Borrower, be aware!

ANDREW BALFOUR AND **JANE HANDS** INTRODUCE THE NEW ACT BORROWER'S GUIDE TO LMA LOAN DOCUMENTATION FOR INVESTMENT-GRADE BORROWERS.

The ACT has worked with the LMA (Loan Market Association) on the development of its investment-grade facility agreement since the project was first launched in 1996. Arising out of the ACT's involvement with successive revisions of the agreement, the guide, which is produced by Slaughter and May, provides detailed negotiating advice for treasurers.

The new edition includes a substantial amount of new material, such as advice on the new defaulting lender and market disruption provisions, published in June 2009 in response to the financial crisis. After a general overview for readers unfamiliar with LMA documentation, the guide provides a clause-by-clause commentary, highlighting key points for borrowers to address.

Designed as a companion volume to the ACT Borrower's Guide to the LMA Facilities Agreement for Leveraged Transactions, the guide is tailored for use by treasurers rather than lawyers.

OVERVIEW. The LMA, the ACT and the BBA (British Bankers' Association) set out their shared approach to the documentation in a joint statement:

- Use of the investment-grade agreement is not mandatory, so borrowers can continue to use their existing documentation if they wish.
- The LMA documentation is a starting point only, and parties are expected to negotiate changes appropriate to their transaction.
- Independent legal advice is necessary.

The investment-grade agreement is designed for "plain-vanilla" loans to UK corporates with a single A credit rating. It is drafted on the assumption that all group members are English companies, a design feature which can be problematic given that many borrower groups are multinational.

Lenders may be banks, financial institutions and a wide range of investment entities. Although, on the whole, the agreement reflects market practice for a syndicated facility for a borrower with an investment-grade credit rating, it is important to appreciate that it will always need to be negotiated.

KEY POINTS FOR BORROWERS TO NEGOTIATE.

Repayment, pricing and fees. These naturally have to be settled on a case-by-case basis.

Tax. Treaty lenders are now routinely included in syndicates, in contrast to the position 10 years ago. 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, for example, the definition of a treaty lender, which is required in clause 13 (tax), is critical in determining the extent of risk allocated to borrowers.

Syndicate composition. Borrowers need to balance carefully their concerns about pricing and availability against the different risks presented by the various categories of lender. Treaty lenders present greater tax risks than UK bank lenders, and non-bank lenders may also present relationship-type challenges which can be critical in the context of a request for a waiver or amendment. Lender default risk has been in the spotlight since the collapse of Lehman Brothers.

Borrowers should consider the degree of control that they need in order to manage these risks, weighing them up against their need for funding and their concerns about pricing. Various tools are available. The new LMA market conditions provisions are discussed 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 transfers. However, other provisions which can be effective are the limitations on the gross-up entitlement (see clause 13 (tax)), as well as "yank the bank"

and "snooze and lose" provisions, discussed under clause 8.6 (right of replacement or repayment and cancellation in relation to a single lender) and clause 35 (amendments and waivers).

Financial covenants. Although the investment-grade agreement does not contain any financial covenants, the LMA publishes a set of pro forma covenants, based on those in the leveraged facilities agreement. These may be used as a starting point, but always require individual tailoring. For more guidance, see the ACT Borrower's Guide to the LMA Leveraged Facilities Agreement, which is on the ACT website.

Representations, covenants and events of default. The agreement includes a set of basic representations, covenants and events of default. Borrowers will require adjustments on a case-by-case basis, although in the current climate, lenders are seeking tighter provisions generally. The main points for focus include:

- **scope:** these provisions cover not only borrowers and guarantors but also in many cases all group members; often borrowers will want to limit the scope of these provisions, for example, to subsidiaries or material companies;
- **materiality:** although 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;
- **clauses 22.3 and 22.4:** clauses 22.3 (negative pledge) and 22.4 (disposals) are very restrictive but include blank provisions anticipating that the parties will negotiate further exceptions;
- **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); and
- **material adverse change event of default:** clause 23.12 (material adverse change) is left blank for the parties to settle their own provision, if any.

THE LMA MARKET CONDITIONS PROVISIONS. The rest of this article contains outline information for readers who have not yet encountered the LMA market conditions provisions. More detail is set out in the guide itself.

The provisions were published in response to the financial crisis. Generally speaking, the concepts addressed by the LMA will be familiar to those who have negotiated loan documentation since then.

The provisions fall into two categories:

- clauses addressing the consequences of a finance party default; and
- amendments to the market disruption and cost of funds provisions.

The LMA did not discuss this new language with the ACT prior to publication, in contrast to previous practice in relation to investment-grade documentation.

However, in broad terms, the provisions are to be welcomed by borrowers, as they should provide a measure of protection against the risk of finance party default and market turbulence of the kind witnessed since the collapse of Lehman Brothers. The proposals addressing the consequences of a lender being in financial difficulty in particular should limit the risks for both lenders and borrowers. As ever, however, some borrower-friendly adjustment of the detail is advisable.

Defaulting lender. Most of the new provisions address the consequences of a lender becoming a defaulting lender. In outline, a defaulting lender is one:

- that fails to fund, or gives notice that it will do so;
- that rescinds or repudiates a finance document; or
- suffers an insolvency event.

Recent deals have conformed to this pattern, though some banks have refused to accept the insolvency limb of the definition, so this element is presented as an option.

Once a lender becomes a defaulting lender:

- The borrower can cancel the undrawn commitment of the defaulting lender, which can be immediately or later assumed by another lender selected by the borrower;
- The participation of the defaulting lender in the revolving facility is automatically termed out and can be prepaid;
- 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 (optional); and
- The defaulting lender is disenfranchised to the extent of its undrawn commitments.

Similar provisions allow an "impaired agent" to be removed by majority lenders, and for borrower and lenders to make payments direct to each other and communicate direct with each other, rather than through the impaired agent.

Points for borrowers to address include:

- the omission of a general right to prepay a defaulting lender; the borrower may want the flexibility to prepay rather than have the defaulting lender stay in the syndicate with voting rights – see clause 8.6 (right of replacement or repayment of cancellation in relation to a single lender); and
- the need to amend the definition of majority lenders, in the light of the provisions for disenfranchisement of a defaulting lender, and to include "snooze and lose" provisions (see clause 35).

Market disruption. Changes have been made to the market disruption provisions which are intended to reduce the likelihood of lenders needing to charge the borrower interest based on their cost of funds rather than LIBOR. While these changes are generally to be welcomed by borrowers, attention to the detail is required. See clause 11 (changes to the calculation of interest).

Cost of funds. In addition the LMA has amended the definition of LIBOR so that the parties may use reference bank rates from the outset, rather than BBA LIBOR as published on-screen. The optional abandonment of screen-based LIBOR in favour of a reference bank rate is not expected to find much favour with borrowers generally. For more, see clause 9 (interest).

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The guide is available on the ACT website at: **www.treasurers.org/loandocumentation**
Also available on the website is the ACT Borrower's Guide to the LMA Facilities Agreement for Leveraged Transactions.