First out or super seniors – same difference?

The similarities and distinctions between typical features of first out revolving credit facilities in the US, and super senior revolving credit facilities in Europe

What is it?

Labelled 'first out' in the US and 'super senior' in Europe, this is a revolving credit facility (RCF) which has priority over other *pari passu* debt in relation to the proceeds of enforcement of collateral and, in the US, guarantee recoveries.

First out facilities in the US are relatively uncommon and appear most often in middle-market financings and restructurings. The terms of first out facilities are often deal specific. By contrast, super seniors are a well known component of a leveraged capital structure in the European market, and the terms are more settled.

How does it work?

Super seniors typically appear beside *pari passu* senior secured bonds. First out facilities, on the other hand, commonly co-exist with *pari passu* term loans and/or *pari passu* senior secured bonds.

The primary feature of super senior or first out facilities across both markets is waterfall priority. That is, priority with respect to the application of proceeds of collateral following an enforcement of collateral and, in the US, guarantee recoveries. The super senior or first out tranche is paid from the enforcement proceeds (including, in the case of first out facilities, enforcement recoveries in a Chapter 11 bankruptcy process) before other *pari passu* debt tranches that are secured by the same collateral.

A standard super senior or first out waterfall provision provides that:

- the obligations under the super senior or first out facility have top payment priority (except for payment of certain enforcement-related and other amounts owing to agents of the *pari passu* creditors in their capacities as such); and,
- following payment in full of the super senior or first out obligations (and the enforcement-related and agent obligations, if any), any remaining proceeds are allocated to the other *pari passu* obligations.

Depending on the context, a first out facility may be documented in the same or a separate facility agreement, whereas super seniors typically appear in their own standalone agreement. Waterfall priority and associated provisions are documented either in an intercreditor agreement (in bank/bond structures, and where the first out/super senior is documented in a separate agreement) or a combined facility agreement.

Importantly (especially for a US bankruptcy analysis), first out/super senior facilities do not have their own first priority lien, which a first lien lender would have in a first/second lien structure. Instead, all *pari passu* creditors share the same grant of collateral (and guarantees) with the result that in Chapter 11 proceedings first outs would typically vote in the same class as the senior secured lenders.

Most first out facilities include simple turnover provisions with respect to proceeds received in contravention of the waterfall provision, while others include highly negotiated and bespoke intercreditor terms. Super seniors do not benefit from subordination provisions, although they do benefit from turnover provisions which capture certain recoveries, typically with respect to collateral.

First out facilities should recover in priority to other senior secured debt in Chapter 11 proceedings. Super seniors, on the other hand, would not automatically take priority over other *pari passu* debt in a bankruptcy process in Europe. Instead, they are structured on the premise that in a default scenario there will be an enforcement of a single share pledge which captures the entire value of the group as a going concern, and thereby enables a lender-driven financial pre-pack outside of formal bankruptcy proceedings.

Control over enforcement

A key issue for structures involving first out and super senior facilities is who controls enforcement actions. A balance must be struck between the interests of a relatively small and well-insulated first out/super priority class of revolving lenders, and the interests of the larger and more exposed class of term loan lenders or bond investors.

First out position – US

First out facilities have generally provided that enforcement actions, whether pre-bankruptcy or during an insolvency or bankruptcy proceeding, are controlled by lenders holding a majority of all senior secured obligations (that is, not the first out obligations).

However, as evidenced by certain recent US transactions, this default position in favour of the larger senior secured creditors has been increasingly circumscribed. First out lenders are becoming more focused on limiting dilatory enforcement by the term loan lenders or bond investors holding a majority of all senior secured obligations.

A few first out transactions in recent years have even flipped the traditional priority of creditors by providing the first out revolving tranche with exclusive control of enforcement actions, while the holders of term loans or bonds were left in the more junior position of having to accept a more passive role.

A compromise is to include a short enforcement standstill period (for example, 90 to 120 days) following the expiration of which, if the term debt holders are not exercising remedies, the first out revolving lenders are able to step into direct remedial action.

Leveraged finance quarterly

In this quarterly feature, Milbank's leveraged finance group distil, compare and contrast key features of the US and European leveraged finance markets.

It will shine a light on the legal blindspots that have arisen as markets and products converge, and as companies increasingly look to structure transatlantic deals.

Contributions from partners on both sides of the Atlantic will look at loans and bonds, with large-cap or big sponsor-backed LBO documentation in mind.

The next contribution, which will focus on intercreditor agreements, will appear in the December/January edition of IFLR magazine.

Further, first out structures have begun incorporating increasingly fulsome intercreditor provisions. Additional protections include:

(a) prohibitions on additional liens in favour of other creditor groups and incurring other *pari passu* debt above a certain threshold; and,

(b) requirements to:

i. (as far as reasonably practicable) notify the non-enforcing creditors of enforcement of shared collateral;

ii. consult in good faith with the non-enforcing creditors prior to and during such enforcement action; and,

iii. act and otherwise co-operate with the non-enforcing creditors in a commercially reasonable manner in any enforcement of shared collateral.

Super senior position – Europe

The European position on enforcement rights differs from that of the US in certain respects. Generally, either the majority super senior lenders or majority senior secured bondholders may initiate enforcement by notice to the security agent. Following this, the super senior lenders and senior secured bondholders are required to consult with each other as to the manner of enforcement for a specified consultation period. This is the case, unless certain circumstances apply. For example, if an insolvency event has occurred or the creditors' representative(s) who initiated enforcement reasonably believes that no consultation period or a shorter consultation period is necessary to avoid materially impairing the ability to effect enforcement, or the value which would be realised on enforcement.

After the consultation period, in the event the security agent receives conflicting instructions as to enforcement from the super senior lenders and the senior secured bondholders, the majority senior secured bondholders would typically be the controlling party for a certain period (for example, three to six months).

If, however, either this minimum period has elapsed and the senior secured bondholders have taken no enforcement action , or, at the end of this period, the super senior liabilities have not been repaid in full, then the super senior lenders can seize control of enforcement by notice to the security agent. In this situation, the security agent would, going forward, be obliged to act in accordance with instructions as to enforcement from the majority super senior lenders.

In all cases, the enforcement instructions must comply with the enforcement principles. Such principles will typically provide that the proceeds of enforcement must be in cash and sufficient to cover the super senior liabilities being repaid in full, and that the sale price must be supported by a fairness opinion.

The table below summarises the key documentary differences between first outs and super seniors.

By Milbank partners Suhrud Mehta in London and Lauren Hanrahan in New York

Feature	US – first out	Europe – super senior
Waterfall priority	✓ (collateral and guarantees)	✓ (typically only collateral)
Equal ranking	✓	✓
Documentation	Most commonly documented as a separate revolving tranche under the facility agreement as the *pari passu* term debt. However, if the other *pari passu* debt consists of notes, the first out facility will be documented in its own facility agreement.	Separate revolving facility agreement with own covenants and default triggers, and consistent with terms of senior secured bonds (but usually goes further by incorporating a maintenance financial covenant, additional information under-takings, and events of default).
Mandatory prepayments	As is customary for US-style revolving credit facilities, a first out facility does not generally include mandatory prepayment provisions, although certain deals have made exceptions, especially with respect to asset sale and insurance proceeds.	Will typically include mandatory prepayment upon a change of control and sale of the group. May also include mandatory pre-payment of: (i) a percentage of flotation proceeds; (ii) insurance proceeds; and, (iii) acquisition/report proceeds. In the case of (ii) and (iii), this is subject to certain carve outs and only to the extent not reinvested in the business. There will either be no requirement to prepay the proceeds of asset disposals, or such provision will mirror the asset sales covenant in the bonds. Prepayments are also required to meet the Note Purchase condition described overleaf.

Feature	US – first out	Europe – super senior
Note/Term Loan Purchase condition	Not applicable. Rarely, voluntary prepayments of term loans may be prohibited after an event of default.	Typically includes a covenant preventing a member of the group from prepaying/repurchasing/redeeming (a Note Purchase) any bonds or other senior secured debt unless no event of default is outstanding and: (i) immediately following such Note Purchase, the aggregate principal amount of all Note Purchases since the closing date is less than a threshold amount or percentage of the original amount of the bonds/senior secured debt; or, (ii) to the extent that the principal amount of all Note Purchases is in excess of the threshold amount, there is a reduction of the principal amount outstanding under the revolving facility. Options include a requirement for: pro rata prepayment and cancellation; prepayment and cancellation in an equal amount; or, full repayment and cancellation.
Maintenance financial covenants	May contain financial covenants customary for US revolving credit facilities, including, for example, a maximum leverage ratio, and possibly a minimum interest coverage ratio.	Typically, a leverage ratio (tested quarterly) accompanied in some cases by a cashflow cover ratio and/or a restriction on incurrence of capital expenditure. Alternatively, only a drawn RCF leverage ratio may apply, which is tested only when the RCF is in fact drawn on a quarterly test date.
Information undertakings	Standard undertakings in a US leveraged loan agreement, including requirements to provide: annual, quarterly and (possibly) monthly financial statements; a quarterly compliance certificate; an annual budget; notification of a default; and, certain other information (including, for instance, documents dispatched to shareholders, details of material litigation, and such other information as lenders may reasonably request regarding the financial condition, assets and operations of the group). Some first out facilities also require periodic reporting regarding the outstanding amount of the other *pari passu* debt.	Similar to the US market and also includes KYC [know your customer] information.

Feature	US – first out	Europe – super senior
Events of default:	Standard events of default in a US leveraged loan agreement including, among other common events of default, those arising from: non-payment; breach of transaction documents; misrepresentation; cross-default; insolvency or bankruptcy of any group member; change of control; material litigation or judgments and, ERISA [Employee Retirement Income Security Act] or similar material adverse employment-related events.	Typically more extensive than in senior secured bonds, including (subject to certain qualifications and remedy periods): non-payment; breach of transaction documents; misrepresentation; cross-default; insolvency of group members; creditors' process; invalidity and unlawfulness; cessation of business; change of ownership of material group companies; audit qualification; expropriation; repudiation/rescission of agreements; material litigation against the group; pensions; and, material adverse change.
• Amendments and waivers	Standard, as for a US leveraged loan agreement. Typically also includes a class vote (or affected lender vote) with respect to modifying the waterfall provision and other mechanics of the first out facility.	Standard, as for a European leveraged loan agreement. Similar to US entrenched rights with respect to modifications to waterfall and intercreditor provisions.
• Acceleration	Lenders holding a majority of the senior secured obligations.	Lenders holding two thirds of the super senior commitments (drawn/undrawn).
Intercreditor terms:		
• Payment subordination	X	X
• Payment blockage	X	X
• Turnover	✓	✓
• Enforcement of collateral:		
– *Who controls*	Lenders holding a majority of the senior secured obligations (that is, not the first out obligations).	Majority (50.1%) of the senior secured creditors or a majority (66⅔%) of the RCF lenders (subject to discussion above).
– *Conduct of process*	Generally controlled by majority of holders of senior secured obligations, although there are recent examples in the US of the first out lenders controlling enforcement rights.	Either class may initiate, but in case of a conflict (following consultation), senior secured bonds control for a period (for example, three to six months). However, super senior may assume control in accordance with security enforcement principles if this period has elapsed and no action is being taken by the senior secured class or if at the end of such period the super senior remains outstanding. The security enforcement principles require proceeds of enforcement to be in cash and sufficient to cover super senior being repaid in full and for sale price to be supported by a fairness opinion.