SLAUGHTER AND MAY

Financing Briefing

March 2009

New LMA Investment Grade Facilities Agreement

The Loan Market Association ("LMA") is shortly to publish revised versions of its recommended forms of facility agreement for investment grade borrowers (the "Investment Grade Agreement"). Slaughter and May assisted the Association of Corporate Treasurers ("ACT") in negotiations with the LMA on the terms of the new Investment Grade Agreement.

The most important change made to the Investment Grade Agreement is the inclusion of an express confidentiality undertaking given by the Finance Parties along similar lines to the undertaking added to the LMA's recommended form of facilities agreement for leveraged transactions (the "Leveraged Agreement") in September last year.

Apart from the new confidentiality undertaking, many of the changes to the Investment Grade Agreement are of a technical or drafting nature. Substantive points which may be of interest to Borrowers are outlined in this Briefing. Capitalised terms have the meanings given in the Investment Grade Agreement.

Changes to the Investment Grade Agreement

Tax

Historically, Borrowers have benefited from a provision protecting them against the need to gross up a Lender following its purchase of a loan participation. Under Clause 24.2(f), a 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 been entitled to a payment under Clause 13 (*Tax gross-up and indemnities*) or Clause 14 (*Increased Costs*) had the transfer not occurred. This provision is based on market acceptance of the view that Borrowers should not suffer greater tax or capital adequacy costs as a result of transfers. The protection is generally most useful in relation to transfers to Treaty Lenders, who may have to be grossed up until they receive clearance to be paid without withholding tax.

However, the LMA sought during discussions with the ACT to remove the protection for Borrowers from greater tax costs, and indeed the Leveraged Agreement now reflects this position. The ACT objected to this proposal, on the grounds that it was not in line with market practice, and as a result, the protection for investment grade Borrowers remains. The protection has however been disapplied in relation to transfers during the course of primary syndication. This is a point which Borrowers may wish to discuss, particularly where primary syndication may not close quickly and there is a risk of transfers during that period to Lenders which may need to be grossed up.

Negative pledge

The exceptions to the negative pledge set out in Clause 22.3 (*Negative Pledge*) have been extended. In particular, it is now 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 the company is exposed in its ordinary course of trading; and
- 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.

In addition, the standard permission for retention of title arrangements in the Leveraged Agreement is now included in the Investment Grade Agreement.

Non-bank Lenders

In response to increased numbers of non-bank lenders participating in syndicates – a topic discussed further below - the LMA have introduced a provision to cater for Lenders wishing to receive public information only. 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. One concern is that the LMA provision does not give the Borrower the right to be notified about such an appointment, so that it will not know of the arrangement. Another concern is the potential impact on voting and requests for amendments and waivers. Borrowers may want to ensure they are protected against the risk posed by Lenders which are liable not to respond to requests, for example by a "snooze and lose" provision such as Clause 41.2(d) of the Leveraged Agreement.

In this context, another change made to the Investment Grade Agreement may be helpful to Borrowers. The LMA have included the insertion of a "yank the bank" provision (Clause 8.6 (*Right of repayment or replacement and cancellation of a single Lender*)), which allows the Borrower to replace a Lender which claims under the gross up provision or the tax or increased costs indemnities. Investment grade Borrowers may wish to consider seeking to extend this provision (as in the Leveraged Agreement, Clause 41.3) to allow the Borrower to replace a Lender which does not consent to a decision where the requisite majority has voted in favour.

Other

Another new provision permits Lenders to grant security over their rights in certain circumstances (Clause 24.8 (*Security over Lenders' rights*)). In outline, 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.

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 would therefore appear to be 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.

Other changes have been introduced in response to market demand. These include a procedure for assignment (Clause 24.6 (*Procedure for assignment*)), and a procedure for the apportionment of interest and fees where a loan transfer settles mid Interest Period (Clause 24.9 (*Pro rata interest settlement*)).

Confidentiality

The most important change made to the Investment Grade Agreement is the inclusion of an express confidentiality undertaking given by the Finance Parties. An undertaking along similar lines has been included in the Leveraged Agreement since September 2008.

Borrowers routinely provide their lending syndicates with sensitive inside information, while investors in their publicly traded securities have access only to publicly available information. The discrepancy between the information available to the different categories of financier was a topic for debate long before the financial crisis, and is now no less sensitive an issue, as companies seek to finance their way through recession.

For Borrowers, the confidentiality of much of the information provided to their lending syndicates is paramount. Previous versions of the LMA documentation did not contain an express confidentiality undertaking, on the grounds that it was implied. However, as 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 an implied duty is uncertain, the LMA agreed to the ACT's proposal that an express confidentiality undertaking should be included.

The LMA focus on the topic of confidentiality gained added momentum due to the immense growth in the number of non-bank Lenders in lending syndicates, in the years leading up to the credit crunch. This in turn focussed attention on the protection of inside information provided by the market abuse and insider dealing regimes. 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 and other trade associations have published a number of papers in the last few years on the issues arising for Lenders in relation to inside information.

While in general the new confidentiality undertaking is a welcome development for Borrowers, some concerns are outlined below. The commentary below considers the confidentiality provisions in both the Investment Grade Agreement and the Leveraged Agreement. Readers may like to bear in mind that, while the changes to the Investment Grade Agreement have been discussed by the LMA and the ACT, the ACT was not consulted in relation to the Leveraged Agreement.

Duration

The confidentiality undertaking falls away 12 months after the earlier of the date when the Finance Party 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 primary syndication and secondary market confidentiality undertaking documentation for some time now, Borrowers may be concerned that it may not be long enough to protect at least some of their Confidential Information. Sensitive long term business plans and projections, for example, may need protection for a much longer period than would be covered where a Lender sells down

its participation within a few weeks of closing. The ACT has expressed the view that this period is liable to be too short from a Borrower's perspective, and the LMA acknowledge by the use of square brackets that it is subject to negotiation. The implied duty of confidentiality on which Borrowers had to rely previously did not have an end date.

Carve-outs

The list of circumstances in which disclosure of Confidential Information is permitted is much longer than that familiar to the market. Some of these changes are modernising, catering for future as well as past developments in the markets. For example, disclosure is permitted to providers of settlement services for the trading of participations, if they have signed a confidentiality undertaking.

Other carve-outs permit disclosure of Confidential Information on terms on which Borrowers may want to reflect, if not improve. Much of the devil is in the detail. For example:

- *Disclosure to Affiliates*. This category has been updated to include Related Funds as well as Affiliates, and extended to include their officers, directors, employees, professional advisers, auditors, partners and Representatives (discussed below). 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. While Borrowers may conclude that notice of confidentiality is not necessary where the recipient is already subject to confidentiality obligations, they may wish to note that those obligations are unlikely to be owed to them, and hence unlikely to be enforceable by them. They may also want to bear in mind that they would be unlikely to know of the disclosure, and have no contractual entitlement to be notified of it. Although in the previous versions of the Leveraged and Investment Grade Agreements, no conditions were attached to disclosure to Affiliates, in the pre-September 2008 LMA stand-alone forms of confidentiality undertaking 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 wish to argue that Lenders should give an undertaking along these lines, on the basis that they were able to do so previously as potential Lenders, in the context of the stand-alone undertakings.

- *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 unless - a new exception - the recipient is a professional adviser who is subject to professional obligations to maintain confidentiality. Normally, a purchaser or counterparty will not be a professional adviser, and so will be required to provide a Confidentiality Undertaking. Borrowers may however wish to bear in mind that they have no contractual entitlement to be notified of disclosures to these recipients. Protection for this category of disclosure is only optional in the Leveraged Agreement.

- *Lenders' Representatives*. The LMA have inserted a provision (Clause 26.13(d) in the Investment Grade Agreement), permitting a Lender to appoint a Representative to receive all communications in relation to the Finance Documents. This provision (mentioned above and also a feature of the Leveraged Agreement) 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 the confidentiality clause, 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 professional confidentiality obligations.

- *Disclosure to secondary market investors and financiers*. Investors and financiers of secondary market purchases are a new category of permitted recipient. 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 about the carve-out here to those mentioned above. Protection in this case is only optional in the Leveraged Agreement.

- *Disclosure to Lenders' chargees*. The Investment Grade Agreement, like the Leveraged Agreement, includes an optional provision, Clause 29.9, setting out terms protecting the Borrower where a Lender creates Security over its rights under any Finance Document (discussed above). In these circumstances, Confidential Information can be disclosed to the chargee. The protection offered (only optional in the Leveraged Agreement, see Clause 24.8) 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.

- *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. The protection is only optional in the Leveraged Agreement. 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.

- *All disclosure categories above*. 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 only on a "need to know" basis.

- *Disclosure by Lender to rating agency*. In another new, albeit optional, category of permitted disclosure, Lenders would be able 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 want to 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 would be permitted to a numbering service provider appointed by the Agent to facilitate secondary market trading. This is an optional provision which the Borrower might wish to include if it approved the appointment of a numbering service provider. The information to be disclosed would not remain confidential but would not normally be price-sensitive.

LMA primary syndication and secondary market confidentiality undertakings

Readers should note that when the LMA updated their approach to confidentiality in the Leveraged Agreement in September 2008, the primary and secondary market confidentiality undertakings were also updated to reflect the new approach. Many of the issues raised above, therefore, will also be relevant in the context of the stand-alone undertakings (in relation to which the LMA did not consult the ACT).

A couple of additional points for Borrowers in relation to the stand-alone undertakings (not arising from the recent changes):

- The Borrower's consent is not required for any alteration to the terms of the undertaking.
- A further concern is enforcement: although the intention is that the Borrower should have a right of action, it is not entirely clear how this would operate in practice.

Future changes

Further changes to the Investment Grade Agreement are anticipated in the coming months, following a separate review which the LMA and the ACT are planning, in the light of the experience gleaned during the financial crisis. In the meantime, work is progressing on a new edition of the ACT Guide to the LMA Investment Grade Agreement.