



Leveraged Finance Transatlantic Briefing

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BACKGROUND

This briefing compares the features of U.S. second lien and European mezzanine intercreditor agreements.

FURTHER INFORMATION

Please feel free to discuss any aspect of this briefing with the partners below or with other members of our Leveraged Finance Group:

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U.S. and European Intercreditors – Overview and Comparison

U.S. second lien and European mezzanine intercreditors operate differently, and have been constructed in order to achieve different objectives.¹ European mezzanine intercreditors typically combine payment seniority, security interest priority (across a range of creditor classes), lien subordination, claim subordination, broad enforcement standstill provisions (extending from acceleration of the junior facility to enforcement of collateral) and release mechanics upon enforcement by senior creditors. U.S. second lien intercreditors establish lien subordination, which regulates the rights of the U.S. second lien with respect to collateral only, and include an enforcement standstill with respect to collateral.

Why? Generally speaking, U.S. second lien intercreditors are predicated on two key assumptions: first, that the business will be reorganized pursuant to Chapter 11; and, second, that the first lien lenders have a comprehensive collateral package (including shares, cash, receivables and tangible assets). U.S. second lien intercreditors routinely contain waivers from the second lien of rights to object to a DIP financing, a section 363 sale, a plan of reorganization supported by first lien lenders and provide relief from automatic stay. European mezzanine intercreditors in contrast, make no assumption as to where the business will be reorganised; instead they assume the financing structure will be amenable to a swift enforcement sale or “pre-pack” resulting in a financial restructuring where “out of the money” creditors’ claims are removed from the structure.

¹ We have focused for discussion purposes on these two types of intercreditor arrangements as the first – second lien relationship in the U.S. more closely resembles the senior-mezzanine relationship in Europe rather than, say, the senior (unsecured) mezzanine relationship in the U.S. or the first-second lien relationship in Europe. European mezzanine is second lien secured.



Overview of key differences

The table below highlights intercreditor differences across these intercreditors:

FEATURE	US: FIRST-SECOND LIEN	EUROPE: SENIOR-MEZZANINE
	★★★★★	★★★★★★
1. Overview	U.S. second lien intercreditors establish lien subordination only (no claim subordination) and limit rights of the second lien with respect to the collateral, i.e., they impose an enforcement standstill with respect to collateral only and contain various bankruptcy (Chapter 11) waivers from the second lien of rights to object to a DIP financing, to object to a section 363 sale and to relief from automatic stay or to object to a plan of reorganisation supported by first lien lenders	European Senior – Mezz intercreditors provide for both types of subordination, contain broad enforcement standstills which extend from acceleration to enforcement of collateral and, importantly, contain mechanics for junior creditors' claims and security to be released upon enforcement by Senior Creditors
2. Payment Blocks	No payment block of second lien by first lien on first lien default	Payment block during senior payment default Typically also for 120 days per year during any other senior default
3. Standstill	<ul style="list-style-type: none"> No standstill on exercise of remedies as unsecured creditors, all rights as unsecured creditors preserved (although newer intercreditors are seeking to limit rights as unsecured creditors as well) Only prevents enforcement of collateral by the second lien – typically between 90-180 days 	<ul style="list-style-type: none"> Standstill on acceleration and enforcement for, typically: <ul style="list-style-type: none"> 90 days following notice of payment default 120 days following notice of financial covenant default 150 days following notice of other default Plus (in some cases) 120 days if senior taking enforcement action
4. Enforcement	<ul style="list-style-type: none"> Voting: Simple majority of >50% of first lien outstanding loans and commitments (not hedging) to enforce First lien creditors control enforcement so long as taking action 	<ul style="list-style-type: none"> Voting: >66 2/3% majority vote of senior (whether drawn or undrawn), debt plus hedging to enforce Mezz entitlement to enforce only after lapse of standstill Senior control enforcement – can override junior mezz instructions to security agent Mezzanine relatively passive – can only influence timing of enforcement action after standstill

Overview of key differences

continued

FEATURE	US: FIRST-SECOND LIEN	EUROPE: SENIOR-MEZZANINE
		
5. Purchase Option	Second lien debt can purchase first lien in full (excluding hedging) following acceleration and/or other triggers (as negotiated) at par plus accrued interest	Mezzanine lenders can purchase senior (in full) (including hedging) following acceleration, at par plus accrued interest
6. Releases of Collateral and Claims	<ul style="list-style-type: none"> Second lien generally agree not to object to asset sales approved by first lien and permitted by second lien documents (and potentially other negotiated exceptions) Second lien will automatically release (on first lien enforcement) and attach to proceeds of sale Meaningful protection afforded by UCC requirement for sale to be made in a commercially reasonable manner (or in transparent 363 sale process in case of a court approved sale in Chapter 11) 	<ul style="list-style-type: none"> Ordinary course: security released if asset sale conditions met Enforcement: junior security and debt and guarantee claims released (or may be disposed of) subject to negotiated pre-conditions Market practice evolving but fair sale provisions are increasingly common, i.e.: public auction/sale process or independent fair value opinion The LMA intercreditor agreement requires the security agent to take reasonable care to obtain a fair market price/value and permits sale of group entities and release of debt and guarantee claims, plus sale of mezz debt claims Recent changes to the LMA provide that the security agent's duties will be discharged when: <ul style="list-style-type: none"> the sale is made under the direction/control of an insolvency officer; made pursuant to an auction/competitive sales process (which does not exclude mezz creditors from participating unless adverse to sales process); made as part of a court supervised/approved process; or a "fairness opinion" has been obtained

Overview of key differences

continued

FEATURE	US: FIRST-SECOND LIEN	EUROPE: SENIOR-MEZZANINE
	★★★★★	★★★★★★
7. Credit Bid	<ul style="list-style-type: none"> Section 363(k) of the U.S. Bankruptcy Code preserves right of secured creditor to bid the amount of its secured claim (i.e. "credit bid") in a sale of its collateral First lien credit bid: Second lien typically agree not to object to sale of their collateral free of their liens in sale approved by the first lien, provided junior liens attach to proceeds of sale. This waiver may qualify as consent by the second lien to a credit bid by the first lien Second lien credit bid: Intercreditor agreements not consistent in approach – some waive second lien right, some preserve it; waiver may not be enforceable Credit bid by the second lien will (unless document provides otherwise) require them to pay off the first lien in cash If credit bid by the second lien provides more value to bankruptcy estate than one supported by the first lien, court may not enforce the second lien waiver – since debtor has fiduciary duty to obtain highest and best price for assets 	<ul style="list-style-type: none"> Possible to implement under European financial collateral arrangements, but subject to documentation terms Junior lenders often seek protection from senior credit bidding senior claims and releasing junior claims and security (leaving junior without residual unsecured claims and without recourse) Junior protection typically sought via fair sale provisions (see above) Recent changes to the LMA intercreditor include explicit provisions dealing with application of non-cash consideration
8. Anti-layering	Not included in first - second lien deals	Anti-layering not LMA standard, but contemplated and often included
9. Senior Headroom	First lien obligations often set at 110%-120% of the amount of the first lien term loans and revolving facility on the Closing Date plus the maximum amount of any incremental facility on the Closing Date	Typically included; often set at 110% of senior term debt (plus RCF/Capex)

Overview of key differences

continued

FEATURE	US: FIRST-SECOND LIEN	EUROPE: SENIOR-MEZZANINE
	★★★★★	★★★★★★
10. Amendment Restrictions	<ul style="list-style-type: none"> Modifications of first lien documents requiring requisite second lien consent subject to negotiation but typically subject to: <ul style="list-style-type: none"> Cap on yield or margin increase and of first lien principal, above the senior headroom amount (see above) Restriction on extending scheduled first lien maturity beyond the scheduled second lien maturity With respect to the second lien and less frequently with regard to the first lien and negotiated out of some deals, restriction on addition of more onerous or new events of default or covenants Modifications of second lien documents requiring requisite first lien consent also subject to negotiation but typically parallel to (and often more restrictive than) the amendment restrictions limiting the first lien documents 	<ul style="list-style-type: none"> Modifications to senior without requiring majority mezz consent typically subject to: <ul style="list-style-type: none"> Senior headroom concept (see above) Negotiated caps on senior margin and fee increases above fixed percentage or weighted average cost Mandatory prepayment waivers, and deferrals of scheduled amortization beyond (say) 9 months or senior headroom concept Standard restriction on amendments resulting in more onerous obligations than senior
11. Senior/First Lien, Mezz/Second Lien Right to Vote Claims (in Insolvency Proceedings)	<ul style="list-style-type: none"> Not included Second liens retain right to vote on plan of reorganisation (e.g., not in a manner inconsistent with the intercreditor agreement) 	<ul style="list-style-type: none"> Rarely seen – typically strongly resisted by junior Usually included for subordinated / intra-group creditors only
12. Hedging	Hedging typically secured if provided by lenders and their affiliates but not regulated by intercreditor	Hedging typically secured and regulated by intercreditor
13. Refinancing of Senior Facilities	U.S. intercreditor agreements provide flexibility for refinancing and often for the inclusion of additional secured debt subject to various conditions being satisfied	Refinancing of senior without mezz or second lien consent is not typically expressly dealt with in senior-mezzanine intercreditors and so structuring solutions would need to be considered on a case-by-case basis

Particular Strengths for Transatlantic

- One Firm Solution: We are one of the very few firms that focus on structuring cross-border, bank-bond leveraged financings harmonising practices across both US and EU markets. We have the experience, credibility and integrated market-leading team across London and NY for senior, second lien, mezzanine and high yield products.
 - Partners in NY and Europe are leaders in their field (across leveraged finance and high yield).
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About Milbank

- Milbank is an international law firm with eleven offices across the globe. We have one of the premier global finance and restructuring practices. Other core practice areas are corporate, litigation and tax.
 - We are not a volume business. Instead we take a hands on approach to transactions and legal issues that are difficult and/or particularly important to our clients.
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What Others Say About Us

“When you absolutely need a financing to be delivered, no matter what the pressures, complexities and costs, Milbank can offer a service that few can match.”

Chambers Global

“The partners are always hands-on, providing advice at a high level...great technical expertise balanced with a commercial approach.”

Chambers UK

“This compact team has positioned itself at the top of the market for both lender- and borrower-side representation.”

Chambers UK

“Top lenders’ counsel anywhere.”

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