



Leveraged Finance Transatlantic Briefing

05 SEPTEMBER 2012

BACKGROUND

As the convergence of markets and products continues, Milbank's Leveraged Finance Group will bring you periodic briefings which distil, compare and contrast key features of leveraged finance markets in the US and in Europe. We will look at loans and bonds, with large-cap or big sponsor backed LBO documentation in mind. As our clients increasingly look to structure transatlantic deals, we hope these briefings prove helpful.

This is the first such briefing, focused on decision-making in connection with bank loans and bonds.

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:

Suhrod Mehta
smehta@milbank.com
+44-20-7615-3046

Lauren Hanrahan
lhanrahan@milbank.com
+1-212-530-5339

Who's Calling the Shots? Decision Making in Loans and Bonds

Contractual decision making in relation to amendments and waivers and the taking of enforcement action (acceleration and realisation of collateral) in loans and bonds is a key area of focus for borrowers and lenders.

The approach adopted in the US loan markets tends to be more lenient than that adopted in the European loan market, albeit that the differences are not fundamental or conceptual. US loans may be amended or accelerated or collateral enforced with the approval of a simple majority of lenders (by outstandings and commitments), whereas the typical European position is to require a two thirds majority. In addition, European LBOs typically confer voting rights on hedge counterparties as part of a single senior secured class with respect to enforcement of collateral. The US loan market is also more lenient with respect to changes to economic terms and maturity: these matters are dealt with by each affected lender (with the consent of a simple majority of lenders) rather than being subject to a unanimity requirement as is the case in Europe, although the position in Europe often gets to the same place as the US market via the "structural adjustment" mechanism.

The US market is not always more borrower friendly – for instance, "you snooze, you lose" provisions are uncommon. Other differences (additional documentary complexity in Europe) result from differences in underlying structure and intercreditor arrangements, in particular with respect to second lien debt and "bond" tranches in European bank-bond deals.

US and European bond terms can diverge on voting issues. In the US, the consent of each noteholder is generally required to amend certain economic terms. In Europe, the "money terms" of a bond can often be amended with the consent of ninety percent (90%) of noteholders.

The following table summarises the position in both markets.



Decision making in loans and bonds

| ISSUES | US | EUROPE |
|---------------------------------------|--|--|
| LOANS |  |  |
| 1. Amendment and Waivers: | Greater than 50% of all outstanding loans and commitments required for most amendments/waivers (Required Lenders). | Greater than 66% of all outstanding loans and commitments required for most amendments/ waivers (Majority Lenders). Lenders under second lien tranches ¹ do not have their own vote as a class, but their loans/commitments are included in the overall majority vote. Bond tranches ² benefit from an independent right (indirect) of bond holders to vote on amendments to their "own" bond covenants. |
| Unanimity required for: | Not typically required. Instead, increase in commitments, reduction or deferral of scheduled amounts, reduction of interest rate, fees and premium, release of all or substantially all collateral/guarantees and assignments of the obligations by borrowers/guarantors require the consent of all affected lenders (or all directly and adversely affected lenders), in addition to the consent of the Required Lenders. | Increase in commitments, reduction or deferral of scheduled amounts/ maturity, reduction of margin, change of currency and change to subordination terms (subject to structural adjustments provision - see below). |
| Super Majority required for: | Rare | Typically around 85% of outstanding loans and commitments. Applies to release of any guarantees/security. Possibly, for changes to the Change of Control provision. |
| Structural Adjustments ³ : | Creation of a new tranche typically implemented with the consent of the Required Lenders. Extension of maturity typically now permitted with the consent of extending lenders only, subject to certain terms and conditions. Reduction of the interest rate permitted with only the consent of consenting lenders in rare cases only. | Increase in commitments, reduction or deferral of scheduled amounts/ maturity, reduction in margin, change of currency and creation of a new tranche (typically ranking pari passu or junior to existing tranches) may be implemented with the consent of Majority Lenders and each directly affected/participating lender. |

- 1 Typically documented under the same credit agreement as the first lien credit agreement, whereas in the US second lien debt is separately documented and so has independent voting rights.
- 2 Where a new tranche has been introduced into the Credit Agreement to on-lend proceeds of a high yield bond issued by an "affiliated" entity. This feature or structuring technique is not seen in the US market.
- 3 "Structural adjustment" provisions are also known as "facility change" provisions.

Decision making in loans and bonds

continued

| ISSUES | US | EUROPE |
|--|--|---|
| LOANS |  |  |
| 2. Acceleration and Enforcement of Collateral: | <p><i>Acceleration:</i> Upon any bankruptcy event of default, acceleration occurs automatically and upon occurrence and continuation of any other event of default, the written notice of the Required Lenders is needed to accelerate.</p> <p><i>Enforcement:</i> The Required Lenders control enforcement actions.</p> | <p><i>Acceleration:</i> As for amendments/waivers. Special approach to:</p> <ul style="list-style-type: none"> • Second lien tranches, which carry an independent right to accelerate following certain events of default (i.e. non-payment, insolvency, cross-acceleration), subject to applicable standstill periods⁴. • “Bond tranches”, whereby: <ul style="list-style-type: none"> (i) if only the non-bond tranches are accelerated, the bond tranches may require comparable action to be taken with respect to the bond tranches; and (ii) each bond tranche has an independent right to accelerate following events of default in relation to that bond tranche’s specific bond covenants. <p><i>Enforcement:</i> As above, but also including exposures⁵ of secured hedge counterparties and:</p> <ul style="list-style-type: none"> • Second lien tranches are typically subject to applicable stand-still periods on enforcement but thereafter may instruct the Security Agent to take enforcement action (subject to the first lien being able to assume control). • Bond tranches’ votes are often, but not always⁶, capped at about 25% of senior secured debt until the “bond” component in the capital structure represents about 66⅔% of the senior secured debt, after which there is no cap (i.e., \$ for \$ voting). |
| 3. You Snooze You Lose: | Typically not included. | Lender commitments/participations are disregarded (numerator and denominator) for voting on all matters if no response (positive/negative) for a specified time (e.g. 10/15 business days) following a request from Agent for a vote. |

4 Standstill periods of 60 or 90 days following a second lien payment default are common. No standstill applies if certain insolvency events have occurred or if the first lien have accelerated or are enforcing security.

5 May be limited to crystallised exposures only (i.e. only to the extent hedges have been terminated).

6 Certain recent bond issues have been awarded uncapped (i.e. € for €) voting rights.

Decision making in loans and bonds

continued



| ISSUES | US | EUROPE |
|---------------------------------|---|---|
| LOANS | | |
| 4. Yank the Bank ⁷ : | <p>If Required Lender consent has been obtained with respect to any amendment requiring the consent of all, or all affected, lenders, non-consenting lenders may be replaced with a non-consenting eligible assignee. The non-consenting lender receives payment of all outstanding principal, interest, fees and other amounts owed to it (including possibly premium, if applicable) from the assignee.</p> <p>Prepayments or revolving commitment termination are allowed in rare cases.</p> | <p>If consent of a significant majority (e.g., 80%) of lenders has been obtained with respect to any amendment requiring the consent of all lenders or of a Super Majority, non-consenting lenders may be replaced by a transfer (in cash at par, plus accrued interest, break costs and other amounts payable) of their drawn and undrawn commitments to a new lender.</p> <p>Prepayments in lieu of a transfer are allowed in some limited cases, often subject to restriction on the source of funding (e.g. new equity or cash which may be distributed).</p> |
| BONDS | | |
| 1. Amendments/Waivers: | <p>Greater than 50% of the principal amount of notes, although (i) without any consent, ambiguities and defects may be rectified, covenants for the benefit of holders added, rights or powers of the issuer surrendered and changes not adverse to the holders made and (ii) amendment of certain economic terms require the consent of each affected holder.</p> | <p>Generally, the amendment of certain economic terms can require the consent of each affected holder, as in the US or, more typically, the consent of 90% of noteholders⁸.</p> |
| 2. Acceleration: | <p>Upon any bankruptcy event of default, acceleration occurs automatically; and upon any other event of default, the written notice of at least 25% in aggregate principal amount of notes is needed to accelerate, which acceleration can be rescinded upon notice from at least 50% in aggregate principal amount of notes.</p> | <p>As in US market.</p> |

⁷ As well as Lenders claiming increased costs or subject to illegality.

⁸ Approximately 80% of a sample of high yield bonds issued in 2012 in Europe required 90% to amend the money terms of the bonds. This divergence from the US is due to indentures governing debt securities registered with the US Securities & Exchange Commission being subject to the Trust Indenture Act of 1939. European bond issuances sold into the US are typically "Rule 144A for life" and are not registered with the US Securities. English law governed investment grade bonds usually have lower thresholds for amendments, so where such companies become "fallen angel" credits, the thresholds for amending the terms of the bond can be lower than ninety per cent (90%).

Decision making in loans and bonds

continued

| ISSUES | US | EUROPE |
|-------------------------------|--|---|
| BONDS |  |  |
| 3. Enforcement of Collateral: | <ul style="list-style-type: none"> • First Lien bonds, sole collateral: Trustee or at least 50% in aggregate principal amount of notes. • Second Lien bonds or shared collateral: Defer control to First Lien holder or at least 50% aggregate principal amount of all debt secured by collateral. | <p>Depends on class/ranking in capital structure⁹:</p> <ul style="list-style-type: none"> • Senior Secured Bond Structures: Greater than 50% of outstanding principal/exposures (drawn/undrawn) of all senior secured debt (including hedging). • Senior Unsecured bonds and sole collateral: To the extent permitted by the intercreditor agreement greater than 50% of outstanding principal of the bonds. |

⁹ Assuming 'typical' European LMA-based intercreditor arrangements. Where bonds (including "bond tranches") are pari passu with term/bank debt the position may be as described above under "Loans".

Particular Strengths for Transatlantic Financings

- 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).

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.

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.”

Legal 500

Key Contacts



Michael J. Bellucci
mbellucci@milbank.com
+1-212-530-5410



Winthrop N. Brown
wbrown@milbank.com
+1-202-835-7514



Neil Caddy
ncaddy@milbank.com
+44-20-7615-3145



Marcus J. Dougherty
mdougherty@milbank.com
+1-212-530-5323



Richard M. Gray
rgray@milbank.com
+1-212-530-5508



Lauren Hanrahan
lhanrahan@milbank.com
+1-212-530-5339



Marc P. Hanrahan
mhanrahan@milbank.com
+1-212-530-5306



Patrick Holmes
pholmes@milbank.com
+44-20-7615-3022



Dr. Thomas Inghoven, LL.M.
tinghoven@milbank.com
+49-69-71914-3436



Dr. Rainer Magold, LL.M.
rmagold@milbank.com
+49-69-71914-3430



William J. Mahoney
wmahoney@milbank.com
+1-212-530-5286



Suhrud Mehta
smehta@milbank.com
+44-20-7615-3046



Rod Miller
rmiller@milbank.com
+1-212-530-5022



Arnold B. Peinado, III
apeinado@milbank.com
+1-212-530-5546



Timothy Peterson
tpeterson@milbank.com
+44-20-7615-3106



Peter Schwartz
pschwartz@milbank.com
+44-20-7615-3045