to resist including them. If the Finance

Parties require representations from the Obligor in relation to certain matters, these should be included in the Facility Agreement and not sneaked in through the backdoor of the board resolutions. Nonetheless, in relation to Dutch Guarantors, it is customary (but exceptions apply) for managing board resolutions to include confirmations that the conclusion and performance of the Finance Documents are within the scope of the objects of the relevant Obligor and will not prejudice one or more of its existing or future creditors (see the comments to Clause 18: Guarantee and indemnity – Additional Clause: Guarantee limitations for Dutch Obligors). The inclusion of other confirmations can be rightfully rejected. Often, the argument for including other confirmations put forward by the legal advisers to the Finance Parties is that the confirmations are required for the purpose of their legal opinion. This argument does not hold. In the legal opinion, the legal advisers can assume the facts which the confirmations relate to, which makes the confirmations themselves superfluous for the purposes of the opinion.

If confirmations are included, the Finance Parties will usually require that the resolution sets out that the Finance Parties can rely on these confirmations. This should be acceptable to the Obligors. However, it is advisable, and should be acceptable to the Finance Parties, to also set out that such reliance is without personal liability for the directors of the Obligor. The legal advisers to the Finance Parties will sometimes put forward that they too should be able to rely on the confirmations. Such suggestion should be rejected. Again, the argument normally put forward by the legal advisers – that they need to rely on these confirmations for the purpose of their legal opinion – does not hold as the matter can be solved by choosing an appropriate structure for the legal opinion.

(d) a copy of a resolution signed by all the holders of the issued shares in each Original Obligor

Although Finance Parties will routinely require that shareholders' resolutions of all Obligors be included in the list of condition precedent documents, the need to accommodate this requirement must be considered on a case-by-case basis. If under a Dutch Obligor's articles of association its entry into the Facility Agreement requires shareholder approval, it is a reasonable requirement which the Obligor should not object to. If the articles of association do not require shareholder approval and obtaining such approval is impractical or otherwise undesirable, the Dutch Obligor can justifiably resist delivering a shareholders' resolution. As with board resolutions, a shareholders' resolution can take the form of minutes (or an extract from minutes) of a meeting, but a written resolution is more common.

As a separate matter, delivering a shareholders' resolution may be appropriate if, in relation to a Dutch Obligor's entry into the Finance Documents, one or more members of the Obligor's managing board may be confronted with a conflict of interests. This could, for instance, be the case if one or more managing board members also serve as managing directors of another Obligor. Depending on the wording of the

Dutch Obligor's articles of association, if there is a conflict of interest, the managing board may not have authority to sign the Finance Documents on the Obligor's behalf without shareholder (or supervisory board) approval. In any event, as a matter of mandatory law, the general meeting of shareholders must in such a case be given the opportunity to designate a person (which may be the relevant managing director) to represent the Obligor. If there is the slightest chance that a conflict of interests may exist, the Finance Parties will usually insist on being provided with a shareholders' resolution in which the conflict of interests issue is addressed. However, recent case law from the Dutch Supreme Court has provided more clarity as to when a conflict of interests occurs and Obligors have more room to argue that there is no conflict of interests in a given situation. The Finance Parties may then agree on a confirmation in the managing board resolution that there is no conflict of interests between the managing board and the Dutch Obligor or drop the matter altogether.

Additional condition precedent: works council advice

Under the Works Councils Act (*Wet op de ondernemingsraden*), a Dutch Obligor that has established a works council must seek the works council's advice if the Obligor (i) obtains an "important credit", or (ii) grants "security" in respect of the "important debts" of another person. The entry into a Facility Agreement as a Borrower may qualify as obtaining an "important credit".

Entering into a Facility Agreement as a Guarantor is likely to qualify as granting "security" for "important debts" of the Borrower or Borrowers.

For these reasons, as a starting point, the Finance Parties will usually require that each Dutch Obligor delivers a works council's advice as part of the condition precedent package. If a Dutch Obligor has a works council and intends to seek the works council's advice, this is not objectionable. If a Dutch Obligor does not have a works council, the matter can be resolved by the Obligor confirming that no works council has been established (and that it has no statutory obligation to establish a works council). In some cases – but these are rare – a Dutch Obligor may have a works council but may rightfully be of the opinion that no works council advice is required. An example could be a situation where the Facility Agreement only makes up a minor portion of the Obligor's financing needs and is entered into as a matter of routine. In this case, the need to produce the works council's advice will need to be discussed with the Finance Parties.

If a works council's advice must be delivered, in practice, the Finance Parties will often also ask to be supplied with the request for advice to the works council. Obligors frequently and successfully reject this request with the argument that the Facility Agreement only requires the Finance Parties to be provided with a copy of the advice itself. The Obligors will, however, need to ensure that the works council's advice is sufficiently clear for the Finance Parties to determine on the basis of the advice only that the Works Councils Act has been complied with.

Again as a starting point, the Finance Parties will usually require that the works council's advice delivered to them is unconditionally positive. Whether this is objectionable will depend on the circumstances. In some cases, the Obligors will have no doubt that the works council will give an unconditionally positive advice, so that a condition precedent to that effect is not problematic. In other cases, the situation may be less clear. In such cases, a compromise position may be that the works council's advice should be positive and that any conditions attaching to the advice will either be met or will not lead to a Material Adverse Effect.

SCHEDULE 3: REQUESTS

No additional comments.

SCHEDULE 4: MANDATORY COST FORMULAE

If the definition of "Mandatory Cost" is limited to the costs of complying with the requirements of the ECB, this Schedule can be limited accordingly. See the comment on Clause 1.1: Definitions – "Mandatory Cost".

SCHEDULE 5: FORM OF TRANSFER CERTIFICATE

If the Facility Agreement is governed by Dutch law, the Transfer Certificate must be replaced by a transfer certificate which meets the Dutch legal requirements for transfers of contract. See the comment on Clause 24: Changes to the Lenders – Transfer and assignment mechanisms.

Irrespective of the governing law of the Facility Agreement, the form of transfer certificate may need to contain optional wording to the effect that the New Lender is a PMP. See the comment on Clause 24: Changes to the Lenders – Transfer and assignment mechanisms.

SCHEDULE 6: FORM OF ASSIGNMENT AGREEMENT

If the Facility Agreement is governed by Dutch law, minor technical amendments should be made to the Assignment Agreement to ensure that it meets the Dutch legal requirements for assignments. See the comment on Clause 24: Changes to the Lenders – Professional market parties.

Irrespective of the governing law of the Facility Agreement, the form of assignment agreement may need to contain optional wording to the effect that the New Lender is a PMP. See the comment on Clause 24: Changes to the Lenders – Professional market parties.

SCHEDULE 7: FORM OF ACCESSION LETTER

For Dutch Obligors, the accession letter must include the full name and corporate seat of the Obligor. See the comment on Schedule 1: The Original Parties.

SCHEDULE 8: FORM OF RESIGNATION LETTER

No additional comments.

SCHEDULE 9: FORM OF COMPLIANCE CERTIFICATE

No additional comments.

SCHEDULE 10: EXISTING SECURITY

No additional comments.

SCHEDULE 11: LMA FORM OF CONFIDENTIALITY UNDERTAKING

If the Facility Agreement is to be governed by Dutch law, it is appropriate to replace the standard form LMA confidentiality agreement in Schedule 11 with a Dutch law confidentiality agreement. For this purpose, the LMA confidentiality agreement can be used as a basis, with such amendments as are necessary for Dutch law purposes. These amendments are of a technical legal nature and are best left to the legal advisers to the parties.

SCHEDULE 12: TIMETABLES

See the comment on Clause 1.2: Construction – Time of day.

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