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BACKGROUND

This briefing compares typical features of “first out” revolving credit facilities in the U.S. market and “super senior” revolving credit facilities in Europe.

A detailed study by Milbank attorneys Marc Hanrahan and Jerome McCluskey of “first out” revolving credit facilities in the U.S. market is available at: www.Law360.com.

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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Leveraged Finance Transatlantic Briefing

First out Revolver or Super Senior Revolver – Same Difference?

What is it?

A revolving credit facility which has priority over other *pari passu* debt in relation to the proceeds of enforcement of collateral and, in the U.S., guarantee recoveries. Labelled “first out” in the U.S. market and “super senior” in the European market.

First out facilities in the U.S. are relatively uncommon and appear most often in middle-market financings and restructuring situations. 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, whereas first out facilities 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” (i.e., priority with respect to the application of proceeds of collateral following an enforcement of collateral and, in the U.S., 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 (i) 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 (ii) following payment in full of the super senior or

How does it work?

continued

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 a separate or the same facility agreement, whereas super seniors typically appear in their own stand-alone 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 in a combined facility agreement. Importantly (especially for a U.S. 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; 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 thus 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, well-insulated, first out/“super-priority” class of revolving lenders with the interests of the larger and more exposed class of term loan lenders or bond investors.

“First Out” Position – U.S.

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 (i.e., not the first out obligations).

Control over enforcement

continued

However, as evidenced by certain recent U.S. 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 typically junior position of having to accept a more passive role. A compromise position is to include a short enforcement standstill period (e.g., 90-120 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.

Furthermore, 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 (i) (as far as reasonably practicable) to notify the non-enforcing creditors of enforcement of shared collateral; (ii) to consult in good faith with the non-enforcing creditors prior to and during such enforcement action; and (iii) to 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 the position found in the U.S. in certain respects. Generally, either the majority super senior lenders or the majority senior secured bondholders may initiate enforcement by notice to the security agent, following which the super senior lenders and the senior secured bondholders are required to consult with each other as to the manner of enforcement for a specified consultation period (unless certain circumstances apply, e.g., 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 in order to avoid materially impairing the ability to effect enforcement or the value which would be realised on enforcement).

Following the consultation period, in the event of the security agent receiving 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 (e.g., 3-6 months).

If, however, either this minimum period has elapsed and no enforcement action has been taken by the senior secured bondholders, 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

Control over enforcement



continued

of enforcement by notice to the security agent (who will henceforth 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 (which typically will 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).

Overview of key differences

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

FEATURE	US	EUROPE
		
1. Waterfall Priority	✓ (collateral and guarantees)	✓ (typically only collateral)
2. Equal Ranking	✓	✓
3. Documentation	Most commonly documented as a separate revolving tranche under the facility agreement as the <i>pari passu</i> term debt or, if the other <i>pari passu</i> 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; consistent with terms of senior secured bonds (but usually go further by incorporating a maintenance financial covenant, additional information undertakings and events of default).
4. Mandatory Prepayments	As is customary for U.S. style revolving credit facilities, a first out facility does not generally include mandatory pre-payment provisions, although certain deals have made exceptions, especially with respect to asset sale and insurance proceeds.	Will typically include mandatory pre-payment 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) subject to certain carve outs and only to the extent not reinvested in the business). There will either be no requirement to pre-pay the proceeds of asset disposals or such provision will mirror the asset sales covenant in the bonds. Pre-payments are also required in order to meet the "Note Purchase Condition" described below.

FEATURE	US	EUROPE
<p>5. Note/Term Loan Purchase Condition</p>	<p>Not applicable. Rarely, voluntary pre-payments of term loans may be prohibited after an event of default.</p>	<p>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:</p> <p>(a) 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</p> <p>(b) 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: (i) <i>pro rata</i> pre-payment and cancellation; (ii) pre-payment and cancellation in an equal amount; or (iii) requirement for full repayment and cancellation).</p>
<p>6. Maintenance Financial Covenants</p>	<p>May contain financial covenants customary for U.S. revolving credit facilities, including, for example, a maximum leverage ratio and also, possibly, a minimum interest coverage ratio.</p>	<p>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.</p>
<p>7. Information Undertakings</p>	<p>Standard undertakings in a U.S. 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 <i>pari passu</i> debt.</p>	<p>Similar to U.S. market and also includes KYC information.</p>

FEATURE

US

EUROPE



8. Events of Default

Standard events of default in a U.S. leveraged loan agreement, including, among other common events of default, events of default 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 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 U.S. 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).

9. Intercreditor Terms

Payment Subordination

X

X

Payment Blockage

X

X

Turnover

✓

✓

(generally with respect to collateral and guarantee proceeds)

(typically limited to collateral)

Enforcement of Collateral:

- Who Controls

Lenders holding a majority of the senior secured obligations (i.e., not the first out obligations).

Majority (50.1%) of the senior secured creditors or a majority (66%) 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 U.S. market 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 (e.g., 3-6 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).

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).

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.”

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