ACT

LEADING TREASURY PROFESSIONALS

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

Produced by

SLAUGHTER AND MAY

April 2013

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

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Introduction

The Association of Corporate Treasurers ("**ACT**") administers the qualification framework for, supports and represents professionals working in treasury, risk and corporate finance. As the leading professional body for international treasury, it 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 the range of differences in the terms of the underlying loan agreements. 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 British Bankers' Association ("**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 sub-investment grade borrowers, has not been approved by the ACT.

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 the LMA's Finance Party Default and Market Disruption Provisions (the "**Market Conditions Provisions**"), in section 7, which cross-refers to more detailed comments in Part II.

- Part II is a commentary on the provisions of the Investment Grade Agreement including the Market Conditions Provisions.

- Part III comments on 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 including the Market Conditions Provisions. 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. While 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 identities of the borrower and the lenders and market conditions.

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 has 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.

Any statements of law and practice reflect the position as at 20 March 2013.

Slaughter and May
April 2013

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 including the Market Conditions Provisions. 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. Key points left for negotiation or insertion
6. Current issues affecting loan documentation
7. The Market Conditions Provisions
8. Amendments made to the Investment Grade Agreement and Market Conditions Provisions in 2011/12
9. Swingline Facilities
10. Letters of Credit
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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."

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 and should always satisfy themselves of the regulatory implications of its use*". 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 versions of the Investment Grade Agreement incorporating a revolving facility are also published in versions incorporating a dollar or euro swingline facility (see further section 9 below). There are currently ten permutations of the Investment Grade Agreement.

The Investment Grade Agreement assumes:

- the Borrower has an 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 (the "**Company**") being a holding company, with some of its Subsidiaries as additional Borrowers and/or Guarantors;
- 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 Obligors are not UK corporates. 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 (not to be unreasonably withheld or delayed) 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 many 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 the covenants regulating disposals and mergers are very restrictive;
- there is a "material adverse change" Event of Default and representation;
- the insolvency and insolvency proceedings Events of Default are very wide-ranging;
- mandatory prepayment is contemplated on a change of control;

- the set-off provision is broadly drafted;
- the consent of all Lenders is required for a non-committed currency to become an Optional Currency;
- the circumstances in which unanimous Lender consent is required for amendments and waivers can in some cases be challenging to interpret; and
- the definition of Break Costs does not give the Borrower credit for one day's interest: this is, in effect, a prepayment premium.

In addition, the Investment Grade Agreement does not incorporate the Market Conditions Provisions as standard (see section 7 below).

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.

Some credits are able to persuade the Arranger to agree that the Borrower's lawyers should do the drafting, but it is more common for the Arranger's lawyers to 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. KEY POINTS LEFT FOR NEGOTIATION OR INSERTION

Key points left blank in the Investment Grade Agreement 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. The ratchet in that agreement operates by reference to leverage. Margin ratchets may also operate on other bases, for example, by reference to the Borrower's credit rating.

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 when the Investment Grade Agreement was first developed. 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 Gross Up and Indemnities*), 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 in recent years.

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 LMA provisions dealing with a defaulting Finance Party are discussed in section 7 below. 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 certain transfers. However, other provisions which can be effective in this context are the limitations on the gross-up entitlement (see Clause 13 (*Tax Gross Up and*

Indemnities)), as well as "yank the bank" and "you snooze and you lose" provisions, discussed under Clauses 8.6 (*Right of replacement or repayment and cancellation in relation to a single Lender*) and 35 (*Amendments and waivers*).

Financial covenants

The financial covenants clause is left blank in the Investment Grade Agreement, acknowledging that the terms of such provisions vary widely in the investment grade loan market. Some investment grade Borrowers remain able to resist giving any financial covenants at all. See comments under Clause 21 (*Financial covenants*).

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. Main points for focus include:

- Scope: the representations, covenants and Events of Default cover not only Obligors 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, a key definition used throughout the Investment Grade Agreement.

- Clauses 22.3 (*Negative pledge*) and 22.4 (*Disposals*) are very restrictive but include blank provisions anticipating that the parties will negotiate further exceptions. Clause 22.5 (*Merger*) is also extremely broadly worded and is not subject to any exceptions or qualifications.

- 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).

- 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 stronger investment grade Borrowers 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*)).

Standalone options

In addition to the blanks and optional provisions in the Investment Grade Agreement itself highlighted above, Borrowers will need to consider whether any of the LMA's "facility agreement slot-in clauses" are required. These include the Market Conditions Provisions (see section 7 below) and the optional provisions containing the mechanics required if letters of credit are to be made available under any revolving facility (see section 10 below).

6. CURRENT ISSUES AFFECTING LOAN DOCUMENTATION

Currently there are a number of issues with the potential to impact loan transactions, the implications of which are not fully or specifically reflected in the Investment Grade Agreement. This may be because the full implications of these issues are unclear, or in some cases, because there is not yet any established market practice for dealing with them. In a number of cases, the fact that any possible risk arising out of these matters (many of which stem from recent or pending regulatory developments) has yet to be allocated in the template is not necessarily to the Borrower's disadvantage.

Topics which are commonly the subject of discussion in current transactions include:

- The impact of the various significant regulatory changes on the short-term horizon, perhaps most notably the finalisation of EU and domestic legislation required to implement Basel III.
- Challenging funding conditions, including as a result of the ongoing difficulties affecting the Eurozone.
- The possibility of Eurozone fragmentation and the effect that a change in euro membership might have on loans or payments denominated in euro.
- The proposed reforms to LIBOR and EURIBOR and the possibility of alternative benchmarks for the loan market.
- The extra-territorial effect of certain new foreign regulatory regimes, perhaps most notably, the US Foreign Account Tax Compliance Act ("**FATCA**").
- Compliance with the increasing array of anti-bribery and corruption and sanctions legislation in force around the world.
- Banks' perceptions of the risks involved in Agency and Security Agency roles in loan transactions and the allocation of any related costs incurred in the performance of such roles.

The LMA has produced guidance notes for members on a number of these issues. Such guidance notes contain the LMA's views and while they may contain provisions which are discussed in the context of the Investment Grade Agreement (for example, the "FATCA Riders" first produced by the LMA in 2012 which provide options for allocating the risk that tax deductions might be required pursuant to FATCA in loan documentation), their contents are not generally approved by the ACT.

Further information on these topical issues, including, where applicable, comments on any relevant LMA guidance notes from the Borrower's perspective, is included at the appropriate juncture of the commentary in Part II of this guide:

- Regulatory developments including Basel III: Clause 14 (*Increased costs*).
- Mandatory Costs: Schedule 4 (*Mandatory Costs*).
- Funding costs and market disruption: Clause 11 (*Changes to the calculation of Interest*).
- Impact of euro break-up on loan documentation: Clause 1.3 (*Currency symbols and definitions*), Clause 29.1 (*Payments to the Agent*), Clause 29.2 (*Distributions by the Agent*), Clause 29.8 (*Currency of Account*) and Clause 35 (*Amendments and Waivers*).
- LIBOR and alternative benchmarks: Clause 9 (*Interest*).
- FATCA: Clause 13 (*Tax gross up and indemnities*).
- Anti-bribery, corruption and sanctions legislation: Clause 22.2 (*Compliance with laws*).
- Agency provisions: Clause 15.3 (*Indemnity to the Agent*).

All of the factors identified above have a potential impact on the terms on which loan finance is available. However, unless and until the market establishes practices to deal with them which are acceptable to all parties, Borrowers should consider any provisions relating to such matters proposed by Lenders as negotiable on a case-by-case basis.

7. THE MARKET CONDITIONS PROVISIONS

The Market Conditions Provisions are a series of optional clauses addressing the potential consequences of a Finance Party default plus amendments to the market disruption and cost of funds provisions. The need for provisions of this kind became apparent in the aftermath of the collapse of Lehman Brothers in October 2008. Most of the Market Conditions Provisions are a welcome addition to facility documentation for Borrowers.

The Market Conditions Provisions are published as a standalone set of optional provisions to be considered for inclusion in the Investment Grade Agreement as required. In contrast they are included in their entirety in the Leveraged Facilities Agreement and generally speaking, most of the concepts addressed by the LMA drafting will be familiar to those who have negotiated new loan documentation since 2009. Accordingly, the commentary in this guide proceeds on the basis that the relevant aspects of the Market Conditions Provisions form part of the Investment Grade Agreement.

The LMA did not consult the ACT on the Market Conditions Provisions before their first publication in 2009, in contrast to previous practice in relation to investment grade documentation. Subsequently, discussions did take place and revised versions of the Market Conditions Provisions were published in December 2011, January 2012 and most recently in August 2012 with the approval of the ACT.

The bulk of the Market Conditions 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 and on its drawn Commitments if it fails to respond in the specified timeframe (a "you snooze you lose" provision).
- 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 to each other and to communicate with each other directly, rather than through the Agent.

For more detailed comments on the provisions relating to Defaulting Finance Parties see:

- 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 and "you snooze you lose": Clause 35 (*Amendments and Waivers*).
- Impaired Agent: Clause 1.1 (*Definitions*).

The Market Conditions Provisions also include:

- Alternative market disruption provisions which are intended to reduce the likelihood of Lenders charging the Borrower interest at their individual cost of funds upon the occurrence of a "Market Disruption Event". These are discussed under Clause 11 (*Changes to the calculation of interest*).
- Alternative definitions of LIBOR/EURIBOR which provide 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 has not found much favour with Borrowers generally and the screen rates remain the standard choice. For more on this topic, please see Clause 9 (*Interest*).

Finally, Borrowers should be aware that the Market Conditions Provisions address the consequences of default or potential default by an Issuing Bank (fronting bank), for use if the LMA Letter of Credit Option is included in the Facilities and (since December 2011), Swingline Lenders, for use if a swingline is incorporated into the revolving facility. In relation to these options, see sections 9 and 10 below.

8. AMENDMENTS MADE TO THE INVESTMENT GRADE AGREEMENT AND THE MARKET CONDITIONS PROVISIONS IN 2011/12

A number of changes have been made to the Investment Grade Agreement and the Market Conditions Provisions since the last edition of this guide was published in February 2010. All of these changes were discussed with and approved by the ACT.

In the Investment Grade Agreement, the key changes include:

- The incorporation into the Investment Grade Agreement of certain provisions which initially appeared in the optional Market Conditions Provisions, notably the provisions which permit expressly the cashless rollover of revolving facility drawings (discussed under Clause 7.2 (*Repayment of Facility B Loans*)).

- The introduction of provisions which facilitate the use by Treaty Lenders of HMRC's DT Treaty Passport Scheme, which became operative in September 2010 (discussed under Clause 13 (*Tax Gross Up and Indemnities*)).

- The addition of a detailed footnote to Clause 14 (*Increased costs*), which highlights that the parties may wish to amend the clause expressly to reflect their commercial agreement with regard to the costs associated with Basel III. The scope of the increased costs clause has been and continues to be a key topic for discussion between Lenders and Borrowers in light of the various new regulatory measures that in recent years have been or are shortly to be imposed on financial institutions. See comments under Clause 14 (*Increased costs*).

- New optional wording allows for Lenders' participations to be freely transferable upon an Event of Default (discussed under Clause 24 (*Changes to the Lenders*)).

- The addition of optional currency definitions prompted by concerns about the impact of euro break-up on loan documentation. See comments under Clause 1.3 (*Currency symbols and definitions*).

The Market Conditions Provisions were comprehensively reviewed in 2011, having been discussed for the first time between the ACT and the LMA. The main improvements from the Borrower's perspective include:

- As mentioned above, the Market Conditions Provisions permit the later assumption by a new Lender of the cancelled Commitments of a Defaulting Lender. This provision has now been aligned more closely with the procedure that applies on the transfer or assignment of a Lender's participation in the Facilities. As a result, it no longer contemplates the payment of a fee to the Agent by the Borrower nor is the identity of the new Lender subject to the Agent's approval. The scope of this mechanic has also been extended beyond a Defaulting Lender's Commitments to Commitments which have been cancelled as a result of the operation of Clause 8.1 (*Illegality*), Clause 13 (*Tax Gross Up and Indemnities*) and Clause 14 (*Increased costs*). This is discussed under Clause 2.2 (*Increase*).

- The addition of a "you snooze you lose" provision, pursuant to which the voting rights attached to the drawn Commitments of a Defaulting Lender can be disregarded if the Defaulting Lender fails to respond to an amendment or waiver request within the specified timeframe. See further comments under Clause 35 (*Amendments and Waivers*).

- Improvements to the "yank the bank" provisions which permit the replacement of Defaulting Lenders. The Agent is no longer required to approve the identity of the Defaulting Lender which is being replaced and the mechanic is now more flexible in that it contemplates that the Lender might be replaced either at par or at an agreed price below par (discussed under Clause 35 (*Amendments and Waivers*)).

9. SWINGLINE FACILITIES

For a number of years the LMA has made available a US dollar and a euro swingline option, presented as "slot-in" clauses for use in conjunction with the Investment Grade Agreements that include a revolving facility.

During 2011, the LMA reviewed the terms of the swingline options and in January 2012 published four new variations of the Investment Grade Agreement (the "**Swingline Agreements**") incorporating the updated versions of the euro and the US dollar swingline option (which are no longer published as standalone provisions). A new section was also added to the Market Conditions Provisions to cater for swingline facilities.

The Swingline Agreements contain the mechanics for a euro or a US dollar swingline (depending on the option selected) which operates within the revolving facility. Swingline drawings will thus reduce the amount available for drawing under the revolving facility. Same day swingline funds are made available for up to five Business Days at a time for the purpose of supporting the Borrower's commercial paper programme.

The 2011 changes to the swingline provisions reflected in the Swingline Agreements and the clauses relevant to swingline facilities in the Market Conditions Provisions, are in general mechanical in nature and not contentious. All were discussed with the ACT prior to publication.

Borrowers should be aware that the new liquidity coverage ratio which forms part of the Basel III package of regulatory changes as currently envisaged will increase the costs to banks of providing certain liquidity facilities, including swinglines. This is discussed at Clause 14 (*Increased costs*).

10. LETTERS OF CREDIT

The LMA letter of credit option consists of a series of provisions which can be slotted into any of the Investment Grade Agreements which incorporate a revolving facility. The letters of credit are fronted by an "Issuing Bank", whose exposure is offset by counter-indemnities from the Obligors and the Lenders. The Lenders are paid a letter of credit fee on utilisations by way of letters of credit and the Issuing Bank is paid a fronting fee for its role.

The availability of fronted syndicated letters of credit has decreased considerably in the years since the financial crisis due to a lack of institutions willing to act as Issuing Bank and to take credit risk on the syndicate members from time to time. Attempts have been made by the LMA to address this issue in the Market Conditions Provisions. In summary, the Market Conditions Provisions aim to protect Issuing Banks by providing a mechanism for cash collateralising the obligations of any Lender which becomes a "Non-Acceptable L/C Lender". This is a Lender with a rating below the agreed minimum requirement, or which is a "Defaulting Lender".

The initial version of the Market Conditions Provisions envisaged that the Borrower could be required to provide such cash collateral as needed. Following discussions with the ACT in 2011, certain improvements to the operation of this mechanism were made to minimise the impact of these provisions on the Borrower as far as possible. In the current version of the Market Conditions Provisions, the Borrower is no longer required to cash collateralise the obligations of a Non-Acceptable L/C Lender in relation to new letters of credit, and may instead opt to reduce the amount of the letter of credit. The requirement for Borrowers to cash collateralise the obligations of a Non-Acceptable L/C Lender in relation to existing letters of credit is now presented as optional. In addition, where the Borrower is to provide cash collateral, it is specifically permitted to provide it by drawing on the revolving facility.

The Leveraged Facilities Agreement contains a revolving facility that can be drawn by way of letters of credit, and incorporates provisions which are largely the same as the LMA letter of credit option.

11. OTHER LMA DOCUMENTATION

The LMA's collection of recommended form documentation has become very extensive. In addition to the suite of Investment Grade Agreements, the Market Conditions Provisions and the letter of credit option referred to above, the LMA publishes a variety of ancillary documents for use in investment grade loan transactions, including confidentiality letters (comments on which are set out in Part III of this guide), mandate letters and a term sheet as well as versions of the Investment Grade Agreement governed by French and German law.

It is worth emphasising that the LMA has generally not involved the ACT in the production of any documentation for investment grade loans other than the Investment Grade Agreement and the Market Conditions Provisions.

The ACT is also not consulted about the LMA's documentation suites for other types of loan transaction. These include:

- the Leveraged Facilities Agreement;
- the Real Estate Finance Facility Agreement (the "**REF Agreement**");
- the Pre-export Finance Facility Agreement (the "**PXF Agreement**"); and
- the recommended form of Facility Agreement for Developing Markets Transactions,

in each case, together with related documentation.

All LMA documentation is available to LMA members on the LMA's website: www.lma.eu.com.

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 amended to include the Market Conditions Provisions.

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 Obligors 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 include:

"*Break Costs*"

Please see comments under Clause 11.4 (*Break Costs*).

"*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 a potential Event of Default.

"*Defaulting Lender*"

A Defaulting Lender is defined (in outline) in the 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 and is continuing.

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

- The Company can cancel the undrawn Commitments of the Defaulting Lender, which can be immediately or later assumed by a new or existing Lender selected by the Company. 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. 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*).
- A "you snooze you lose" provision operates in relation to its drawn commitments if the Defaulting Lender fails to respond to that vote within a specified timeframe. This provision was added to the Market Conditions Provisions in December 2011 following discussions between the LMA and the ACT. 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 adopted in many loan transactions documented since the 2007-2009 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. This issue is discussed further under Clause 8.6 (*Right of replacement or repayment and cancellation in relation to a single Lender*).

The LMA definition of a Defaulting Lender has been fairly widely adopted. Initially, some banks (a minority) expressed reluctance to accept the insolvency limb to the definition. As a result, this element is presented as an option in the LMA's drafting although it is not generally excluded.

Points to note include:

- 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. Periods of between three and ten Business Days are reasonably typical. 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 "Bankruptcy" event of default in the ISDA Master Agreements. The definition is broad and protects the Borrower against a wide range of insolvency-type events. It may not, however, achieve the desired result in certain circumstances. For example, contractual provisions triggered by the exercise of the authorities' powers under the Banking Act 2009 to stabilise, put into administration and/or resolve ailing banks can be disapplied when those powers are exercised. In addition, the definition of "Insolvency Event" (in paragraph (h)), excludes insolvency processes which are required by law or regulation not to be publicly disclosed. The latter carve out (added to the definition in August 2012) is not aimed at English insolvency processes, although it may be relevant in relation to the processes of other jurisdictions[1].

[1] eg The Netherlands, as highlighted by De Brauw Blackstone Westbroek in the Dutch edition of the ACT Borrower's Guide to LMA Loan Documentation for Investment Grade Borrowers.

- The LMA drafting places no obligation on the Defaulting Lender to notify the Borrower upon becoming aware of its Defaulting Lender status. There is also no general obligation on the Agent to notify the Borrower if it becomes aware that a Lender is a Defaulting Lender. However, it may do so at its discretion and the Agent is obliged to disclose the identity of a Defaulting Lender as soon as reasonably practicable upon the written request of the Company or Majority Lenders. One might take the view that a general notification obligation is unnecessary, as the various limbs of the definition should, 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 Market Conditions Provisions applicable to Letters of Credit, 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" (a Defaulting Lender or a Lender which does not meet the specified minimum rating requirement) 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.

"*EURIBOR*"

Please see comments under Clause 9 (*Interest*).

"*Financial Indebtedness*"

The function of this definition in the Investment Grade Agreement is essentially to capture all kinds of indebtedness, for the purposes of the negative pledge (Clause 22.3) and the cross-default clause (Clause 23.5). As a result, Borrowers quite often seek a general exclusion for intra-group arrangements and debt (including exposure under documentary credits or performance bonds) 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. The definition is unlikely to be appropriate for use in financial covenant ratios (if applicable), where a narrower concept of financial debt may be required (see for example the definition of "Borrowings" in the Leveraged Facilities Agreement).

Borrower Notes

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.

Leasing

Paragraph (d) catches indebtedness under any lease or hire purchase arrangement treated as a finance or capital lease for accounting purposes. The exclusion of operating leases from the definition of "Financial Indebtedness" is customary and not generally the subject of controversy. However, it is a topic that has received increased focus in recent years due to the FASB/IASB proposals, first aired in 2009, to dispense with the distinction between finance leases and operating leases and bring all lease assets and liabilities onto the balance sheet, the so-called "right of use" model. Although it is not currently clear precisely when these proposals will come into force and in what form, the project is progressing and a revised Exposure Draft of the new accounting standard is expected to be published for comments in the second quarter of 2013. As a result, some Borrowers may be concerned about the impact of the proposed changes on their loan agreements should the Group be required to change its approach to accounting for lease exposures during the term of the loan.

The Investment Grade Agreement contains an optional "frozen GAAP" provision, which requires that each set of financial statements delivered pursuant to the Agreement is prepared on a basis consistent with the first (see comments under Clause 20.3 (*Requirements as to financial statements*)). Pursuant to that provision, if there is a change in accounting standards or policies, the Company is required to notify the Agent and provide information sufficient to enable the Lenders to compare the most recently delivered financial statements with the original set and to determine whether the financial covenants (to the extent applicable) have been complied with.

Frozen GAAP is helpful but is not a long term solution to dealing with accounting changes that impact contractual provisions as it requires the Borrower to produce two sets of accounts. The LMA frozen GAAP wording is also not broad enough to reverse the effects of the proposed new lease accounting standard on provisions other than any financial covenant tests, including the reference to finance leases in the definition of Financial Indebtedness.

Borrowers may wish to pre-empt the potential difficulties in interpreting references to finance leases in the Agreement should the changes come into effect during the term of the Facilities by including specific language to clarify that any reference to a finance or capital lease is a reference to a lease or hire purchase contract which would, in accordance with GAAP as applicable on the date the Agreement is entered into, be treated as such. A number of Borrowers, in particular those with significant operating lease commitments, have agreed such provisions in recent transactions.

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". 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 as could certain redeemable shares.

The LMA formulation is quite widely used, although variations are also quite common: for example, the addition of a requirement that the transaction must also be treated as a financial debt under applicable GAAP.

Ideally, from the Borrower's perspective, if there are additional categories of debt which should be included in "Financial Indebtedness", these should be described specifically and this catch-all paragraph, deleted. Some strong Borrowers do achieve that position.

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.

Some stronger Borrowers are able successfully to exclude derivatives transactions from Financial Indebtedness. There are various arguments in favour of doing so.

Borrowers might take the view that derivative transactions, in particular those entered into to protect against fluctuations in any rate or price should not form part of Financial Indebtedness because they are not a means of raising finance and therefore not appropriate for inclusion in the definition of Financial Indebtedness. If derivatives are entered into for the purpose of raising finance, (it might be argued), they are likely to be captured by paragraph (f) of the definition of Financial Indebtedness as transactions which have "the commercial effect of a borrowing" in any event, discussed above.

In the Investment Grade Agreement, as already noted, "Financial Indebtedness" is used in only two clauses: the negative pledge (Clause 22.3) and the cross-default Event of Default (Clause 23.5). To the extent derivatives exposures are relevant to those clauses, it may be preferable to deal with them specifically in those provisions rather than to incorporate the fair value from time to time of such exposures into the definition of Financial Indebtedness.

In the negative pledge clause, "Financial Indebtedness" is used in the restriction on "Quasi-Security" arrangements, which are prohibited where they are entered into for the purpose of raising Financial Indebtedness or financing the acquisition of an asset.

If derivatives are included in the definition of "Financial Indebtedness", the suspension, cancellation or close out of those transactions (which may occur as a result of circumstances affecting its counterparty) could trigger the cross-default Event of Default. This may be justifiable if the transaction is terminated, and an Obligor becomes subject to a payment obligation in favour of the counterparty and then defaults on that obligation. The same may not be true if (for example) an insolvency event of default occurs affecting the Obligors' counterparty and as a result, a termination payment becomes due. Accordingly, there are reasons for excluding derivatives transactions, or at least, for addressing them specifically in this context. This point is discussed further at Clause 23.5 (*Cross-default*).

There may be additional grounds for deleting paragraph (g) from Financial Indebtedness depending on how the definition is used in the document. 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) due to the potential for year on year fluctuation in the value of derivative exposures. If the definition of Financial Indebtedness is used to define a threshold or limit (for example, if the Agreement restricts the amount of Financial Indebtedness which may be incurred by the Obligors), Borrowers may seek to delete paragraph (g), or limit its application, so that it does not apply where the definition is used to set a limit or threshold for the same reason. Borrowers may also argue that the inclusion of derivatives at fair value does not reflect the effectiveness of the hedge. Accordingly, if the derivatives in question qualify for hedge accounting, that may be a further reason to exclude their fair value in this context.

Counter-indemnity obligations

Paragraph (h) covers a company's counter-indemnity obligations in respect of guarantees, bonds, letters of credit or other instruments issued by a bank or financial institution. Borrowers may seek to restrict this definition to counter-indemnity obligations in respect of liabilities of entities which are not members of the Group where the liability of that third party is of a type described in one of the other paragraphs of the definition of "Financial Indebtedness". This narrower approach is presented as standard in the Leveraged Facilities Agreement. Guarantee or indemnity arrangements in respect of the "Financial Indebtedness" of Group members are addressed in paragraph (i) in any event.

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.

No double-counting

Various paragraphs of this definition have the potential to overlap. In particular where the definition of Financial Indebtedness is used in the Agreement to define a threshold or limit (for example, in the context of a covenant restricting Financial Indebtedness or a basket for permitting indebtedness or security), it is common to make clear that "Financial Indebtedness" will be calculated without double-counting.

"*GAAP*" and "*IFRS*"

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

"*Impaired Agent*"

The 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*)).
- The Lenders and the Borrower can make payments to each other directly, 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 (Clause 31.5 (*Communication when Agent is Impaired Agent*)).

"*LIBOR*"

Please see comments under Clause 9 (*Interest*).

"*Majority Lenders*"

Prior to December 2011, "Majority Lenders" was calculated by reference to Lenders' undrawn Commitments while the Facilities remain undrawn, and by reference to the Lenders' drawn Commitments if Loans are outstanding (ie the Facilities have been drawn). If the Facilities encompass both term and revolving facilities, and the term facility is drawn at a point when the revolving facility is not, this could result in the revolving facility Lenders being effectively disenfranchised. This point was emphasised when the Market Condition Provisions were published. In that context, the definition of "Majority Lenders" would have had the potential to confer disproportionate voting power on a Defaulting Lender whose revolving facility Commitments have been termed out (see Clause 7.2 (*Repayment of Facility B Loans*)) in circumstances 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). Accordingly, when the Investment Grade Agreement was revised in December 2011, the definition of "Majority Lenders" was conformed to the equivalent definition in the Leveraged Facilities Agreement, and is now only determined according to Lenders' "Total Commitments", which encompasses both drawn and undrawn Commitments.

If the Agreement encompasses more than one Facility (eg a term and a revolving facility) and Lenders do not hold participations in each Facility in the same proportions, as noted in the LMA's Users' Guide to the Primary Documents, the relative participations of the Lenders in each Facility at the relevant time will determine "Majority Lenders", which has the potential to create anomalies eg if the term Commitments are significantly larger than the revolving Commitments. In some circumstances therefore, Lenders may seek to adjust this definition.

"*Mandatory Costs*"

Please see comments under Schedule 4 (*Mandatory Costs*).

"*Margin*"

Please see comments under "Repayment, pricing and fees" in section 5 of Part I.

"*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*).

"*Screen Rate*"

Please see comments under Clause 9 (*Interest*).

"*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 Agreement, as their accounts will have to be consolidated with those of the parent undertaking. 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 Agreement.

Clause 1.2: Construction

Paragraph (d) defines the meaning of "continuing" in the context of Defaults and Events of Default.

Borrower Notes

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 routinely obtain the more favourable version, whether or not they are investment grade.

Clause 1.3: Currency symbols and definitions

This new optional clause, containing definitions of the major currencies (euro, dollars and sterling) was added to the Investment Grade Agreement in August 2012. Definitions of additional currencies may be required if relevant to the Facilities.

Borrower Notes

As a result of economic conditions in the Eurozone, the past few years have seen increased focus on the risk that one or more countries could cease to be part of the euro, resulting in the potential re-denomination of certain obligations in euro into the new domestic currency of an exiting country. The factors which will determine which obligations are vulnerable to re-denomination in that scenario are complex. In short, it is thought that an obligation in euro may be better protected from the risk of re-denomination if the contracting parties have made clear that they intend to receive euro notwithstanding changes in euro membership from time to time. One of the ways in which this may be achieved is by including a definition of what the parties mean by the term "euro".

Please see also comments under Clauses 29.1 (*Payments to the Agent*), 29.2 (*Distributions by the Agent*), 29.8 (*Currency of Account*) and Clause 35 (*Amendments and Waivers*) in relation to the impact of the Eurozone crisis on loan agreements.[3]

Clause 1.4: 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 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 generally 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*).

[3] For further information on the legal aspects of the Eurozone crisis and its impact on financing and other contractual documentation please refer to www.slaughterandmay.com.

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**"). The Term Facility is capable of multiple drawings (if that is the position commercially agreed), but 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 Revolving Facility Loan can be re-drawn at the end of its term, as long as (among 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 an optional provision, which forms part of the Market Conditions Provisions. For an introduction to this topic, please see section 7 of Part I.

The procedure as set out in the initial version of the Market Conditions Provisions allowed the Borrower to cancel the undrawn Commitment of a Defaulting Lender or a Lender to whom the provisions of Clause 8.1 (*Illegality*) apply, and to arrange for that undrawn Commitment to be assumed by a new or existing Lender of its choice. In December 2011 the increase mechanic was extended to operate also in relation to the participations of Lenders whose Commitments have been cancelled as a result of a claim under Clause 13.2 (*Tax gross-up*), Clause 13.3 (*Tax indemnity*) or Clause 14.1 (*Increased costs*).

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 is (optionally) limited in time to an agreed number of days following cancellation. It could take weeks or even months to find another Lender.

- The new Lender cannot be a member of the Borrower Group. Some Borrowers may seek to resist this limitation. For more on debt buybacks in the context of LMA loan documentation, see Clause 24.1 (*Assignments and transfers by the Lenders*).

- The Agent is (optionally) entitled to claim from the Borrower its costs and expenses (including legal fees). The mechanics for the introduction of another Lender in this scenario should not be more onerous than those applicable on the addition of a new Lender following a secondary market purchase, so the Agent's need for a separate indemnity for costs is not clear.

- Optional provision is made for the payment of a fee by the Borrower to the Increase Lender.

- The right to use the increase mechanic extends only to circumstances where the undrawn Commitments of the Lender in question have been cancelled. It does not apply in circumstances where a single Lender is permitted to be prepaid or replaced (see Clause 8.6 (*Right of replacement or repayment and cancellation in relation to a single Lender*)). Borrowers may take the view that the increase mechanic should also operate in such circumstances.

Prior to the revision of the Market Conditions Provisions in December 2011, the increase mechanic contained other features which did not operate favourably from the Borrower's perspective:

- The LMA's original version of the Market Conditions Provisions envisaged (optionally) that the new Lender must be approved by the Agent "acting reasonably". As Agent approval is not required for secondary market transfers or where a Lender is replaced pursuant to Clause 8.6 (*Right of replacement or repayment and cancellation in relation to a single Lender*), this requirement did not seem justified in the context of the increase mechanic.

- The LMA's original version of the Market Conditions Provisions made provision for the payment of a fee by the Borrower to the Agent, in addition to fees and expenses. This has been replaced with a provision for the payment of a fee by the new Lender to the Agent, which is consistent with the position in relation to secondary market transfers (and such fees are usually set at the same level as transfer fees).

As these provisions are not included in the current version of the Market Conditions Provisions, Borrowers will wish to ensure that they are not included in loan documentation going forward.

CLAUSE 3: PURPOSE

This provision contains blanks for the parties to specify the purpose to which each of the Facilities may be applied.

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 sometimes 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 Event of Default).

The test is less onerous for Rollover Loans, which can be drawn even if there is a Default continuing or going to result from the Loan. Please see 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.

Very strong credits have even 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 Obligors are satisfied that the representations selected as the Repeating Representations – see comments on Clause 19 (*Representations*) – can properly and safely be repeated on each Utilisation Date. The qualification "in all material respects" is important comfort for the Obligors.

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 is rather restrictive: the currency in question has either to be listed at the outset, or approved by the Agent acting on the instructions of all (not only Majority) Lenders; in addition, it must be readily available and freely convertible into the Base Currency.

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).

If the Optional Currencies are not LIBOR currencies or euro, the Agreement may also need to be amended to make provision for the interest rate that is to apply to drawings in the relevant currency. This is discussed at Clause 9 (*Interest*).

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.

Borrower Notes

The last date for delivery of a Utilisation Request does vary depending on syndicate size and logistics, as does the latest time, which may in some cases be as early as 9.30 am.

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 around 10 am, although the required time does vary).

Clause 6.3: Change of currency

The mechanism for currency-switching of Term Facility Loans is set out in this Clause.

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 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 in early versions of the Investment Grade Agreement. 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.

There is, accordingly, a potential risk for Borrowers in relation to a Revolving Facility in which a Defaulting Lender participates; that the Defaulting Lender's participation in Revolving Facility Loans may not be available for re-drawing at the end of the Interest Period.

To address that risk, the Market Conditions Provisions enable the term-out of Revolving Facility Loans made by a Defaulting Lender. In addition, language expressly permitting Rollover Loans to be effected on a cashless, or book-entry, basis (which initially formed part of the Market Conditions Provisions) was added to the Investment Grade Agreement in December 2011.

Term-out of Revolving Facility Loans made by Defaulting Lender

Under the 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

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

It is market practice for revolving advances to be rolled over by book entry, without any cash payment. However, before 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 Facility 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. This Clause also makes provision, optionally, for the prepayment of a Lender in circumstances where it has become unlawful for any Affiliate of that Lender (for example, its parent company) to permit the Lender to lend.

Borrower Notes

The LMA extended this provision to address unlawfulness stemming from laws applicable to Affiliates of the Lender, in addition to laws applicable to the Lender itself, in December 2011. The extension is optional as it may be of most relevance to Lenders whose holding companies are US based or are US-listed, due to the far-reaching effects of, for example, certain US sanctions legislation.

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 a requirement for the mandatory prepayment of outstanding Loans, as well as potentially operating as a drawstop. Cancellation and prepayment can be on either 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 a change of control being a prepayment event, though it is now almost universally adopted except by the very strongest credits. 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 or more days.

Where the change of control provision operates on a Lender by Lender basis, Borrowers sometimes also seek the right to replace or exercise the "Increase" mechanic (see Clause 2.2) in relation to Lenders who wish to be prepaid as a result of a change of control.

The definitions of "control" and "acting in concert" need to be settled with care. Borrowers may wish to 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 Part 6 (Disclosure Required by certain Publicly-traded Companies), Schedule 7 (Matters to be dealt with in Directors' Reports) of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 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 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 often 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 provisions dealing with a single Lender where (in outline) the Borrower is required to gross up that Lender pursuant to Clause 13.2 (*Tax gross up*) or to indemnify that Lender pursuant to Clauses 13.3 (*Tax indemnity*) or 14.1 (*Increased Costs*).

Prepay and cancel affected Lender

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 rather than to repay it and cancel its Commitment, replacement may be difficult in practice, as it requires repayment of the outgoing Lender at par, and may also involve the Borrower in the payment of fees.

Replacement of Defaulting Lender/Cancellation of Defaulting Lender's undrawn Commitments

The Market Conditions Provisions dealing with Defaulting Lenders allow the Borrower to cancel the undrawn Commitment of a Defaulting Lender. The Borrower is also entitled to replace a Defaulting Lender. Please see Clause 35.4 (*Replacement of Defaulting Lender*).

Borrower Notes

Replacement of Lenders

Borrowers may wish to consider extending the "yank the bank" provision so that it is triggered by the operation of Clause 8.1 (*Illegality*) (which is quite commonly achieved). The scope of the provision might also be extended to apply to individual Lenders who wish to be prepaid as a result of a change of control or who do 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 the latter, please see the commentary on Clause 35 (*Amendments and Waivers*).

Borrowers may also consider adjusting the timing provision, 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 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 has no general right to prepay Defaulting Lenders. The Borrower may not be disadvantaged to a significant extent by the absence of a general right to prepay Defaulting Lenders, as Defaulting Lenders are unable to vote to the extent of their undrawn Commitments, and are subject to a "you snooze you lose" provision to the extent of their drawn Commitments (discussed at Clause 35 (*Amendments and Waivers*)). However, 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 a general prepayment right along these lines to date (including in relation to Term Facilities). Under the 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 it is conceivable 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 for some Borrowers it may be worth making it clear that cancellation as a result of the operation of 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 replace LIBOR for Loans denominated in euro.

LIBOR is defined in the Investment Grade Agreement, by reference to the screen rate currently known as BBA LIBOR, with Reference Bank rates as a fall-back: if BBA LIBOR is not available on screen, LIBOR will be in response to a request from the Agent, the "Reference Bank Rate" (see further below) rounded up to four decimal places.

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 is calculated from quotes from a broad panel of banks.

BBA LIBOR has been the primary benchmark used in the syndicated loan market since it was launched in 1986, save that EURIBOR is more commonly used for loans in euro than euro LIBOR. Although the Market Conditions Provisions (which were first published in the wake of unprecedented funding conditions in the interbank market) contain an alternative definition which enables the parties to dispense with BBA LIBOR (or EURIBOR as applicable) and adopt the Reference Bank Rate as the primary benchmark, this has not, in general, been used. BBA LIBOR (or EURIBOR) as published on screen with the Reference Bank Rate as a fallback remains the standard choice for syndicated loans.

The definition of LIBOR used in loan documentation has become a topic for discussion more recently as a result of publication in September 2012 of Martin Wheatley's review of the LIBOR process, prompted by the results of investigations by various regulators into the misconduct of various contributor panel banks in relation to their LIBOR submissions.

The Wheatley Report recommends a number of changes to the administration and calculation of BBA LIBOR. Certain proposals have the potential to impact the manner in which LIBOR is used and defined in loan documentation, specifically:

- the reduction of the number of currencies and maturities for which LIBOR is produced; and
- the transfer of responsibility for LIBOR from the BBA to a new administrator and the possibility of changes to the current calculation methodology, in particular the suggestion that the contributor panels should be broadened.

At the time of writing, these proposals are in the process of being implemented. It is currently expected that the recommendations will be implemented in full during the course of 2013. Some of the key issues for Borrowers to be aware of in relation to the LMA's approach to defining "LIBOR" and as a result of the proposed changes to LIBOR are summarised below.

Borrower Notes

BBA LIBOR and Reference Bank Rates

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 reasonable market size in the London interbank market at 11 am on a given day. The panel banks (who currently participate voluntarily) 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 question[4]. To calculate the rate, the panel banks' 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.

The rate at which the Reference Banks are required to quote in the Investment Grade Agreement (the "**Reference Bank Rate**") is crafted as a proxy for BBA LIBOR and is thus defined as "*the rate at which the relevant Reference Bank could borrow funds in the London interbank market…in the relevant currency and for the relevant period, were it to do so by asking for and then accepting interbank offers for deposits in reasonable market size in that currency and for that period*".

If the Reference Bank Rate fallback applies, the potential for divergence between BBA LIBOR and the Reference Bank Rate will depend on factors including the extent to which the Reference Banks appointed for the purposes of the Facilities do not reflect the characteristics of the BBA panel banks. Logically, the divergence might

[4] More detail about the calculation of BBA LIBOR is provided on the BBA's LIBOR website: www.bbalibor.com.

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 level of expertise in the relevant currency 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.

Borrowers should note that the current formulation of the Reference Bank Rate appeared initially in the Market Condition 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 Market Conditions Provisions (and since December 2011, in the Investment Grade Agreement), the LMA has recommended the BBA LIBOR approach.

About three Reference Banks are usually appointed by the Agent in consultation with the Borrower. Borrowers are therefore likely to 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.

Discontinued LIBOR fixings

As mentioned above, one of Wheatley's recommendations for improving LIBOR is that LIBOR rates should not be produced for currencies and maturities which are used insufficiently to permit verification of the rates based on actual trading. This was one of the first proposals to be addressed and the BBA confirmed at the end of 2012 that the following LIBOR fixings would be phased out imminently:

- the NZ$ rates were discontinued at the end of February 2013;
- the Danish Kroner and Swedish Kronor rates were discontinued at the end of March 2013; and
- the Aus $ and CAN $ rates are to be discontinued at the end of May 2013.

In addition, the following maturities are to be removed from the LIBOR framework at the end of May 2013: 2 week, 4 month, 5 month, 7 month, 8 month, 9 month, 10 month, 11 month[5].

[5] The 2 month maturity was originally proposed to be discontinued but is now to be retained as a result of market feedback.

Thus from the end of May 2013, a reduced total of 42 LIBOR rates will be published daily comprising the following: overnight/spot-next, 1 week, 1 month, 2 month, 3 month, 6 month and 12 month rates for each of CHF, euro, EUR Same Day, GBP, JPY and US$.

Parties to loan agreements which reference LIBOR currency rates which are to be or have been discontinued will need to specify an appropriate alternative rate if the parties do not wish the Reference Bank Rate fallback to apply. The ACT published a guide containing information on potential alternative rate sources in January 2013[6].

Existing documentation which permits the selection of Interest Periods of maturities for which LIBOR fixings (in all currencies) are to be discontinued should not require amendment as it should be possible to prepare interpolated rates, but whether the documentation permits interpolation and the basis on which such rates will be calculated is a point that Borrowers may wish to explore with the Lenders.

Proposed changes to rate setting process

The definition of LIBOR in the Investment Grade Agreement designates a "Screen Rate", which refers to the "British Bankers' Association Interest Settlement Rate" as displayed on the appropriate page of the Reuters screen. Depending on how the transition to the new administrator's rate (referred to below for convenience as "new LIBOR") is managed, it is conceivable that this definition would not be adequate to identify new LIBOR when the BBA resigns its current role.

This could lead to disputes as to whether the "Screen Rate" (ie BBA LIBOR on screen) is available.

If the "Screen Rate" is unavailable, "LIBOR" reverts to the Reference Bank Rate. As described above, the manner in which the Reference Bank Rate is calculated tracks the BBA's current definition of LIBOR. Accordingly, it might also be possible that when new LIBOR is adopted and BBA LIBOR ceases to be available, uncertainty could arise as to the availability of Reference Bank quotes (perhaps because the Reference Banks feel unable to quote on that basis or perhaps because they are overwhelmed with requests).

If the Reference Bank Rate is unavailable, the result under the Investment Grade Agreement is a "Market Disruption Event" (see Clause 11 (*Changes to the Calculation of Interest*)). A Market Disruption Event entitles each Lender to charge the Borrower its actual cost of funds pending agreement on an alternative rate. This may be an unattractive outcome for Borrowers.

6 This guidance is available from the ACT website: www.treasurers.org.

There is also the possibility that "new LIBOR" may not be displayed on the same Reuters screen pages as BBA LIBOR. BBA LIBOR is displayed on Reuters pages LIBOR01 or LIBOR02 (depending on the currency).

In this instance the definition of "Screen Rate" in the Investment Grade Agreement provides a means of addressing the change, but consultation between the parties will be required. That definition does not specify the screen page, instead referring to the "appropriate page" of the Reuters screen and goes on to provide that if such screen is replaced or ceases to be available, the Agent in consultation with the Company and the Lenders is entitled to specify another page or service displaying the appropriate rate.

In a number of agreements negotiated after the publication of the Wheatley Report, varying attempts have been made to remove and/or supplement the reference in the definition of "Screen Rate" to the "British Bankers' Association Interest Settlement Rate" with a view to ensuring that the agreement is not disrupted by the launch of new LIBOR.

Following consultation with its members and the ACT, on 11 March 2013 the LMA published a note[7] to members containing a revised definition of "Screen Rate". The revised definition is intended to avoid any uncertainty which could arise as a result of the reference to the BBA Interest Settlement Rate following the proposed change of administrator and/or the official publisher of LIBOR. It reads:

*"**Screen Rate**" means:*

(a) in relation to LIBOR, the London interbank offered rate administered by the British Bankers Association (or any other person which takes over the administration of that rate) for the relevant currency and period displayed on pages LIBOR01 or LIBOR02 of the Reuters screen (or any replacement Reuters page which displays that rate)[; and

(b) in relation to EURIBOR, the euro interbank offered rate administered by the Banking Federation of the European Union (or any other person which takes over the administration of that rate) for the relevant period displayed on page EURIBOR 01 of the Reuters screen (or any replacement Reuters page which displays that rate),]

or [in each case,] on the appropriate page of such other information service which publishes that rate from time to time in place of Reuters. If such page is replaced or service ceases to be available, the Agent may specify another page or service displaying the relevant rate after consultation with the Company.

[7] The LMA's note "IBOR definitions in the LMA Primary Documents" is available to LMA members on the LMA website: www.lma.eu.com. A link to the paper can also be found on the ACT website: www.treasurers.org.

The above definition could be viewed as unnecessary. The widespread use of the Investment Grade Agreement means that the majority of existing syndicated loan documentation is likely to contain the definition of "Screen Rate" which currently appears in the Investment Grade Agreement and references the BBA. The Wheatley Report emphasises the need to effect the proposed changes to LIBOR without disrupting existing documentation. Accordingly, any changes to the rate which are sufficiently fundamental as to trigger the fallback Reference Bank rate or cause other interpretative difficulties, might be considered unlikely.

On the other hand, the revised definition might be viewed as a prudent administrative change, in particular given the possibility that the ultimate result of disruption could be a "Market Disruption Event" as outlined above. Borrowers may not, however, wish to go further and include drafting which purports expressly to accept new LIBOR howsoever calculated or any replacement benchmark whatever that may be. It does not seem based on current information that LIBOR (or its calculation methodology) will change so fundamentally as to prompt commercial disputes as to whether it remains the contracted rate, but Borrowers may be reluctant to take the risk that it might. The new definition is, therefore accompanied by a footnote which warns users to consider whether the definition reflects their commercial agreement and that changes to the definition could have implications under associated interest rate hedging arrangements.

For the reasons given above, some Borrowers are focusing carefully on the implications of changes to the definition of LIBOR. Until the shape of new LIBOR and the manner in which any transition to it is to be managed become clearer, the appropriate definition of LIBOR may continue to be discussed on a case by case basis.

Fallback rates and alternative benchmarks

In the medium to longer term, there may be further changes to the way in which benchmark rates are described in loan documentation, although what those might be cannot currently be predicted. The Wheatley Report recommends that the financial trade associations (which would include the LMA) should reconsider the practice of using quotes from LIBOR panel banks as a fallback rate in documentation. In addition, the Report recommends that consideration be given to whether there are alternative benchmarks that might be used in place of LIBOR.

As LIBOR was developed with the syndicated loan product in mind, no alternatives which would be viable across the market have yet been identified. These issues remain to be explored.

EURIBOR reform?

The EU has initiated a consultation aimed at identifying key issues and shortcomings in the production and use of benchmarks and various similar initiatives are underway at an international level, meaning that the EURIBOR calculation process (although different to that applicable to BBA LIBOR) may come under similar scrutiny going forward. As a result, the revised definition of "Screen Rate" quoted above contemplates administrative changes to EURIBOR as well as LIBOR.

LIBOR/EURIBOR zero floor

The LMA published a note containing an optional zero floor provision to be inserted into the LMA definitions of LIBOR and EURIBOR in late 2011. This was in response to negative CHF LIBOR during the summer of 2011, which gave rise to concerns that a negative LIBOR rate could erode Lenders' margins. The effect of the optional language (which is still not included in the Investment Grade Agreement although it does now appear in the LMA Leveraged Facilities Agreement and other LMA recommended forms) is that if LIBOR is negative, it will be deemed to be zero for the purposes of the Agreement.

The zero floor has become quite widely adopted by Lenders and commonly appears in first draft loan documentation. If included, Borrowers should ensure that the zero floor is matched in any associated interest rate hedging arrangements. This is to preserve the protection of the swap and also to ensure there is no impact on hedge accounting treatment if applicable or on the exemption of the swap from central clearing requirements under the European Market Infrastructure Regulation[8].

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 in relation to the manner in which Mandatory Costs are calculated and charged.

8 For further information on the European Market Infrastructure Regulation and its impact on non-financial counterparties please refer to www.slaughterandmay.com.

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 (a defined term), 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 often 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 is to be repaid or to reduce in instalments, Borrowers may select Interest Periods shorter than they would otherwise be allowed, 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 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 Agreement, match the provisions of their hedging arrangements.

Borrowers should note that LIBOR fixings are to be discontinued for 2 week, 4 month, 5 month, 7 month, 8 month, 9 month, 10 month, 11 month periods with effect from the end of May 2013 (see comments at Clause 9.1 (*Calculation of interest*) above).

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 Borrowers should not 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 the 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 allow the Lenders to pass on to the Borrower their actual cost of funds in place of LIBOR (or EURIBOR if applicable) in the event of significant market difficulties. These were the subject of some scrutiny and debate as a result of the 2007-2009 financial crisis. Lack of liquidity in the inter-bank market and widespread criticism of BBA LIBOR as not accurately reflecting Lenders' cost of funds during that period led many syndicates to consider whether the circumstances constituted a Market Disruption Event. There were, however, no publicly reported instances of actual cost of funds being charged to Borrowers pursuant to these provisions in the London market.

As a result of these debates, the LMA introduced an alternative market disruption regime as part of the Market Conditions Provisions. Both the existing provisions in the Investment Grade Agreement and the version set forth in the Market Conditions Provisions are discussed below.

Market Disruption Event: the Investment Grade Agreement

As mentioned under Clause 9 (*Interest*), LIBOR is defined in the Investment Grade Agreement by reference to a Screen Rate and, if that rate is not available, the Reference Bank Rate.

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:

- 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 Market Conditions Provisions

The market disruption regime set forth in the Market Conditions Provisions essentially stipulates 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 a Market Disruption Event (see above) affecting the "Alternative Reference Banks"), will the Lenders' actual cost of funds become applicable.

Under the Market Conditions Provisions, the Reference Banks are re-named "Base Reference Banks" 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".

As mentioned above, an "Alternative Market Disruption Event" is effectively equivalent to a 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 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 market disruption machinery in the Market Conditions Provisions requires 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 or at least delay the risk of this eventuality. Effectively, the Alternative Reference Bank Rate is used as a safety net before the Borrower is required to pay the Lenders their cost of funds.

Borrower Notes

The Market Conditions Provisions are probably more borrower-friendly than the LMA's standard market disruption provisions in the Investment Grade Agreement, in that they provide a further hurdle for Lenders to meet before the Borrower is forced to accept Lenders' individual funding costs. However, they remain relatively little-used in the investment grade loan market. The primary reason for their lack of use is most likely that the Market Conditions Provisions (as the more borrower-friendly option) do not form part of Lenders' standard forms for investment grade Borrowers. They are incorporated in full into the LMA Leveraged Facilities Agreement and therefore appear with more frequency in leveraged loan documentation. Another reason for the limited use of the alternative market disruption provisions in investment grade loans may be simply that they are longer and more complicated than the standard choice.

Nonetheless, the Market Conditions Provisions warrant consideration, in particular in difficult market conditions and/or when entering into Facilities that are likely to be syndicated broadly. If these aspects of the Market Conditions Provisions are used, particular issues for Borrowers to note include:

- 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 the funding costs of 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 be 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 care. For example, choosing LIBOR panel banks for the relevant currency (or banks with similar characteristics to such LIBOR panel banks) could (based on LIBOR as currently calculated at least) reduce the possibility that the market disruption provisions could be triggered.

Whether the Investment Grade Agreement provisions or the Market Conditions Provisions are applicable, the most effective protection for Borrowers against market disruption provisions being invoked by Lenders is probably achieved by setting the threshold percentage for triggering a Market Disruption Event as high as possible. Historically, the required threshold was often Lenders whose participations represent 50% of the Loan in question for investment grade Borrowers. There has been some downward pressure on this figure in recent years, with several deals at 35%, but stronger Borrowers remain able to retain a higher percentage.

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* or by a specified percentage.

Clause 11.4: Break Costs

If a Borrower makes a prepayment 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 both leveraged and investment grade Borrowers obtain this concession regularly. Sometimes (rarely) 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 Gross Up and Indemnities*) and 14 (*Increased costs*).

Another objection to the LMA's definition of Break Costs that is often raised is 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 (sometimes referred to as "break gains").

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

CLAUSE 12: FEES

Clause 12.1 is a market standard provision for the payment of the commitment fee. Commitment fees are typically set out in this Clause as a percentage of the Margin (often around 30-40%). Clauses 12.2 and 12.3 make provision for the payment of arrangement and agency fees to the Arrangers and the Agent as set forth in a separate Fee Letter as is customary.

If other types of fee are payable in relation to the Facilities (for example, utilisation fees often apply to standby Revolving Facilities which are not intended to be drawn) this Clause will need to be amended appropriately.

Borrower Notes

Under the Market Conditions Provisions no Commitment Fee is payable to a Defaulting Lender. This is an optional provision which is commonly adopted. It is difficult to envisage a scenario in which a Borrower would not want to include it.

CLAUSE 13: TAX GROSS UP AND INDEMNITIES

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 some 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 comments under Clause 24.2 (*Conditions of assignment or transfer*), at paragraph (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. The introduction, in September 2010 of HMRC's DT Treaty Passport Scheme (the "**DTTP scheme**", discussed further below) has, where applicable, improved the timeframes within which such directions can be obtained, but there remains a greater risk of withholding tax arising in the case of Treaty Lenders than in the case of UK Lenders. A 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 Clause 13.2(k) and (l) (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(k)) 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 fifteen years, 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 (under either the ordinary procedure or, where applicable, the DTTP scheme), the Borrower must withhold tax. The ordinary 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. In relation to Treaty Lenders who do not hold or are unable to use the DTTP scheme, 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 general 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 sets 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 provision in the Investment Grade Agreement for a third condition to address these requirements, but it is left blank, and 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 Agreements means that Lenders 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 recommends), they may be unaware of the omission of the third condition. They should make sure that this additional condition is included in their Agreements where Treaty Lenders are permitted.

What should the third condition be? There is no single correct answer to this question. The LMA notes that this is a complex area and that "if appropriate" additional wording should be inserted "to apportion risk as agreed by the Parties". Lenders and/or their advisers sometimes still 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. The applicable process depends on whether the Treaty Lender holds and wishes to use a passport under the DTTP scheme or not. As already mentioned, in relation to Treaty Lenders which do not hold a passport under the DTTP scheme, application for a direction to be paid gross has to be made to both the foreign taxing authority and HMRC, and the process is usually slow. The application process will be much quicker under the DTTP scheme but, in either case, 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 (which is also reflected in the forms of Transfer Certificate and Assignment Agreement included as Schedules 5 and 6 to the Investment Grade Agreement) 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 not forming the primary syndicate to confirm at signing that they are a Qualifying Lender, to identify the relevant Treaty, and for all Lenders 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 addressed to the Borrower by secondary market purchasers too. For more detail please see (a) above.

The DTTP Scheme

The most significant change to the LMA tax provisions in recent years was the result of the introduction of the DTTP scheme, which became operative on 1 September 2010. Provisions catering for the operation of this scheme were added to the Investment Grade Agreement in December 2011. Under the DTTP scheme, Treaty Lenders can (but are not required to) apply for a passport which confirms their eligibility for treaty relief. Passports are valid for five years and will cover all loans entered into by the passport holder in that period. If the DTTP Lender wishes to use its passport in relation to a particular loan, it is able to take advantage of an accelerated clearance process.

The clearance process is initiated by the submission by the Borrower of Form DTTP2 to HMRC. The Form DTTP2 must be submitted within 30 working days of the relevant Lender's entry into the loan. Following receipt of a duly completed Form DTTP2, HMRC's guidance indicates that it will issue the direction "as soon as practicable". The guidance states that HMRC will attempt to assist if there is a particularly tight timescale but does not provide any specific commitment as to the timeframe within which directions will be provided.

The Borrower therefore needs to know whether any Treaty Lenders in the syndicate are DTTP Lenders. To that end, the terms and conditions of the DTTP scheme oblige DTTP Lenders to make Borrowers aware of their obligation to apply for a DTTP direction in relation to the loan within 30 working days of entry into the loan. In addition, HMRC maintain a searchable online database of DTTP lenders[9].

The LMA tax provisions (Clause 13.2(g)) stipulate that the Borrower may only submit a Form DTTP2 in relation to a Treaty Lender if the relevant Lender has confirmed to the Borrower that it holds a passport and wishes the DTTP Scheme to apply to the Agreement (see Clauses 13.2(g) and (i)). Accordingly, Borrowers must await confirmation from each Treaty Lender that it (a) holds a passport and (b) wishes to use it, before filing any Form DTTP2. The Investment Grade Agreement makes provision for this in relation to the primary syndicate by requiring syndicate members to confirm their passport status in the Schedule to the Agreement (Schedule 1) where their names appear. Lenders who acquire their participation on the secondary market are asked to make the relevant confirmation in the Transfer Certificate or Assignment Agreement (see Schedules 5 and 6).

The Investment Grade Agreement does not specifically oblige the Borrower to file the Form DTTP2. If, however, the Borrower does not do so within the requisite time period (having been provided with the relevant information by the Lender) or files the DTTP2 but it is rejected or no direction is forthcoming, the consequence is that the "ordinary" Treaty clearance procedure applies. Accordingly, provided the Borrower notifies the Lender in writing, the Lender is obliged to co-operate with the Borrower to obtain authorisation in the normal way (as outlined above).

The DTTP scheme is a welcome development for the syndicated loan market. The process of obtaining clearance is considerably simpler in relation to Treaty Lenders who have applied for and obtained a passport. Most (though not all) banks that are regular members of lending syndicates have by now acquired passports.

(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.

9 www.hmrc.gov.uk/cnr/dttp-register.pdf

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 Clauses 13.2(g)(i) and (h) 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 (whether under the ordinary procedure or the DTTP scheme), Treaty Lenders and Borrowers are required to co-operate.

Borrower Notes

Clause 13.2(g)(i) 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".

These comments apply equally to Clause 13.2(h), which contains an equivalent obligation which applies if a DTTP filing is not made or is rejected (see comments on the DTTP scheme above).

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 Lenders 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 Lenders' argument continues, the risk of other tax liabilities needs to be covered by an indemnity. The basis for this view is the Lenders' "cost plus" approach to lending: costs which might erode their profit should not be for their account.

Lenders regard Clause 13.3 as a 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 occasionally be able to refuse to give it, or (more likely) to 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 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 provision 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 and whether or not it holds a DTTP scheme passport. 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 13.7: VAT

This clause was amended in 2010 to reflect the changes made to the VAT place of supply of services rules introduced in January 2010. The essence of the clause remains that the cost of any irrecoverable VAT in respect of supplies made by or to a Finance Party under any of the Finance Documents, and the irrecoverable VAT element of any costs and expenses for which a Finance Party is entitled to be reimbursed or indemnified, is not borne by the relevant Finance Party but is passed on to the Company or the Obligors as appropriate. This clause is not commonly negotiated.

FATCA

What is FATCA?

The US made significant amendments to its tax laws in March 2010 by introducing the Foreign Account Tax Compliance Act ("**FATCA**") as a means of addressing US tax evasion by US account holders. FATCA was enacted in response to the growing concerns of US Congress that foreign financial institutions were assisting US taxpayers in hiding money offshore to escape US tax.

FATCA achieves this objective by requiring foreign financial institutions ("**FFIs**") to provide detailed information on their US account holders to the US Internal Revenue Service ("**IRS**").

As the US Government does not have direct jurisdiction over most FFIs, FATCA encourages FFI compliance primarily via the imposition of a 30% withholding tax on, *inter alia*, US source income paid to FFIs who do not comply with FATCA's reporting requirements. This withholding tax will start to apply to payments of US source income from 1 January 2014 and, from 1 January 2017, to the gross proceeds of the disposal of an asset which produces US source income.

Whether the withholding obligation will apply to a payment will depend on the status of the person making the payment, the status of the recipient and the source of the payment. The withholding tax regime can therefore affect FFIs as either recipients or payers of payments. Accordingly, in order to determine the extent to which FATCA might affect a syndicated loan transaction two key issues to determine are a) the FFI status of the parties and b) whether any payments under the Finance Documents will constitute US source income.

"FFI" is a broad concept designed to catch any foreign entity, which is, as defined, a financial institution. There are three general types of activity that cause an entity to be regarded as an FFI: accepting deposits in the ordinary course of banking or similar business, holding financial assets for the account of others and engaging primarily in the business of investing, reinvesting or trading in securities. Insurance companies providing policies which constitute "financial assets" (such as life assurance) will also be regarded as financial institutions, as will holding companies of groups which include such an insurer. Accordingly, in the context of syndicated loans, it is possible that FFIs will exist in the Borrower Group as well as among the Finance Parties.

A payment of interest under a loan agreement will in general be US source income for an FFI if it is made by a US Borrower or by an Agent or Guarantor on behalf of a US Borrower. Where an Obligor has a US trade or business, interest paid by that trade or business will also have a US source.

FATCA's withholding tax regime may also eventually extend to "foreign passthru payments" made by certain FFIs. This concept caused considerable alarm when it appeared as the payments would not themselves need to have a US source; they need merely to be "attributable" to US source payments. However, the US regulations issued in January 2013 regarding the implementation of FATCA confirm that foreign passthru payments will not apply before 1 January 2017 at the earliest and make it clear that it may be some years before detailed rules on foreign passthru payments are issued.

FATCA and syndicated loans

The FATCA legislation is complex and, understandably, has provoked concerns from Lenders and Borrowers about how FATCA withholding risk should be allocated and how compliance with the reporting requirements might be achieved. Lenders worried about the cost and effort required to comply with FATCA in order to avoid withholding and have raised legitimate concerns about their ability to comply without breaching applicable confidentiality and data protection rules. Borrowers were primarily concerned because of their contractual position: if a Finance Party suffers FATCA withholding on a payment made to it under a Finance Document, the risk is that it would (in the absence of a specific exclusion in the Agreement) be able to pass this cost on to the Borrower under Clause 13.2 (*Tax gross-up*), Clause 13.3 (*Tax indemnity*) or even Clause 14 (*Increased costs*). Exemption from FATCA withholding depends on compliance and information reporting performed by FFI Finance Parties over which the Borrower has no control.

The current expectation, however, is that the impact should not be as significant as initially feared.

If there is no FFI in the Group and the Finance Parties will not be receiving (or making) US source payments, the transaction is likely to have little or no exposure to FATCA.

Moreover, 2012 saw the development of bilateral inter-governmental agreements ("**IGAs**") between the US and other jurisdictions which should ease FATCA concerns considerably for FFIs by making compliance far easier and all but eliminating the threat of withholding for FFIs in relevant jurisdictions. The global spread of IGAs will reduce very substantially the number of FFIs that would need to make – or would ever suffer – the withholding imposed by FATCA.

The US signed an IGA with the UK in September 2012 and the IRS has since entered into IGAs in substantially the same form with several other jurisdictions. Many more will certainly follow. The US Treasury is currently engaging with more than 50 jurisdictions to agree IGAs and expects to conclude negotiations in most cases by the end of 2013.

The effect of the UK/US IGA is that financial institutions in the UK (which will include UK branches of overseas institutions but not overseas branches of UK financial institutions) will be able to report information on their US account holders to HMRC rather than the IRS. Such institutions will be "deemed compliant" for FATCA purposes. There will be no FATCA withholding on payments to a deemed compliant FFI; and payments made by a deemed compliant FFI will be safe too unless the FFI has elected to assume primary withholding responsibility (a scenario which is not expected to arise in practice). A Lender in a country which does not have the benefit of an IGA should therefore be able to lend via a branch in an IGA jurisdiction and thereby remove any risk of FATCA withholding.

Grandfathering

The January 2013 regulations containing the detail of the FATCA regime clarify that certain historic and current transactions will be grandfathered and therefore fall outside the FATCA withholding and compliance rules for their duration. In particular, grandfathering will apply to any obligations outstanding on 31 December 2013. So, for instance, most loans advanced or committed to in 2013 will be outside the scope of FATCA throughout their life and will not give rise to any compliance requirements or withholding tax. However, if an existing "obligation" is materially modified on or after 1 January 2014, it may be treated as a new obligation and subsequently lose grandfathering protection. It follows that grandfathering cannot be a complete solution, even for obligations entered into before grandfathering expires.

Allocation of risk in loan documentation

Lenders which do not have IGA protection or who are not compliant FFIs could include a number of provisions to mitigate FACTA withholding risk; these could for example require that no Obligor is a US person, a non-US person owned by a US person or an FFI. Similarly, provisions could be included requiring such Obligors to resign before any withholding would arise. Lenders and Obligors may also want the right to replace any Agent or other administrative party that is a non-compliant FFI before withholding arises.

All of these provisions may assist in limiting FATCA risk. However, it will still be necessary for the parties to agree contractually how to allocate FATCA withholding risk if FATCA withholding arises.

In the US, the market position is relatively settled in that FATCA risk is generally placed on the Finance Parties. It is accepted that Finance Parties should bear the cost of any FATCA withholding because only they can comply with FATCA reporting requirements and thereby eliminate the risk.

In contrast, the approach in the European loan markets to date has not been so settled and deals are very much negotiated on transaction-by-transaction basis.

The key driver behind European lenders' initial reluctance to accept FATCA withholding tax risk was the possibility of conflicts with confidentiality and data protection rules, as mentioned above. With the development and spread of the IGA concept, that concern should be fading, but the approach reflected in drafting produced by the LMA on this topic continues to reflect the original uncertainty. The LMA has not made any changes to the Investment Grade Agreement to address FATCA, but has produced a note for members containing three sets of riders which provide various options for addressing reporting requirements and the allocation of withholding risk (to the extent applicable)[10].

Summary

Whether FATCA withholding risk actually arises in a deal (and the level of risk) depends on a number of factors. The emergence of IGAs is likely to provide a solution to the issue of FATCA withholding in the context of the Investment Grade Agreement and it is expected that Lenders will become more comfortable accepting FATCA risk in loan documentation as a result[11] and therefore Borrowers may justifiably argue for the inclusion of provisions which achieve that[12]. However, at the time of writing, it remains the case that the allocation of FATCA risk may require negotiation in the context of the transaction in question.

[10] The FATCA riders are available to LMA members on the LMA website: www.lma.eu.com.

[11] Further information on the current position with regard to FATCA is available from the ACT website at www.treasurers.org.

[12] See, for example, the LMA's FATCA "Rider 3" and the provisions promulgated by the Loan Syndications and Trading Association, the equivalent of the LMA for the US syndicated loan market.

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*).

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 Agreement. "Increased Cost" is defined very broadly, to comprise:

"(i) a reduction in the rate of return from the Facility or on a Finance Party's (or its Affiliate's) overall capital;

(ii) an additional or increased cost; or

(iii) a reduction of any amount due and payable under any Finance Document,

which is incurred or suffered by a Finance Party or any of its Affiliates to the extent that it is attributable to that Finance Party having entered into its Commitment or funding or performing its obligations under any Finance Document."

The Finance Parties' ability to claim Increased Costs under Clause 14 is subject to certain exceptions, which cover claims which are addressed under the tax or Mandatory Costs provisions and costs which are attributable to the wilful breach by the relevant Finance Party or its Affiliates of any law or regulation.

The scope of the increased costs clause has been a key topic for discussion between Borrowers and Lenders over the past decade, first as a result of the implementation of Basel II and more recently in light of the various new regulatory measures that have been or are to be imposed on banks as a result of the global financial crisis, including the package of measures known as "Basel III". Borrowers scarcely need to be advised that the costs of Basel III (the key components of which are outlined below) and other regulatory changes are likely to be passed on to them, if not by means of provisions such as the increased costs clause, then by increases in pricing.

Clause 14 does not address Basel II (the currently applicable capital standards) or Basel III specifically, but instead highlights, in a footnote that has increased in length quite dramatically over the past two years, that the parties may wish to amend the clause expressly to reflect their commercial agreement with regard to the costs associated with these rules.

Borrower Notes

Basel II

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 ("**BCBS**") in June 2004 ("**Basel II**"). Basel II currently forms the basis for the EU Capital Requirements Directive (2006/48/EC and 2006/49/EC[13]) and its implementation in the UK by the Financial Services Authority ("**FSA**").

Under Basel II (as under Basel I), banks must meet a solvency ratio (capital to risk-weighted assets) of a minimum of 8% and Total Tier 1 capital may not be less than 4%. Tier 1 capital currently includes ordinary shares and disclosed reserves ("**Core Tier 1**"), preference shares and certain other hybrid debt instruments 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 the FSA currently requires banks as a supervisory policy to meet a 4% Core Tier 1 ratio and a post-stress Tier 1 ratio of 6-7%).

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% risk 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 must use external credit assessments where available (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.

[13] As amended, *inter alia*, by Directive 2009/111/EC ("**CRD II**") and 2010/76/EU ("**CRD III**").

Exclusion of Basel II costs

The Investment Grade Agreement provides optionally for the exclusion of Basel II costs from the scope of the increased costs clause in a footnote to Clause 14. Most investment grade Borrowers have been including this exclusion in their increased costs provisions for a number of years.

Basel II has been fully implemented in the EU for almost five years, and thus some Lenders may question whether it remains necessary to exclude it from the increased costs clause (which applies only to Increased Costs arising out of changes in law after the date of the Agreement).

There are two main reasons why the exclusion of Basel II costs from increased costs clauses remains justifiable. The first concerns claims for the costs of the initial implementation of Basel II. The likelihood of claims of this kind would appear to be diminishing, since Basel II has now been widely implemented. However it has not been universally implemented, notably it has not been fully implemented in the US, a point acknowledged in the LMA's footnote to Clause 14. 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, arguably 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 continue to consider whether it is appropriate in the circumstances of their transaction to seek to exclude Basel II costs.

If the parties have agreed to exclude Basel II from the scope of the increased costs clause but it is commercially agreed that Basel III will <u>not</u> be excluded (see further below), a further complication arises. The LMA highlights in its footnote to Clause 14 that as elements of Basel III operate as amendments to Basel II, care should be taken to clarify that the Basel II carve out does not operate to exclude Basel III, and goes on to provide some optional language to that effect.

Basel III

In December 2010, the BCBS published a further set of bank capital requirements aimed at strengthening existing standards, and rules imposing two new liquidity standards and a new leverage ratio (imposing a 3% cap on banks' balance sheets as a proportion of their Tier 1 capital) in two documents: "Basel III: A global regulatory framework for more resilient banks and banking systems" and "Basel III: International framework for liquidity risk measurement, standards and monitoring" (subsequently revised in January 2013 as "Basel III: The Liquidity Coverage Ratio and Liquidity risk monitoring tools") plus a Guidance Note "Guidance for national authorities operating the counter-cyclical capital buffer". These rules, together with "Globally systemically important banks: assessment methodology and additional loss absorbency requirement – rules text" which was published in November 2011 and contains certain supplementary rules applicable to "global systemically important banks" ("**G-SIFIs**"), have collectively become known as "Basel III". Further guidance has been published in the form of questions and answers on aspects of Basel III.

Basel III maintains the general approach to capital regulation in Basel II but imposes more onerous and thus more costly capital requirements. In summary, although the basic 8% solvency ratio remains unchanged, common equity (ordinary shares and retained earnings) must be the predominant form of Tier 1 capital (the minimum common equity ratio will rise from 2% to an effective 7% of risk-weighted assets including the capital conservation buffer) and the quality of bank capital will be improved, among other things as a result of stricter definitions for Core Tier 1 and Non-Core Tier 1 capital. "Innovative securities", for example, will no longer be able to be included in Tier 1 capital. In addition, banks will be required to build up capital buffers in good times that can be drawn down in periods of stress.

New liquidity standards are being introduced to reflect the central role of liquidity for banks. These comprise a liquidity coverage ratio ("**LCR**") requiring banks to hold a stock of highly liquid assets sufficient to survive short-term liquidity stress and a net stable funding ratio ("**NSFR**") requiring banks to maintain sufficient sources of stable funding over a longer period.

The impact of the LCR on the cost and availability of certain types of loan facility is an area of particular concern for the loan market. The LCR, which is currently expected to come into effect on a phased basis starting on 1 January 2015, requires a bank to hold high quality liquid assets in a quantity sufficient to meet its anticipated net cash outflows (including a specified proportion of its undrawn lending commitments which are available for drawing over the next 30 days) over a 30 day stressed period. The amount of liquid assets that the LCR requires a bank to hold is calculated by reference to an assumed drawdown rate which varies according to the nature of the facility. The LCR therefore potentially gives rise to increased costs for all types of lending commitments, but the drawdown rate applicable to liquidity facilities such as swingline loans and to loans extended to financial institutions and "financial corporates" is higher than the rate applied to other types of facility. The cost impact of the LCR will therefore be greater in relation to these types of facilities (although not as great as originally envisaged as a result of the BCBS's relaxation of aspects of the proposal in January 2013).

Banks' capital costs will therefore increase as a result of Basel III and banks are also facing the costs of compliance with a new regulatory regime in the form of the leverage ratio, which did not form part of Basel I or Basel II. This is a potential concern to Borrowers in the context of the increased costs clause, but may also have other implications in relation to loan documentation and transactions in particular in terms of Lenders' due diligence and information requirements. For example, as certain types of liquidity facilities and facilities extended to financial institutions and financial corporates attract differing regulatory treatment under the LCR as described above, Lenders may need to monitor more closely the use to which facilities can be applied. It may also be necessary to consider whether certain types of non-financial corporate, for example, treasury companies could fall to be treated as financial corporates under the new rules. To date, it is not apparent that these latter issues are having any direct impact on loan documentation, but suggestions made by the LMA in 2011 indicate that this may become an issue for Borrowers to consider more closely as implementation date for the LCR draws closer[14].

Basel III is currently in the process of being implemented into EU and national law around the world. The BCBS initially intended that Basel III (which is to be implemented in the EU via the fourth Capital Requirements Directive and the Capital Requirements Regulation, together, "**CRDIV**") would be brought into effect gradually over a period from 1 January 2013 to 1 January 2019. The EU authorities published the draft CRDIV legislation in July 2011 with a view to complying with this timetable but as political agreement has not yet been reached, it is now clear that it will not come into effect as originally planned. The new Capital Requirements Regulation will not require implementation in the UK through legislative means or rules of the Prudential Regulation Authority ("**PRA**") as it will be directly applicable in all EU member states. The revised Directive, however, will require UK legislative measures and amendments to the Handbooks of the Financial Conduct Authority ("**FCA**") and PRA, who will assume regulatory responsibility for these areas from the FSA on 1 April 2013. It is anticipated that the required changes will be implemented in line with the eventually agreed implementation timetable for CRD IV.

14 Further information on Basel III and the impact of the LCR on the loan market is available from www.slaughterandmay.com.

Recoverability of Basel III costs under Clause 14

Basel III represents a very significant regulatory change for the banking industry which may increase materially the regulatory cost for banks in originating and participating in loan assets. It has led to increased focus on the potential for increased costs claims arising out of these changes since the first components of Basel III were published in 2009.

There has been some debate, in relation to agreements entered into since the publication of the Basel III rules, as to whether Increased Costs arising out of Basel III would constitute Increased Costs arising out of a "change in law" for the purposes of Clause. As highlighted above, the Basel III rules do not have the force of law and require EU and national legislation to be effective in individual countries. Therefore it must therefore be considered arguable (and consistent with the approach to Basel II outlined above) that the enactment of implementing legislation could constitute a change in law occurring after the date of the Agreement, in particular given how broadly Clause 14 is drafted.

Accordingly there is a commercial point to be addressed: should Basel III costs be within or excluded from the scope of the increased costs clause?

In general, Lenders have sought to protect their potential right to make such claims. The usual argument is that while Basel III remains in the process of being implemented, Lenders are unable precisely to quantify or price the costs of the changes.

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. Accordingly, previous market practice with regard to significant regulatory change has been to exclude the possibility of increased costs claims once the regulations in question had been published and digested. This 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 clause. 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 loan facilities. The LMA acknowledged this prior to the implementation of Basel II by the addition to the Investment Grade Agreements in 2005 of optional language excluding costs arising from Basel II from the scope of Clause 14 discussed above (Basel II was not fully implemented in Europe until January 2008).

The BCBS has now published most of Basel III and the CRDIV proposals are at an advanced stage in the EU. Accordingly, it is hoped that the market is now, or should shortly arrive at a point where Lenders are able to provide more certainty to Borrowers with regard to the potential for increased costs claims arising out of Basel III. This is the case in particular in relation to costs associated with the increased capital requirements and the LCR, the impact of which banks should now largely be in a position to anticipate. Given, however, that the implementation of Basel III in the EU will differ in some respects from the proposals published by the BCBS and that aspects of the new framework (the leverage ratio and the NSFR) have not yet been finalised, Lenders' entitlement to claim costs arising out of Basel III (or at least those elements which remain to be finalised) pursuant to the increased costs clause is likely to continue to be debated. Borrowers are encouraged to continue to engage with Lenders on this topic.

Although it is important that the provisions of the increased costs clause are clarified to exclude Basel III in due course, Borrowers may take some comfort from the fact that increased costs claims have only very rarely been made to date and the recoverability of Lenders' increased capital costs pursuant to Clause 14 cannot be considered to be beyond doubt. An increase in capital required as a result of (for example) Basel III will fall within the scope of Clause 14 only to the extent that it is attributable to the Finance Party's having entered into its Commitment or funding or performing its obligations and it may be difficult for Lenders to calculate in a sufficiently transparent manner the increased cost attributable to a particular loan. The reputational damage that could result from the making of an increased costs claim is thought to be a further factor which minimises the likelihood of the clause being invoked in practice. In addition, if a Lender were to claim under the increased costs clause, it could be removed from the syndicate under Clause 8.6 (*Right of replacement or repayment and cancellation of a single Lender*).

Other regulatory changes affecting the loan market

Basel III is one of a number of regulatory changes on the horizon with the potential to affect the loan market in varying ways. The impact of overseas legislative and regulatory measures may be a relevant consideration in relation to certain facilities. For example, in some European transactions involving US banks, Lenders have sought to reserve their rights to make increased costs claims for costs arising out of the US Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**"), following the approach in the LSTA Model Credit Agreement Provisions[15].

15 LSTA is the Loan Syndications and Trading Association, the equivalent of the LMA for the US syndicated loan market.

The Dodd-Frank Act, among other things, imposes more stringent capital requirements on US financial institutions. Accordingly, stronger Borrowers in such situations have sought to exclude costs arising out of the Dodd-Frank Act from the scope of the increased costs clause.

For further information on this topic, Borrowers are referred to the LMA's September 2012 guide, "Regulation and the Loan Market" which contains a useful overview of various developing regulations which have the potential to affect the loan market[16].

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 Lender. 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 a Lender. 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, PRA or FCA 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. Other conditions may include that such costs are claimed on a non-discriminatory basis, ie Lenders may only claim Increased Costs from a Borrower to the extent they are making similar claims of other borrowers to whom they have extended credit.

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.

16 The guide is available from the LMA website: www.lma.eu.com.

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.

Borrowers should be aware the in September 2012, the LMA made a number of changes to the Leveraged Facilities Agreement aimed at broadening significantly the scope of the Borrower's indemnity to the Agent and the other administrative parties to that Agreement, including the Security Agent. Equivalent changes were not made to the Investment Grade Agreement.

In the Leveraged Facilities Agreement, the scope of the Borrower's indemnity to the Agent now extends specifically to encompass the costs of instructing lawyers, accountants and other advisers and more generally to any other cost, loss or liability incurred by the Agent in acting as Agent under the Facilities. Further, the Borrower is required to reimburse any Lender for any payment that Lender makes to the Agent pursuant to the Lenders' indemnity to the Agent (Clause 26.10 in the Investment Grade Agreement).

The broadening of the Borrower's indemnity obligations in this way was not an aspect of the LMA Agreements that was generally negotiated, at least until the LMA revised the language in the Leveraged Facilities Agreement. It does not represent general market practice and thus does not appear in the Investment Grade Agreement. Borrowers are likely to seek to resist any suggestion that the language of the indemnities as appears in the current Investment Grade Agreements should be extended.

Although there are good reasons for resisting any extension of the Borrower's indemnity obligations in relation to all types of loans (not least on the grounds that the Agent is the Lenders' Agent and is paid a fee for its role), there is a distinction between the scope of the Agency role in investment grade and leveraged loans which is relevant in this context. This is due to the greater complexity and (often) tenor of leveraged loans, which makes them more likely to be amended or restructured during their life and also to the likelihood that leveraged loans tend to be held by larger syndicates, and thus (it might be argued) potentially require greater administrative input from the Agent.

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 it 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 covering the Agent's and the Arranger's transaction costs and expenses (including legal fees), the Agents' costs and expenses relating to amendment and waiver requests and any costs and expenses incurred by the Finance Parties in connection with the enforcement or preservation of their rights under any Finance Document.

The Company is required to pay transaction costs "promptly on demand", and both amendment and enforcement costs, within three Business Days of demand.

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. Investment grade Borrowers are regularly permitted periods from around 5 Business Days to 21 days for payment pursuant to this provision.

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. While 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 also used in some 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. While 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 simply 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 (if all of the least borrower-friendly options are selected) 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, who generally negotiate 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 point that may arise in Facilities where there are multiple Obligors is whether the Material Adverse Effect should be assessed by reference to each Obligor, or by reference to the Obligors or the Group as a whole. As Facilities are usually extended on the basis of the strength of the Obligors and/or Group as a whole, Borrowers should not generally need to accept a test which applies on a single company basis. 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 pending or threatened*). Borrowers often seek 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 may also need to carve out from representations specific matters which they have disclosed to the Lenders.

When are the representations given?

Representations are made on the date the 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 to the primary syndicate 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 customary, however, 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 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 potentially amounted to another gross up provision, but with none of the exceptions set out in the tax gross-up provision (see 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 Gross Up and Indemnities*). 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 Gross Up and Indemnities*), 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 Gross Up and Indemnities*), and a repetition of this representation is liable to cut across that provision (a point that is acknowledged in the LMA's Users' Guide to its Primary Documents).

Further, the LMA's Users' Guide acknowledges that this obligation is not usually required from Obligors which are English companies.

Where the Obligors include any non-English companies, amendment to this representation is likely to be required, as to Clause 13 (*Tax Gross Up and Indemnities*).

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 the definition of "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 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 may be 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 Companies Act 2006 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. 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 any issues that arise during the term of the Facilities are covered by the information undertaking set out in Clause 20.4 (*Information: miscellaneous*).

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 can vary quite considerably from one Borrower and deal to another, and may even start 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 added to in the Investment Grade Agreement in April 2009 (see Clause 36 (*Confidentiality*)).

A separate but related concern in recent years 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 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 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 (which more commonly arise in the leveraged loan market due to the greater involvement of non-bank lenders in that 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. If the issue arises, 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 (120 to 180 days), and half-yearly accounts within 3 to 4 months (90 to 120 days) 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 (if applicable).

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 delivered with the audited accounts will be signed by the auditors, or reported on by them in an agreed form.

The background to this clause 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 9 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.

In relation to loans which contain financial covenants, 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 in paragraph (c), 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, the parties may prefer the "frozen GAAP" provision, for the convenience and certainty it provides in enabling the covenants to be measured on a consistent basis.

Since it is possible that the accounting practices or principles on the basis of which financial covenants are set may change during the life of the Facilities, 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 Agreement as a result. In the context of the switch to IFRS in 2005, 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 definitions of GAAP and IFRS are 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 pending or threatened*)).

Listed Borrowers may wish to limit requests pursuant to this provision to information which is not 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 relevant Obligor 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 MLAs 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 rules set out in the Companies Act 2006 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 Obligors 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 before signing. Clause 20.7 requires the Obligors 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*" *checks*) addresses matters arising from the Money Laundering Regulations 2007 (the "**Regulations**").

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 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.

The Joint Money Laundering Steering Group has for many years published 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 PRA or FCA).

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 therefore should 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); the JMSLG Guidance states that money laundering risk in relation to listed Borrowers should be regarded as low.

- 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.

The comments above with regard to the language of Clause 20.7 should also be taken into account in Clause 2.2 (*Increase*) and Clause 8.6 (*Right of replacement or repayment and cancellation in relation to a single Lender*), both of which make participation by the relevant new/replacement Lender conditional upon the completion of all necessary "know-your-customer" or similar checks.

Borrowers should be aware that in February 2013, the European Commission published a proposal for a Fourth Money Laundering Directive which (if accepted) is likely to be adopted at some point before 2016. The main purpose of the new directive is to incorporate the new set of international standards adopted by the Financial Action Task Force ("**FATF**") in February 2012. The new directive, among other things, proposes to streamline the rules on CDD and beneficial ownership. In particular, under the current proposal Borrowers would be required at all times to maintain adequate, accurate and current information on their beneficial owners which can be accessed by Lenders and the authorities in a timely manner (although it is not clear whether there is a consensus that this is a feasible measure in practice). It is thought that the new directive is unlikely to have a major impact in the UK given that the UK Government has already implemented many of the new FATF standards.

CLAUSE 21: FINANCIAL COVENANTS

The LMA has not to date produced financial covenant provisions for investment grade Borrowers. This Clause is left blank in the Investment Grade Agreement in recognition that stronger Borrowers may not be required to give any financial covenants at all, and for those Borrowers that are, the terms will vary. For Borrowers who are required to give financial covenants (and the number of Borrowers who are able to access loan finance without them has diminished in recent years), which covenants are appropriate will depend on the circumstances, including the nature of the Group's business and its credit quality.

Borrower Notes

Financial covenants are a standard feature of leveraged loan agreements. The LMA added financial covenant provisions to the Leveraged Facilities Agreement in 2005. Those provisions, which are also published as a standalone suite, reflect the typical suite of financial covenants seen in private equity-backed leveraged acquisition financings. They comprise:

- Leverage (Total Net Debt to EBITDA);
- Interest Cover (EBITDA to Net Finance Charges);
- Cashflow Cover (Cashflow to Net Debt Service); and
- annual limits on Capital Expenditure.

This suite is not designed for, and will not be appropriate in its entirety for investment grade loans. The nature and extent of the financial covenants in a loan to an investment grade corporate will generally be much more limited, and the terms of any covenants much less restrictive, than would be the case for a leveraged credit. However, although there is still some relationship between the specificity with which financial covenant provisions are drafted and the quality of the Borrower, in more recent years, financial covenant provisions have in general become more detailed across the board. This may in part be due to the market having become familiar with the LMA financial covenant provisions for leveraged transactions, elements of which have been adapted for use outside their originally intended context.

There can be advantages in using elements of these LMA provisions as a starting point. The form is familiar to the market and the more granular financial covenant definitions used in the leveraged market can be helpful as they prompt focus on each element of calculation. Borrowers should, however, consider whether covenants drafted in this detailed manner are appropriate for non-leveraged loans. The level of detail the LMA provisions provide may be more than is necessary in corporate credit facilities, in particular for stronger Borrowers.

In a leveraged acquisition financing, where a group is taking on a significant amount of debt, the Lenders lend against a financial model, built to assess the enlarged group's ability to service its debt over the life of the Facilities based on detailed assumptions. The covenants are set to provide the business with some headroom to underperform the base case model. Financial covenants in leveraged loans are complex because they are crafted to benchmark the base case financial model, and are tailored closely to the assumptions used in it.

In contrast, in corporate deals, in particular in investment grade deals, the Borrower's financial condition is measured by reference to its Original Financial Statements. Covenants may be phrased much more simply, by reference to accounting concepts used by the Group without such detailed definition.

An additional difference between the investment grade and the leveraged loan market is that investment grade Borrowers are usually obliged to deliver half yearly and annual accounts (see Clause 20.1 (*Financial statements*)). Financial covenant testing (if applicable) therefore usually takes place half-yearly or annually. In leveraged transactions, financial covenants are generally tested quarterly.

The LMA financial covenant provisions for leveraged transactions were the only financial covenant provisions produced by the LMA until 2011/12, when, as mentioned in Part I, the LMA published the REF Agreement and the PXF Agreement. Each of these contains financial covenant provisions of a type which the LMA considers appropriate for transactions of the relevant nature.

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-specific 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.

- 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, subject to the expiry of any applicable grace period.

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.

Borrower Notes

An issue that seems to be discussed with increasing frequency in some sectors of the loan market is whether the Borrower should provide the Lenders with specific protection, in the form of representations and/or undertakings, with regard to the Obligors' compliance with anti-corruption and sanctions legislation.

In September 2012, possibly prompted by the increasing range of anti-corruption legislation being put in place around the world, the LMA added a new representation and undertaking regarding anti-corruption laws to the Leveraged Facilities Agreement. These provisions address the Group's compliance with the UK Bribery Act 2010, the US Foreign Corrupt Practices Act of 1977 and other applicable anti-corruption laws as well as the Group's institution and maintenance of appropriate compliance policies and procedures. The undertaking also requires the Group not to use the proceeds of the Facilities for any purpose which would breach such legislation.

The new provisions in the Leveraged Facilities Agreement do not specifically address sanctions or anti-terrorism legislation, but clauses which address that area in a similar fashion are sometimes suggested. Experience suggests that the majority of requests for provisions relating to compliance with sanctions legislation originate from Lenders which are subject to the jurisdiction of US sanctions legislation.

Where such provisions stem from concerns arising out of overseas regulatory regimes to which Lenders are subject (whether they cover sanctions, anti-corruption laws or both), they can present practical difficulties for Borrowers if the transaction otherwise has no connection to the jurisdiction of the relevant regime, thus potentially necessitating the involvement of additional legal counsel. There are also technical legal issues which may need to be addressed, for example, on behalf of EU Borrowers who are asked to warrant or undertake to comply with US sanctions legislation, which is the product of a conflict of laws between the US and the EU regime. EU legislation as well as local legislation in some EU countries prohibits compliance with certain extra-territorial US sanctions laws (including those affecting Cuba) as potentially prejudicial to EU interests.

The reasons for requiring specific provisions in this regard can be difficult to discern given the protection offered to Lenders by Clause 8.1 (*Illegality*) and the Clause 19.2 (*Non-conflict with other obligations*) and Clause 22.2 (*Compliance with laws*). In general, such provisions should not be required in investment grade loans, save perhaps where the Borrower has operations in certain emerging market jurisdictions. If the issue does arise, the affected Lenders will need to provide the Borrower with information sufficient to enable the Borrower to understand the risk that needs to be addressed and what it is required in relation to the transaction in question.

Such provisions are not a feature of the Investment Grade Agreement for the reasons explained above.

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 in April 2009 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. 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.

Borrower Notes

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.

Borrowers should also be aware of 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 Agreement is signed can be exempted by being listed in Schedule 10, 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 secured exceeds the limit stated in Schedule 10.

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 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) makes 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. Borrowers should consider whether this is a factor which is or could become likely to be relevant to their hedging arrangements and, if so, discuss with the Lenders how to address it in the Agreement. Whether Borrowers are permitted under the Investment Grade Agreement to collateralise derivative exposures is an issue that is likely to crop up increasingly frequently, due to the impact of the

European Market Infrastructure Regulation[17] and other regulatory developments affecting the derivatives industry. It is probable that these developments will result in a greater number of Borrowers choosing, or being obliged to provide collateral for their derivatives. Whether as a consequence of regulatory requirements directly applicable to them, or because the wider regulatory environment makes collateralisation desirable for economic reasons, Borrowers who collateralise their derivatives or may do so in the future will most likely wish to negotiate a specific exception to the negative pledge for this purpose.

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.

17 For further information on the European Market Infrastructure Regulation and its impact on non-financial counterparties please refer to www.slaughterandmay.com.

Retention of title etc

Sub-paragraph (viii) was 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.
- Security arising in consequence of any finance or capital lease (an exclusion which is provided as standard in the Leveraged Facilities Agreement).
- 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. Sometimes Borrowers prefer that this threshold operates by reference to the value of the security assets rather than by reference to the amount secured (which of course assumes the assets can be readily valued). The Borrower will need to ensure that the amount of indebtedness which can be secured and/or the value of the security assets permitted to be provided is high enough. The limit is often expressed as either a fixed amount or the higher of a fixed amount and a specified percentage of the Group's net worth.

Clause 22.4: Disposals

The basic prohibition here is 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. Borrowers should note in this context the broad and non-exhaustive definition of "assets" in Clause 1.2 (*Construction*) of the Investment Grade Agreement, which "includes present and future properties, revenues and rights of every description".

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 refer to the wider concept of 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

This extremely broadly worded covenant prohibits any amalgamation, demerger, merger or corporate reconstruction by any member of the Group.

Borrower Notes

The scope of this covenant is somewhat unclear. For example, there may be uncertainty as to what the terms "merger" and "demerger" mean as a matter of English law. In addition, in contrast to the negative pledge and the disposals covenant in the Investment Grade Agreement, it is not subject to any exceptions or qualifications.

As a result, Borrowers will often seek to delete it entirely (achieved by stronger Borrowers), or otherwise seek to limit its application. It is common, for example, for this provision to be limited to Obligors only (rather than any member of the Group). Borrowers may also argue that it should be applicable only in circumstances where an Obligor is not the surviving entity which results from the restricted merger or other transaction.

More generally, Borrowers may seek to qualify this undertaking by reference to materiality or Material Adverse Effect (discussed in the introduction to Clause 19 (*Representations*) above).

Certain kinds of reorganisation such as solvent liquidations or reorganisations are another commonly sought exception to this provision (and provided as an optional exception to the equivalent undertaking in the Leveraged Facilities Agreement). A particular point for Borrowers to be aware of is that this provision should not operate to restrict transactions which are specifically permitted under other covenant provisions, for example, disposals which fall within the exceptions to Clause 22.4 (*Disposals*) or, if applicable, the exceptions to any covenant restricting certain acquisitions.

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.

Borrower Notes

To avoid questions arising in the future with regard to the scope of this provision, some Borrowers like to extend it to include, without limitation, a general description of the nature of the business of the Group as at the date of the Agreement.

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:

- The specific grace period was added for payment failure on the part of the Borrower when this is due to a Disruption Event as referred to above.

- 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

Financial covenants generally require that the specified financial ratio is complied with during a "relevant period". Questions sometimes arise as to whether a Default (ie a potential Event of Default) occurs if, at some point during the "relevant period", it appears that the covenant tests will not be met on the relevant testing date. The answer will depend on the terms of the agreement. The occurrence of an Event of Default will generally not be established until on or after the expiry of the relevant period, as financial covenants are usually tested by reference to accounts delivered pursuant to Clause 20 (*Information Undertakings*).

If the financial covenants are tested as at a particular date and on that date the covenants are breached, in general, an Event of Default has occurred. The breach is not conceptually capable of actual cure after that date and thus no grace period for the cure of any financial covenant breach is contemplated in the Investment Grade Agreement.

There are, however, some methods of achieving the same effect as a "grace period" for a financial covenant breach. Perhaps potentially of most relevance to investment grade Borrowers is the possibility of negotiating a "deemed cure" right. This is a provision which states that if a financial covenant is breached on the relevant testing date, but on the next testing date, the covenant is complied with, the past breach is deemed never to have happened. Although the breach remains "live" during the intervening period, a deemed cure right can be helpful in the event of a technical breach of covenant arising due to temporary circumstances and is sought by some investment grade Borrowers. Such "deemed cure" provisions are quite commonly achieved in the leveraged loan market.

There is another means of "curing" a financial covenant breach, which is reasonably customary in private-equity sponsored leveraged acquisition financings. An equity cure right is a right to pay additional equity or subordinated debt into the Group, for the purposes of curing a financial covenant breach. The terms of the equity cure will specify how the new equity is to be treated for the purposes of the financial covenant provisions. If the covenants are satisfied once retested taking into account the addition equity, the breach will be effectively "cured".

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 contemplates 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 Event of Default is wide-ranging: it covers any representation made or deemed to be made by an Obligor in the Finance Documents or in any other document delivered by or on behalf of any Obligor under or in connection with any Finance Document (without specifying to whom). Borrower may seek to limit its application to representations made or deemed to be made by an Obligor to the Finance Parties in the Finance Documents (which themselves touch on the accuracy of information delivered to the Finance Parties, for example Clause 19.10 (*No misleading information*)).

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 (or more accurately, to address the event or circumstance which gave rise to the misrepresentation).

Clause 23.5: Cross default

Under this provision, a default under any other Financial Indebtedness of any Group member is an Event of Default under the 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 the Facility, 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 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 Agreement on the basis of defaults under other financing arrangements.

Borrower Notes

The Clause focuses on defaults relating to Financial Indebtedness. It applies to defaults by any member of the Group. Strong Borrowers have historically succeeded in restricting the cross-default provision to defaults by Obligors only, or Material Subsidiaries.

Paragraphs (a) and (b) provide that if some other Financial Indebtedness is not paid when due, or becomes due and payable prior to its specified maturity as a result of an event of default (however described), there will be an Event of Default under the Agreement. In general, this is hard to dispute.

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 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.

Paragraph (c) provides for cross-default if another lender cancels or suspends its commitment as a result of a default. A strong Borrower may be able to argue successfully that the cancellation of an undrawn commitment should not be a cross-default, in particular if the cancellation of the facility in question has no impact on its ability to pay its debts as they fall due.

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 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. Strong Borrowers may be able to restrict Clause 23.5 to cross-acceleration.

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.

Borrowers who are unable to negotiate appropriate limitations to paragraphs (a) to (d) will need to bear in mind that the definition of Financial Indebtedness includes both financial debt and also (at paragraph (g)), derivatives transactions. As discussed under Clause 1.1 (*Definitions*) in relation to "Financial Indebtedness", derivatives transactions can become terminable or come to an end, or obligations under them can be suspended, as a result of circumstances affecting the Obligor's counterparty, in addition to events affecting the Obligor itself.

If paragraphs (a) to (d) of the cross-default Event of Default are triggered as a result of circumstances affecting an Obligor's counterparty, the *de minimis* threshold in paragraph (e) may not be sufficient to avoid an Event of Default, in particular if the swap has not actually been terminated. As a result, Borrowers may try to limit the application of this Event of Default in relation to derivatives transactions. It might be argued (for example) that only paragraph (a) of the cross-default Event of Default should apply to derivatives transactions (ie a cross-default Event of Default should occur only if an Obligor fails to pay a swap counterparty an amount that has become due).

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 (where 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: a careful analysis of the effect of the proposed wording 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. Strong credits may be able to limit its application, for example to Obligors and Material Companies.

Paragraph (a) includes language which largely tracks the statutory test for cashflow insolvency in section 123(1)(e) of the Insolvency Act 1986. However, it also provides that an Event of Default 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 negotiations with a single creditor with a view to rescheduling any of its debts. Borrowers should seek to exclude these additional elements on the grounds that they provide for too early a trigger. This amendment has been accepted by Lenders in a number of recent transactions. Alternatively, a Borrower could seek to limit the trigger so that it relates only to Financial Indebtedness and does not prevent the Borrower from negotiating with other creditors, such as trade creditors. Borrowers also often seek to exclude negotiations with the Finance Parties from this provision (an exclusion which is offered as standard in the Leveraged Facilities Agreement).

Paragraph (b) may be construed as a reference to the balance sheet test for insolvency in section 123(2) of the Insolvency Act 1986. As there are a number of reasons why the assets of viable companies might be less than their liabilities (for example to take advantage of certain tax concessions) a number of investment grade Borrowers argue successfully for the deletion of paragraph (b) on the basis that the reference in paragraph (a) to the inability (or admitted inability) of an Obligor to pay its debts as they fall due provides adequate protection. At a minimum, Borrowers could request that references to "any member of the Group" be narrowed to Obligors and Material Subsidiaries and possibly for the inclusion of a cure period of a specified length of time.

Clause 23.7: Insolvency proceedings

This Event of Default is triggered essentially by action being taken which would lead to the opening of 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..." and Borrowers often succeed in amending this clause so that an event of default is only triggered on the occurrence of specific events. It is also problematic in two of the ways mentioned in the commentary on Clause 23.6 (*Insolvency*): in its unamended form it can be triggered by the relevant proceedings being initiated in relation to any member of the Group and by reference to a single creditor or single debt.

Paragraph (a) of this Event of Default excludes the solvent liquidation or reorganisation, and paragraph (c) the solvent liquidation, of any member of the Group which is not an Obligor. Borrowers may prefer to address this point using the approach in the Leveraged Facilities Agreement, which excludes such solvent liquidations and reorganisations (and other matters according to its defined term "Permitted Transactions") from the entirety of the Insolvency proceedings Event of Default rather than just specific paragraphs. Otherwise, it is conceivable that, for example, a transaction such as a solvent creditor's scheme of arrangement that would arguably not fall foul of paragraph (a) by virtue of the carve-out might nonetheless fall foul of paragraph (b). In addition, Borrowers have succeeded in obtaining the benefit of these exclusions for any entity to which the trigger applies, including both Obligors and members of the Group which are not Obligors.

Note that the references in paragraph (a) to the suspension of payments and the coming into effect of a moratorium are duplicative of the wording in Clause 23.6(c) so could be deleted.

Paragraph (d) is often revised so that any enforcement of security is made subject to a minimum value threshold or qualified in some other way by reference to materiality. A Borrower may, for example, wish to have the reference to "any assets" narrowed to "all or substantially all of its assets".

Finally, since April 2009, this provision has included a carve-out for "frivolous or vexatious" winding-up petitions which are discharged, stayed or dismissed within a number of days to be agreed. In the equivalent provision in the Leveraged Facilities Agreement, 14 days is the suggested time limit although Borrowers often seek a much longer period, such as 30 or even 60 days. In addition, as the aim of this carve-out is to ensure that an Event of Default does not occur as a result of a petition which is swiftly discharged etc, Borrowers may wish to consider striking out the additional condition, that the petition is "frivolous or vexatious", which could be uncertain in its interpretation.

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.

Borrower Notes

In order that the Event of Default should apply only in appropriate circumstances it is important to ensure that the materiality threshold is fixed at a sensible level. Borrowers often obtain a 30 day time limit in which 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.

The implications of a change of control of the Company are 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.

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

Clause 23.12: Material Adverse Change

The precise wording of this Event of Default is left blank in the Investment Grade Agreement for the parties to negotiate. There are 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*).

Borrower Notes

Inclusion of this Event of Default (the "**MAC**") is fairly common, but a reasonably significant number of Borrowers manage to argue successfully that it should be deleted. 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.

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

In the Investment Grade Agreement the Lenders' right to accelerate the Facilities is triggered by the occurrence of an Event of Default "[which is continuing]". Use of square brackets in the 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 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 potential 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.

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 Gross Up and Indemnities*) for more guidance on this topic; and/or

- requiring transferees to have a specified minimum credit rating. If a minimum credit rating is agreed, it is typically set around single A, although in some deals the required minimum rating may be slightly lower.

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. This is discussed further below at Clause 24.2 (*Conditions of assignment or transfer*).

The emergence in recent years of debt buybacks below par in the leveraged loan market has focused attention on the question of whether a Borrower (or a Group member or other related party such as a shareholder) could itself qualify as a permitted transferee if it wished to purchase a participation in the Facilities. This possibility might make a broad definition of a permitted transferee advantageous for Borrowers. However, the Borrower (or a Group member's) ability to undertake a debt buyback, absent specific provision, will usually involve a careful consideration of both this Clause and the other terms of the Agreement.

The potential for debt buyback transactions will not be of relevance to all investment grade Borrowers. The economic benefits of such transactions are generally the result of purchasing the debt below par, so by definition such transactions are only likely to be of interest only to Borrowers at the bottom end of the investment grade spectrum and crossover credits.

Following the first wave of debt purchase transactions in the leveraged loan market, the LMA added optional clauses to the Leveraged Facilities Agreement which either prohibit such "Debt Purchase Transactions", or provide a framework within which they are permitted. If an investment grade transaction is of a type where debt buybacks could be a possibility, Lenders may suggest the inclusion of provisions along the lines of the Leveraged Facilities Agreement which specify the manner in which such transactions can be undertaken, to ensure that all Lenders are given the ability to participate in the buyback if they wish (and are prompted to do so by a footnote to this Clause which was added to the Investment Grade Agreement in December 2011).

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 limited, it may be appropriate to seek to narrow 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). The requirement for the Borrower's consent applies unless the assignment or transfer is to another Lender (or an Affiliate of a Lender) or, optionally, unless it is made at a time when an Event of Default is continuing. Further limitations on the Borrower's right of veto are set out in Clause 24.2(b)-(c).

Clause 24.2(f) includes important protection for Borrowers from tax gross-up or indemnity obligations and increased costs claims following an assignment or transfer.

Borrower Notes

Paragraph (a)

This provides that transfers and assignments of the Lenders' rights and obligations under the Agreement are subject to the Borrower's consent save in very limited circumstances. 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 by the Lenders*). In addition, often, Lenders seek to disapply the consent right when an Event of Default has occurred and is continuing, although strong Borrowers continue to resist this (which is why the provision is optional in the Investment Grade Agreement).

In the leveraged loan market, in contrast, Borrowers usually have to negotiate to achieve consent rights. Borrowers should be aware that the equivalent provision in the Leveraged Facilities Agreement requires Lenders only to consult with the Borrower in relation to the identity of new Lenders, and the right to be consulted falls away after an Event of Default has occurred.

The difference in approach in the Leveraged Facilities Agreement is the result of concerns 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, factors which historically have been of much more importance to leveraged loans.

The need to ensure liquidity and the need to attract new investors to the loan market in recent years is a factor which arguably affects the whole loan market. Nonetheless, the Borrower's right of veto in relation to a loan transfer has generally held up well in the investment grade market and is a feature of the Agreement which Borrowers will fight to protect.

If circumstances do arise where Arrangers seek to curtail the Borrower's consent right beyond the circumstances set forth in the Investment Grade Agreement, which may, for example occur in relation to larger acquisition facilities which will need to be sold beyond the primary syndicate, there are various techniques which provide some balance between the Arrangers' desire to secure liquidity and the Borrower's wish to maintain a level of control over the composition of its syndicate. One device, which is commonly employed in the leveraged market, is a "whitelist" of named institutions to whom the initial Lenders are able to transfer their participations without the consent of the Borrower. This may be a list of two or three of the Borrower's relationship banks, or in deals involving bigger syndicates which are likely to be traded on an ongoing basis, a reasonably lengthy list of institutions, possibly accompanied by a requirement to refresh the list by agreement from year to year.

Where the Borrower's ability to veto transfers and assignments is restricted, other mechanisms for controlling syndicate composition become more important. For example, restricting the scope of the tax gross up entitlement may deter some potential Lenders.

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 fairly standard practice. What would constitute a reasonable withholding of consent in these circumstances is difficult to specify in precise terms, although there is authority which indicates the general approach the English courts might take to this question.

Although this point has never come before the English courts in the context of loan trading, there is a certain amount of English caselaw on the topic of when consent is unreasonably withheld in landlord and tenant disputes (where the landlord's consent may be required in relation to an assignment of the lease). As the courts have invoked the principles applied in the landlord and tenant cases in relation to other commercial contracts it seems prudent to consider the general principles applied in those cases in relation to the transfer of a loan participations. In summary, the comfort that Borrowers can take from the courts' approach in those cases is that it will be for the Lenders to prove that the Borrower was acting unreasonably in withholding (or delaying) its consent, rather than for the Borrower to prove the reasonableness of its actions. Further, the party withholding consent is required to take account of its own commercial interests and not those of the other party (in this case, the Lender). The reasonableness or otherwise of the relevant party's actions will be considered objectively: in other words, the test is whether, given the circumstances, a reasonable person would have decided to withhold consent in that party's position.

The practical implication of these general principles (on the assumption they would apply) is that what is reasonable will depend on the circumstances. For example, in the context of a club facility comprising relationship banks, it might be reasonable for a Borrower to refuse to accept a Lender with whom it has no relationship into the syndicate. The same may not be true if the facilities are widely held and broadly syndicated. Accordingly, if the Borrower considers that its consent to a proposed transfer or assignment is to be withheld, it should consider its reasons for doing so.

Very strong Borrowers may seek to delete the requirement to act reasonably to limit the circumstances in which its right to withhold consent might be challenged. If that is not achievable, it may be useful in the interests of certainty to define 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 an amendment or waiver request.

In relation to timing, 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 (and longer periods are achieved by some).

Paragraph (c)

The Borrower may not withhold consent on the grounds of an anticipated increase in Mandatory Costs. This is resisted by some Borrowers. The topic of Mandatory Costs has, however, recently become potentially more controversial which could lead more Borrowers to pay attention to this condition. Please see comments under Schedule 4 (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.

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.

However, since the amendments made to the Investment Grade Agreement in April 2009, this protection for Borrowers has been disapplied in relation to transfers during the course of primary syndication (and does not apply at any time in the Leveraged Facilities Agreement). This point is commonly negotiated.

A further amendment was made to this Clause in December 2011, when mechanics to facilitate the operation of the DTTP scheme (discussed under Clause 13 (*Tax Gross up and Indemnities*) above) were introduced into the Investment Grade Agreement. The new provision disapplies the Borrower's protection against tax risk on transfers to Treaty Lenders if:

- the new Lender holds a passport under the DTTP scheme and has provided, in the Transfer Certificate or Assignment Agreement, the requisite details to permit the Borrower to make the filings required to obtain a direction that the new Lender can be paid without any Tax Deduction; and

- the Borrower has failed to make the required filing within the applicable time limit (30 days of the relevant transfer date).

It is open therefore to the Borrower to mitigate any potential tax risk relating to such Lenders by ensuring that the "Borrower DTTP Filing" is made on time. However, the Borrower's ability to make the DTTP Filing is dependent on the Borrower being aware of the transfer or assignment. This may not be a particular issue in circumstances where the Borrower's consent is required for the transaction to proceed, but where the Borrower's consent is not required, the Borrower is dependent on the Agent to deliver to it a copy of the relevant Transfer Certificate or Assignment Agreement. The Agent's obligation is to do so "as soon as reasonably practicable" following execution of the same by the Agent (see comments on Clause 24.7 (*Copy of Transfer Certificate or Assignment Agreement to Company*)). Depending on the circumstances, this may or may not be in sufficient time to permit the Borrower to submit Form DTTP2. Accordingly, Borrowers may wish to consider amending this new wording in Clause 24.2(f) to ensure that it is protected in the event that it is not notified in time.

Minimum transfer/hold amounts

The Investment Grade Agreement does not impose any minimum amount on transfers and assignments or any requirement on the Original Lenders to maintain a minimum participation in the Facilities. Such devices are arguably of more importance in circumstances where the Borrower has no right to veto changes to the Lenders (which is not the case for most investment grade Borrowers), but warrant consideration where the Borrower is keen to ensure that its syndicate does not become too large or that its Original Lenders remain in the syndicate for the term of the loan.

Sub-participation and other "behind the scenes" transactions

As mentioned above, the Investment Grade Agreement is silent on the subject of transfers of participations in the Facilities which do not involve changes to the Lender of record. From a Lender's point of view, an attractive feature 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 Borrower, 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. In acquisition financing transactions, it may be important to restrict such transactions in the interests of maintaining confidentiality. More generally, they can be problematic if the Borrower finds itself in financial difficulties. At the point at which the Borrower needs a waiver or an amendment to its facility, or faces insolvency, 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. The difficulties of securing a corporate rescue without information about the "behind the scenes" transactions are well documented.

In the light of these concerns, some Borrowers seek limited information rights in relation to "single name" credit derivatives and sub-participations.

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. This is a point which is extremely important to some Borrowers and such rights are agreed, sometimes in addition to a provision which requires Lenders to retain control of their voting rights in relation to the Facilities.

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 clause included in the 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 optional provision was 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 is in broad terms 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.

Borrowers should be aware that provisions such as Clause 24.8 have become increasingly important to Lenders for the purposes of accessing central bank funding, on which banks have become more reliant as a result of the 2007-2009 global financial crisis and the ongoing difficulties in the Eurozone.

For example, the Discount Window Facility ("**DWF**") is part of the Bank of England's sterling monetary framework. The DWF enables eligible banks and building societies to borrow gilts, for 30 or 364 days, against a wide range of collateral in return for a fee, including (since 2011) certain loans. More recently in July 2012, the Bank of England launched the Funding for Lending Scheme ("**FFLS**"). This aims to encourage banks to increase their lending to UK households and non-financial corporates by raising the amount of gilts they are able to borrow (for a term of up to four years) by reference to the amount lent by that bank. In other words, the more a bank increases the size of its loan book, the greater the amount of FFLS funding will be available to it. The significance of this in the present context is that FFLS funding must be secured and the collateral eligibility criteria are the same as applicable for the purposes of the DWF. Accordingly, FFLS funding can also be lent against certain types of loan.

The use of loans as collateral, depends, among other things, on the absence of restrictions which would inhibit the effectiveness of the mechanism by which the asset is delivered to the Bank of England as collateral. A provision which expressly permits Lenders to create security over their rights will therefore be important and this is the case in particular, in relation to investment grade and fully drawn term loans. In broad terms, for the purposes of the DWF and the FFLS, only English law, high quality, fully drawn, senior loans to UK borrowers which are not banks or part of a banking group are eligible (which thus excludes partially drawn loans such as revolving facilities, subordinated loans and leveraged loans).

This Clause is now commonly included in syndicated loan agreements. Some investment grade Borrowers seek to limit the Lenders' permission to use its participation in the Facilities as security by reference to security for obligations owed to a federal reserve or central bank, excluding the permission to securitise the loan which appears in the LMA clause.

Clause 24.9: Pro rata interest settlement

This optional provision was introduced by the LMA in April 2009 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 may 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.

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 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 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 Market Conditions Provisions include a new paragraph (g) which can be added to this Clause and which will be helpful to Borrowers. It requires 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 especially in cases where the Borrower's right to veto transfers and assignments is curtailed (see Clause 24.2 (*Conditions of assignment or transfer*)) to enable them to monitor the identity of syndicate members. This could be critical if a Borrower gets into financial difficulty.

Clause 26.13: Relationship with the 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 that date (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 optional 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. Many Borrowers object to the inclusion of this provision, in particular in investment grade facilities.

CLAUSE 27: CONDUCT OF BUSINESS BY THE FINANCE PARTIES

This Clause is most often discussed in the context of Clauses 13.4 (*Tax Credit*) and 16 (*Mitigation*). It provides, in outline, that nothing in the 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 and Clause 29.2: Distributions by the Agent

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

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.

Borrower Notes

In September 2012, the LMA made some minor changes to the equivalent of these provisions in the Leveraged Facilities Agreement as part of a package of minor changes seemingly aimed at providing further protection against the risk that a loan in euro could be re-denominated in a euro exit scenario.

In summary, in an English law contract which is subject to the jurisdiction of the English courts, an obligation in euro may be better protected from the risk of re-denomination in a euro exit scenario if the parties make clear that they intend to receive euro notwithstanding changes in euro membership from time to time, for example, by including a definition of "euro" (which is now included in the Investment Grade Agreement as an optional provision, see Clause 1.3 (*Currency symbols and definitions*)) and by providing for payments to be made outside the Eurozone (which could assist in particular if exchange and capital controls are in place within relevant Eurozone countries).

Thus in the equivalent to Clauses 29.1 (*Payments to the Agent*) and 29.2 (*Distributions by the Agent*) in the Leveraged Facilities Agreement, payments in euro are now required to be paid in a principal financial centre in such Participating Member State or London "as specified by the Agent", enabling the Agent to direct that payments are made outside the Eurozone.

On the assumption that both the Borrower and the Lenders wish to prevent the contract being re-denominated[18], the LMA's changes are potentially helpful.

See also comments at Clause 1.3 (*Currency symbols and definitions*), Clause 29.8 (*Currency of Account*) and Clause 35 (*Amendments and Waivers*) in relation to provisions aimed at mitigating the impact of euro break-up on loan documentation.

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.

[18] There may of course be limited situations where it could be advantageous for a Borrower operating in an exiting member state, whose cashflows are re-denominated as a result of euro exit to meet its payment obligations in respect of a loan advanced in euro in the new currency of the relevant country. For further information on this topic, please go to www.slaughterandmay.com for links to a detailed series of publications on the legal aspects of the Eurozone crisis.

Borrower Notes

A potential concern arises here in relation to Defaulting Lenders. (For an introduction to the Market Conditions Provisions, please see section 7 of Part I). If a Borrower achieves the right to prepay a Defaulting Lender (which is limited under the 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. Such a position, while defensible in principle, may, however, be problematic for Lenders who wish to use the loan as collateral (see Clause 24.8 (*Security over Lenders' rights*)), as the eligibility of the loan as collateral may depend, among other things, upon the absence of set-off rights. A possible alternative may be to 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 to LMA loan documentation, 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 29.8: Currency of Account

Paragraph (a) of this Clause purports to designate the currency of the Loan as the currency of account and the currency of payment of any sum due from an Obligor under any Finance Document. Paragraphs (b) and (c) go on to require that each payment of principal and interest respectively shall be made in the currency in which the relevant amount is denominated on its due date.

Borrower Notes

This is one of the boilerplate clauses which became the subject of increased focus as participants in the loan market started to become concerned about euro break-up.

The equivalent of Clause 29.8 (*Currency of Account*) in the Leveraged Facilities Agreement was amended in September 2012 to make clear that payments are required in the currency in which the relevant amount is denominated "pursuant to the Agreement", a potentially useful clarification that is designed (it is assumed) to exclude any deferral to the law of any particular Eurozone country to determine the currency of payments in a euro exit scenario. This change was part of a package of changes made to the Leveraged Facilities Agreement to address this issue.

See further comments at Clause 1.3 (*Currency symbols and definitions*), Clauses 29.1 (*Payments to the Agent*) and 29.2 (*Distributions by the Agent*) and Clause 35 (*Amendments and Waivers*).

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 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 may seek 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*) was amended in December 2011 to provide that any two parties to the Agreement may communicate by email or other electronic means if they agree to do so and provide each other with their email addresses and any other necessary information. The previous version of this Clause permitted the Agent and the Lenders to agree to email communication on a bank-by-bank basis and did 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 34: REMEDIES AND WAIVERS

This Clause provides that no failure to exercise or delay by any Finance Party in exercising its rights under any Finance Document shall operate as a waiver of that right. Its purpose is to preserve the rights of the Finance Parties unless they cease according to the terms of the document or are waived pursuant to Clause 35 (*Amendments and Waivers*).

In a 2009 Court of Appeal case, which concerned a commercial contract, it was held that a contracting party had lost its right to terminate the contract for breach by virtue of it having continued to perform the contract following the breach, notwithstanding the contractual remedies and waivers provision. The party in question had, by its conduct, affirmed the contract.

As a result, Lenders became concerned that they could be at risk of being taken to have waived their rights arising out of an Event of Default in circumstances where they continued to advance funds following an Event of Default. In an attempt to address this, Clause 34 was amended in December 2011 to provide specifically that no election to affirm any of the Finance Documents on the part of any Finance Party will be effective unless in writing.

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.

If the amendments set forth in the Market Conditions Provisions are adopted, Clause 35 further provides for:

- the disenfranchisement of a Defaulting Lender to the extent of its undrawn commitments; and

- the replacement of a Defaulting Lender.

The right to replace a Defaulting Lender is largely the same as the existing right to replace a single Lender following a tax gross up claim or an indemnity claim for tax or increased costs (discussed under Clause 8.6 (*Cancellation and repayment or replacement of a single Lender*) above).

Borrower Notes

Matters requiring unanimous consent

The list of matters requiring unanimous consent set out in Clause 35.2 (*Exceptions*) is, subject to the matters highlighted below, reasonably standard. Borrowers should be aware, however, that in the event that amendments and waivers are required, although the list of matters requiring unanimous consent is specific, the introductory wording "*An amendment that has the effect of changing, or which relates to..*" can sometimes lead to difficult questions as to whether Majority Lender or unanimous Lender consent is required, in particular where (for example), the Margin or payment provisions have the potential to be affected by changes to covenant terms (which may of course not be a relevant consideration for many investment grade Borrowers). It can be difficult to negotiate or limit this introductory wording. In the context of covenant exceptions, it can therefore be helpful to provide specifically that further exceptions (eg to the "No disposals" covenant or the negative pledge), can be agreed with Majority Lender consent.

Nonetheless, in broad terms, the list of matters requiring unanimous consent in the Investment Grade Agreement reflects what is normally agreed. The exception is the reference to any amendment or waiver that has the effect of changing or which relates to "*any requirement that a cancellation of Commitments reduces the Commitments of the Lenders rateably under the relevant Facility*", which as the most recent addition to the list, has not yet been adopted into general usage. The change was probably driven by Lenders' concerns about certain restructuring techniques that have been employed in the leveraged market more recently which have the effect of extending the maturity date of the Facilities without the need to obtain unanimous Lender consent. This may not be a particularly controversial addition in relation to investment grade loans which, as already mentioned, are not amended and restructured in the same manner or with the same frequency as leveraged loans, but Borrowers should be aware of the background to enable them to determine whether the new provision requires negotiation in the context of their facilities.

The restructuring techniques referred to above are very sensitive to the terms of the document in question. Some "amend and extend" transaction structures, for example, might involve the creation, within the framework of the existing facilities, of a new tranche of debt with a longer maturity than the existing tranches. Existing Lenders are invited to "roll" their commitment into the new longer tranche following which the new tranche is drawn to prepay the existing commitment of those Lenders who accept the invitation. Any Lender who does not wish to participate in the new tranche will remain in the existing tranche, and if Majority Lenders consent, the pre-existing commitments of those Lenders who have rolled into the new tranche, are cancelled. This route, where available, can be a helpful way of extending secured loans, where a forward start facility (which is generally structured as a parallel facility to which existing Lenders can commit, and which will commence on expiry of the existing facility) would require new security to be taken.

This latest amendment to Clause 35.2 is most likely aimed at closing off the above and similar routes that would generally fall to be explored only by sub-investment grade or leveraged borrowers in the absence of unanimous lender consent. The important point for investment grade Borrowers is that in sub-investment grade and leveraged facility agreements, it is also typical to make specific provision for "structural adjustments", including extensions to maturity dates, to be effected with more than Majority Lender consent, but without unanimous Lender consent. Accordingly, Borrowers who are in cross-over territory, or who can only borrow on a secured basis may wish to think about how any future amendments might need to be effected more carefully, and consider whether a "structural adjustment" mechanic (a form of which was added to the Leveraged Facilities Agreement in September 2012), could potentially be helpful.

An amendment that may be useful to Borrowers with multi-tranche facilities is the ability to make changes affecting particular tranches of debt (eg an extension to the maturity date) with the consent of all Lenders in the affected tranche, rather than the unanimous consent of Lenders generally.

In relation to the list of decisions requiring unanimity, Borrowers should also note that in September 2012, the LMA added changes to the governing law and jurisdiction provisions of the Leveraged Facilities Agreement (the equivalent of Clauses 38 (*Governing Law*) and 39 (*Enforcement*) in the Investment Grade Agreement) to the list of decisions requiring unanimity.

The background to this is that in broad terms, contracts considered most at risk of re-denomination in a euro exit scenario and/or disruption due to exchange and capital controls are those governed by the law of the exiting/imposing member state. The addition of changes to the law and jurisdiction provisions to the list of decisions which require unanimous Lender consent reflects that Lenders are focused on the potential impact of the choice of law and jurisdiction applicable to the Agreement (or the impact of changing the agreed terms) should the euro break up or fragment.

There is not much evidence to date, that this latter amendment to the Leveraged Facilities Agreement is being used either in that context, or more broadly.

"You snooze you lose"

To the extent a Defaulting Lender has voting rights, an insolvency practitioner may be unable or unwilling to vote. The "you snooze you lose" protection added to the Market Conditions Provisions in December 2011 may be helpful in that regard (see Clause 35.4 of the Market Conditions Provisions).

The "you snooze you 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).

To date, "you snooze you lose" provisions have not routinely been a feature of investment grade facility documentation (save in relation to Defaulting Lenders), although they are achieved by some Borrowers. The Leveraged Facilities Agreement includes a "you snooze you lose" provision, which applies to Lenders who do not give their consent to a decision to which a specified majority have given their consent as well as to Defaulting Lenders. The prevalence of these broader provisions in leveraged loan documentation is the result of the generally larger syndicates that tend to be put in place in the market, which may include a significant proportion of non-bank Lenders. Investment grade Borrowers with larger and/or diverse syndicates may also wish to consider including such provisions in their loan documentation, although Borrowers should be aware that the existence of these rights could prompt a swift negative response to consent requests from affected Lenders or their representatives. It is also possible that they could also make it easier for the Lenders to obtain the necessary majority to accelerate the debt.

Replacement of Lenders

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. A provision along those lines is included in the Investment Grade Agreement, 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. A provision along these lines is included in the Leveraged Facilities Agreement (Clause 41.3), but not the Investment Grade Agreement. This type of provision can also be helpful outside the leveraged market, especially to Borrowers with larger syndicates.

The third set of circumstances is where the Lender is a Defaulting Lender. This type of provision is included in the Market Conditions Provisions.

Clause 35.5 (*Replacement of a Defaulting Lender*) was amended in December 2011 to provide for the replacement of the Defaulting Lender either at par, or below par if so agreed between that Defaulting Lender, the new Lender and the Company.

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 was added to the Investment Grade Agreement in 2009 in light of the increasing numbers of non-bank lenders being included in lending syndicates. This focused attention on two related topics:

- Syndicates may 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 confidentiality undertaking was a welcome development for the protection of the information provided to syndicates, there are some points of detail which some 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, Borrowers may be concerned that it may not be long enough to protect all types of Confidential Information. The LMA acknowledges 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 which Borrowers had to rely on prior to the introduction of this express confidentiality undertaking 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 of this guide).

Some of the changes made by the LMA in 2009 were 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 includes Related Funds and officers, directors, employees, professional advisers, auditors, partners and Representatives (broadly defined and discussed below) as well as Affiliates. 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 pre-2009 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.

- *Lenders' Representatives*. The Investment Grade Agreement (at Clause 26.13(c) (*Relationship with the Lenders*)) permits 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*. 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 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. Some 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*. This is an optional category of permitted disclosure, permitting Lenders 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 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 at least to exclude items (vi) and (xii) from that representation as it is impossible to determine at the date upon which the Agreement is signed whether future information is price sensitive. Many investment grade Borrowers will seek to delete this representation entirely. There are benefits to certain Borrowers in permitting such disclosure as numbering service providers exist to facilitate trading but that will not be a relevant concern for all investment grade loans.

- *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 of this guide for comments on the LMA 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.

CLAUSES 38: GOVERNING LAW AND 39: ENFORCEMENT

The Investment Grade Agreement is expressed to be governed by English law. Clause 38 (*Governing Law*) also contains optional wording which provides that any non-contractual obligations arising out of or in connection with the Agreement are governed by English law. A footnote explains that this wording is optional as where the Agreement forms part of a suite of documents, some of which are governed by the laws of another country (for example, security documents), it may be inappropriate to designate English law as the law of any non-contractual obligations arising out of or in connection with those documents.

Clause 39.1 (*Jurisdiction*) designates the parties' choice of jurisdiction. This Clause confers exclusive jurisdiction on the courts of England for the benefit of the Finance Parties only. The intention of the Clause is to restrict as far as possible the Obligors' ability to bring proceedings in relation to the Agreement other than in the courts of England, while preserving the Finance Parties' rights to bring proceedings where they choose.

Borrower Notes

A jurisdiction clause of this type is customary in loan documentation and is not often altered. Borrowers, should, however, be aware that a 2012 decision of the French *Cour de cassation* could prompt Lenders in certain circumstances to make changes to it.

In summary, the validity of jurisdiction agreements which confer jurisdiction on the courts of an EU country (and, under current rules, where one of the parties is domiciled in the EU) is governed by an EU Regulation known as Brussels I[19]. In September 2012, the *Cour de cassation* decided that a unilateral or "one-sided" jurisdiction clause, similar in nature to that used in the Investment Grade Agreement, did not meet the requirements of Brussels I and was thus invalid.

The *Cour de cassation* decision relates to the interpretation of Brussels I, which as an EU Regulation forms part of the law of all EU member states. Although it is by no means clear that other member states would adopt the same interpretation of Brussels I as the *Cour de cassation*, until such time as the point comes before the Court of Justice of the European Union, there is a view that the French ruling potentially casts doubt on the validity and effectiveness of this type of jurisdiction clause across the EU.

In light of this decision, the LMA circulated a note to members in January 2013 outlining some alternative forms of jurisdiction clause and their advantages and disadvantages, reflecting that the extent of the risk of invalidity and the appropriate solution will vary depending on the circumstances of the transaction. No view is expressed on the suitability of these clauses in this guide as this is a complex legal topic which requires consideration on a case by case basis. If Lenders raise this point, Borrowers will need to discuss the implications of the proposed changes with their legal advisers.

SCHEDULE 4: MANDATORY COSTS

The Mandatory Costs Schedule provides a means of calculating certain regulatory costs incurred by Lenders in relation to their lending function. The Mandatory Cost is the average of the Lenders' "Additional Cost Rates", weighted in proportion to their participation in the relevant Loan, calculated in accordance with the formulae set out in the Schedule.

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

[19] Equivalent rules apply also to the EEA countries.

The applicable "Additional Cost Rate" depends on whether the Lender in question funds its participation in the Facilities from the UK or from a Facility Office in the Eurozone. The LMA Mandatory Costs provisions do not contemplate loans being funded from elsewhere.

The Additional Cost Rate for any Lender whose Facility Office is in the UK is calculated by reference to a formula. This formula takes into account, in relation to sterling loans, the Lender's cost (if any) of complying with the Bank of England's reserve asset or "cash ratio deposit" costs plus, in relation to both sterling and non-sterling loans, FSA costs (or the costs of any authority which replaces all or any of their functions).

The Additional Cost Rate for any Lender whose Facility Office is in the Eurozone is the percentage notified by that Lender as its cost of complying with European Central Bank ("**ECB**") requirements in respect of Loans made from that Facility Office.

The costs imposed by the Bank of England and the ECB are calculated on an individual bank basis according to the specified formula. FSA (or FCA/PRA) costs are calculated based on a Reference Bank average.

The nature of each of these costs, and the manner in which they are charged is explained in more detail below.

Borrower Notes

Bank of England reserve asset or "cash ratio deposit" costs

"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, in summary, short term (ie less than 2 years) sterling liabilities, net of sterling loans made to other banks in the UK banking sector. The Bank of England uses the income earned on these deposits to fund its monetary policy and financial stability operations[20].

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.

Reserve assets costs are thus only relevant to sterling loans.

20 Note that the FSA published a proposal for consultation in February 2013 to increase the deposit ratio from 0.11% to 0.18% of Eligible Liabilities and the threshold, from £500 million to £600 million, in view of a shortfall in funding of the Bank of England's policy functions over the period 2008 to 2013.

Supervisory fees

The FSA began to charge fees for its supervisory function when it took on the role from the Bank of England in 1998.

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.

FSA fees decreased significantly in the decade which followed their introduction, but since 2008/9, they have been increasing. By way of illustration, the average for the year 2008-9 was roughly £24 per £1 million MELs. Rates for 2012/13 range from £40 to £66 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.

FSA supervisory fees are payable on both sterling and non-sterling loans. The LMA formulae ensures 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 in respect of FSA supervisory fees is calculated on the basis of the rates applicable to the Reference Banks. Each Reference Bank is asked to quote its average supervisory fee rate, so that the Agent can compute the average of those quotations. Accordingly, these costs are factored into the formula whether or not actually incurred by individual Lenders.

From 1 April 2013, the FSA will relinquish its supervisory responsibilities for UK banks to the PRA and the FCA, who will be responsible for the 2013/4 supervisory fees. The FSA has been consulting on the proposed changes to the FSA fee calculation methodology and details are expected to be published shortly.

As mentioned above, supervisory fees are calculated on the basis of a Reference Bank average. Borrowers may like to note the potential impact which the selection of the Reference Banks may have for this purpose. 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.

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 been prepared expressly to concede 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 this aspect (item E) from the Mandatory Costs 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.

In practice, even where this aspect of the Mandatory Costs formula is included, it is not clear whether or not banks have 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.

ECB reserve requirements

ECB reserve requirements apply to all Eurozone 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 Eurozone 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 Eurozone 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 Eurozone Lender could suffer is the difference between the rate it is paying to fund the deposit and the rate paid by the NCB.

Until May 2004, the Investment Grade Agreement entitled the Borrower to prepay a Lender which charges ECB costs and cancel its Commitment and Borrowers may seek to reinstate that concession. To date, however, Lenders have not generally passed on ECB costs to Borrowers in practice and Lenders are obliged effectively to try to ensure that ECB costs are not charged, under Clause 16 (*Mitigation by the Lenders*).

A warning: 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 (or any successor authority of any of them). The Agent is required merely to consult the Borrower. The Borrower may take the view 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.

Perceived shortcomings of the Mandatory Costs regime

As will be apparent from the commentary above, the amount of Mandatory Costs potentially payable to each Lender in the syndicate can vary depending on whether the Bank of England cash ratio deposit scheme applies to it, the location of its Facility Office and its status under the FSA Fee Rules. Larger syndicates and the participation of non-bank Lenders in syndicates (eg funds who are outside the Bank of England reserve asset requirement regime) give rise to the potential for greater variation than might have been the case at the time when the Mandatory Costs schedule was designed.

In January 2013, the LMA circulated a note[21] highlighting that Agent banks are experiencing operational difficulties in administering the Mandatory Costs calculation due to the potential for non-pro rata allocation of Mandatory Costs to Lenders. The note describes the operation of the Mandatory Costs schedule as currently drafted and sets out, as a result of these difficulties, some possible alternative options for Finance Parties to consider. The options suggested include:

(i) Changing the Mandatory Costs methodology to include fewer variables: for example, by calculating the Additional Costs Rate applicable to loans funded from the UK by reference to the Agent's own or Reference Banks' Bank of England and FSA charges and calculating the ECB costs of a loan funded from the Eurozone by reference to a percentage determined by the Agent.

(ii) Removing the distinction between Lenders lending from the UK and Lenders lending from the Eurozone and treat the latter in the same way as UK Lenders.

[21] The note is available from the LMA website: www.lma.eu.com.

(iii) Treating non-bank Lenders in the same way as bank Lenders for the purposes of the Additional Cost Rate, such that there would be no variation in who is reimbursed in respect of Bank of England costs and who is not (in the same way as is currently the case for FSA costs).

(iv) Charging Mandatory Costs for sterling loans only (as the FSA costs for non-sterling loans are lower and they attract no Bank of England costs).

Alternatively, the LMA suggests that the Mandatory Costs Schedule be removed from the Agreement altogether, which would mean that such costs would in the future be built into loan pricing rather than charged as a separate item.

The LMA's note concludes by making the point that any such changes will require the consent of the Borrower community.

These options (and any others Lenders might devise) will need to be considered by Borrowers as and if proposed. Whether option (i) is attractive may depend on the identity of the Agent or Reference Banks. Options (ii) and (iii) above might at first sight appear the least attractive of the options proposed from the Borrower's point of view, as their impact is likely (in theory at least) to be an increase in the overall Mandatory Costs rate which is actually paid. Option (iv) may be worth exploring although Borrowers would need to be provided with information sufficient to understand its implications fully.

The option of dispensing with Mandatory Costs altogether may be appealing to Agent banks from an administrative perspective. Whether this option would be beneficial to Borrowers clearly depends on the knock-on effect, if any on Margins, which may be difficult to assess. If the Mandatory Costs Schedule were abandoned, Borrowers would wish to ensure that the costs previously within the scope of Mandatory Costs are not capable of being the subject of a claim under any other provision of the Agreement, for example, Clause 14 (*Increased costs*).

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 that party's final receipt of any Confidential Information.

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 acquire an interest in the loan. 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 acquires the participation but does not become a Finance Party (for example where it takes a sub-participation), the confidentiality undertaking falls away 12 months from the termination of the relevant acquiror's interest in the loan. If no deal is concluded, the confidentiality undertaking falls away on the date falling 12 months after the relevant party's last receipt of any Confidential Information. (For an explanation of the differences between novation, assignment and sub-participation, please see the commentary on Clause 24.1 (*Assignments and transfers by the Lenders*)).

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, some information 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 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.

The terms specified below have the following meanings in this guide:

Investment Grade Agreement	LMA recommended form of multi-currency term and revolving facilities agreement for multiple borrowers and guarantors, August 2012.
Leveraged Facilities Agreement	LMA senior multi-currency term and revolving facilities agreement for leveraged acquisition finance transactions, December 2012.
LMA confidentiality and front running letter for primary syndication	LMA confidentiality and front running letter for primary syndication, June 2011.
Market Conditions Provisions	The Users' Guide to LMA Finance Party Default and Market Disruption Clauses in conjunction with the recommended form of primary documents, August 2012.
LMA secondary market confidentiality letter	LMA confidentiality letter (seller) for use with LMA secondary loan documentation, March 2011.

About the Association of Corporate Treasurers[22]

The ACT administers the qualification framework for, supports and represents professionals working in treasury, risk and corporate finance. As the leading professional body for international treasury, the ACT provides the widest scope of benchmark qualifications, defines standards, promotes best practice and supports continuing professional development. The ACT is the voice of corporate treasury representing the interests of its members.

The ACT's Policy & Technical team represents the profession to government, regulators and standard setters and promoters of industry standard terms (including the LMA). More generally, the team seeks to promote best practice in treasury and corporate finance.

Further information about the ACT is available at www.treasurers.org.

22 Established by Royal Charter.

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About Slaughter and May

Slaughter and May is a leading international law firm that advises on a wide range of often groundbreaking transactions and has a varied client list that includes major corporations, financial institutions and governments.

Our loan finance practice advises both investment grade and sub-investment grade borrowers in all industry sectors which gives us a depth of understanding of borrowers' needs. We also act for leading financial, commercial and industry players and banks, providing us with a wide perspective on the market.

Slaughter and May provides ongoing advice to the ACT in relation to the LMA's investment grade loan documentation and related issues.

Further information about Slaughter and May is available at www.slaughterandmay.com.

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