

**THE ACT BORROWER'S GUIDE TO
THE LMA FACILITIES AGREEMENT FOR
LEVERAGED TRANSACTIONS**

produced by

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THE ACT BORROWER'S GUIDE TO THE LMA FACILITIES AGREEMENT FOR LEVERAGED TRANSACTIONS

INTRODUCTION

The LMA Senior Multicurrency Term and Revolving Facilities Agreement for Leveraged Transactions (the “**Leveraged Facilities Agreement**”) was first published in 2004. It was subsequently revised in December 2005, June 2007, February 2008 and, most recently, in September 2008. The purpose of this guide is to provide an overview of the Leveraged Facilities Agreement and to highlight certain key borrower issues arising from it of which corporate treasurers should be aware.

Whilst the Association of Corporate Treasurers (ACT) is closely involved in the settlement of the terms of the LMA facility agreements for investment grade borrowers (the “**Investment Grade Documents**”), the LMA did not seek the views or comments of the ACT on the terms of the Leveraged Facilities Agreement. **The Leveraged Facilities Agreement is therefore a more lender-friendly document than the Investment Grade Documents and, importantly, is not endorsed by the ACT¹.**

The general format of the Leveraged Facilities Agreement will, however, be familiar to users of the Investment Grade Documents and certain of the “boilerplate” provisions are substantially the same. A number of these common provisions are explained in detail from a Borrower perspective in our existing ACT Guide to the LMA Documentation for Borrowers (last revised in June 2007, the “**ACT Borrower's Guide to the Investment Grade Documents**”, available from the ACT website at <http://www.treasurers.org/loandocumentation>). Relevant sections are cross-referenced in the text of this guide. Readers may also find the Introduction to Loan Finance, included in the International Treasurer's Handbook 2008 (the “**Handbook**”), useful by way of background. Appendix 2 to this guide contains a table summarising further information available to ACT members which may be helpful in relation to particular provisions of the Leveraged Facilities Agreement.

This guide is in two parts:

- **Part I** contains an overview of the Leveraged Facilities Agreement. It also contains a summary of certain key points for negotiation (which are explored in more detail in Part II).
- **Part II** is a commentary on certain key provisions of the Leveraged Facilities Agreement (and an explanation of some key omissions). It provides background to the most commonly negotiated aspects of the document and includes a series of “Borrower Notes” highlighting particular issues which Borrowers may wish to discuss with Lenders.

¹ The ACT is involved in the working party which develops the Investment Grade Documents, with the objective of balancing the interests of Borrowers and Lenders. The ACT endorses the Investment Grade Documents as a starting point for negotiations only and expects parties to negotiate changes in relation to individual transactions.

References to the Leveraged Facilities Agreement in this guide are to the version most recently published by the LMA on 26th September 2008 and terms defined in the Leveraged Facilities Agreement have the same meanings in this guide.

NOTE

This guide is written in general terms and its application to specific situations will depend on the particular circumstances involved. Whilst this guide seeks to highlight certain issues that are regularly raised by Borrowers in relation to the Leveraged Facilities Agreement, it does not purport to address every issue that Borrowers could or should raise. The guide does not attempt to describe the most Borrower-friendly approach that may be taken in relation to any particular issue. In general, the observations relating to loan market practice in the guide are drawn with mid to large size transactions in mind and 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 identity of the Borrower and its investors, the identity of the Lenders, the size of the transaction, overall leverage and market conditions. In particular the guide has largely been written in the period July to early September 2008 and does not seek to address the implications of developments in the global financial markets in mid to late September 2008.

Readers should therefore take their own professional advice when using the Leveraged Facilities Agreement. 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 loss, however caused, occasioned to any person by reliance on it.

Slaughter and May
September 2008

PART I: OVERVIEW

PART I: OVERVIEW

1. BACKGROUND TO THE LEVERAGED FACILITIES AGREEMENT

1.1 The LBO market in Europe

Before analysing the Leveraged Facilities Agreement from a Borrower's perspective, the backdrop against which it is to be negotiated should be considered briefly. During the two year period to summer 2007, investors in the European leveraged finance market saw continuing pressure on lending terms, fuelled by low interest rates, relatively low default rates and strong liquidity in the debt markets (in large part due to the increasing significance of non-bank lenders such as hedge funds, CDOs, CLOs and other types of institutional investor). Liquidity was such that many deals were oversubscribed, resulting in pricing and structural reverse flex.

During this period, financing structures evolved to meet the demands of the changing investor base. Borrowers, in particular the large private equity houses, took full advantage of the available liquidity and both lending terms and financing structures reflected their bargaining strength.

At the time of writing, this picture has changed. The market remains in the grip of a "credit crunch" triggered by the US sub-prime mortgage crisis and for larger deals in particular, available leveraged lending terms are very different from those that might have been achievable in early 2007. Pricing has gone up, deals are smaller and deal structures have become more conservative. The shift in bargaining strength has meant that Borrowers are facing resistance to some of the more aggressive positions seen whilst the bull market continued.

The events of the past 18 months illustrate the speed at which market conditions can change and the difficulty of creating a model form document which contains terms appropriate for all leveraged deals. Whilst the Leveraged Facilities Agreement has been quite widely used since its launch in 2004, it is very much a starting point for drafting. Amendments (usually quite significant) are required to reflect the agreed financing structure, the particulars of a given deal, Borrower-specific issues and those areas where the document has been outpaced by the market. It does not reflect many of the common concessions agreed by Lenders, and contains certain provisions which are almost always deleted or amended by well-advised Borrowers. This guide seeks to highlight many of these issues, whilst recognising that achievable terms are something of a moving feast.

1.2 Transaction for which the Leveraged Facilities Agreement is designed

The Leveraged Facilities Agreement is based on an assumed transaction which contains certain traditional features of a European leveraged buyout. The key features of the assumed transaction are as follows:

- the equity sponsors, the Investors, contribute "equity", (whether in the form of true equity or shareholder loans or a combination thereof), to a holding company, the Parent;
- the Parent contributes "equity" to a borrowing subsidiary, the Company;
- senior and mezzanine loans are made available to the Company for the acquisition of the Target;

- the Company acquires the Target, using the proceeds of the senior and mezzanine loans plus the proceeds of the “equity” investment;
- the Vendor of the Target agrees to defer a proportion of the purchase price for the acquisition by means of a Vendor Note issued by the Parent;
- the senior and mezzanine debt is cross-guaranteed by the Parent, the Company, the Target and (within legal limits) its Subsidiaries;
- the Senior and Mezzanine Lenders have the benefit of a shared security package held by a Security Agent;
- the Company will enter into hedging arrangements in relation to the senior and mezzanine debt, ranking pari passu;
- the Parent will issue warrants to subscribe for shares in the Parent to the Mezzanine Lenders; and
- all other sources of finance to the Parent, the Company, the Target and the rest of the Group will be subordinated to the debt owed to the Senior and Mezzanine Lenders and the Hedge Counterparties.

The Leveraged Facilities Agreement contains the terms of the senior loans funding the assumed transaction, comprising A, B and C Term Facilities plus a Revolving Facility. The assumed transaction is further illustrated in the diagram set out in Appendix 1 to this guide (replicated from the LMA User Guide to the Leveraged Facilities Agreement).

The document assumes that English law is the governing law, that the Obligors are incorporated in England and Wales and that syndication will take place in the euromarkets. Appropriate local advice will be required to adapt the document for use in relation to Obligors incorporated outside England and Wales (or non-corporate Obligors).

1.3 Use of the Leveraged Facilities Agreement for other leveraged financing structures

In a number of respects, the transaction assumed for the purposes of the Leveraged Facilities Agreement does not reflect structures commonly adopted for leveraged buyouts in the few years preceding the credit crunch, although since the onset of the credit crunch, Lenders are increasingly reverting to more traditional LBO structures. By way of example, many leveraged transactions structured prior to the onset of the credit crunch contained various layers of subordinated debt. In particular, a second lien tranche was very common and PIK notes were quite often found at the bottom of the subordination structure. Mezzanine debt was often warrantless and very often there were no Vendor Notes. The Leveraged Facilities Agreement is quite commonly used as the basis of all or parts of the facilities agreement for these more complex transaction structures, but will require amendment to reflect the agreed structure.

Refinancing of leveraged buyouts is common, often coupled with “debt pushdown” arrangements whereby the acquisition debt is novated to Target Group level (to the extent permitted by law). The Leveraged Facilities Agreement is designed to document acquisition debt, but is commonly adapted for leveraged refinancing.

1.4 Use of the Leveraged Facilities Agreement outside the LBO market

The mechanics of the Leveraged Facilities Agreement can be adapted and are used for other types of acquisition facilities and the Lender-friendly set of representations, covenants and Events of Default have increasingly been used to some degree in corporate facilities for sub-investment grade and cross-over credits. Additionally, some detailed provisions of the Leveraged Facilities Agreement, as noted below, might be considered to be more Borrower-friendly than the Investment Grade Documents. As a result, the terms of the Leveraged Facilities Agreement (and the concessions first negotiated by private equity LBO Borrowers) have had a fairly significant impact outside the LBO market and the contents of this guide are to this extent likely to be relevant to all types of credit.

Particular aspects of the Leveraged Facilities Agreement which might be of interest outside the LBO context include:

- the certain funds provisions (see Clause 4.5 (*Utilisations during the Certain Funds Period*));
- the clean-up period provisions (Clause 28.21 (*Clean-Up Period*));
- the financial covenant provisions (Clause 26 (*Financial Covenants*));
- the definitions of “**Change of Control**”, “**Material Adverse Effect**” and “**Material Company**” (see Clause 1.1 (*Definitions*));
- the Margin ratchet (Clause 1.1 (*Definitions*) and Clause 14 (*Interest*));
- the pensions-related provisions (see Clause 1.1 (*Definitions*) and Clauses 24.29, 27.26 and 28.18 (*Pensions*));
- the “yank-the-bank” clause (Clause 41.3 (*Replacement of Lenders*)); and
- the “debt buy-back” provisions (Clause 30 (*Restrictions on Debt Purchase Transactions/Debt Purchase Transactions*)).

The provisions of the Leveraged Facilities Agreement which might be considered more Borrower-friendly than the equivalent provisions in the Investment Grade Documents include:

- elements of the definition of “**Financial Indebtedness**” (see Clause 1.1 (*Definitions*));
- the carve outs to the negative pledge (Clause 27.15 (*Negative Pledge*)); and
- the qualifications to the insolvency related Events of Default (see Clause 28.6 (*Insolvency*), Clause 28.7 (*Insolvency Proceedings*) and Clause 28.8 (*Creditors’ Process*)) (although these provisions generally are still tough on Borrowers and are commonly negotiated).

1.5 The Leveraged Suite

The LMA publishes various other documents as part of its leveraged suite, each of which are designed to be used in conjunction with the Leveraged Facilities Agreement. The key ancillary documents are as follows:

- **User Guide:** The User Guide contains background information regarding the Leveraged Facilities Agreement and the assumed transaction structure. It also contains some explanatory text on selected clauses.
- **Term sheet:** The leveraged term sheet is based on the provisions of the Leveraged Facilities Agreement and therefore will also require amendment and tailoring. It is a traditional “bullet point” term sheet. Recent years have seen the increasing use of very detailed term sheets, with the bulk of negotiations on key terms taking place at the term sheet stage. The leveraged term sheet is therefore not very widely used. Most private equity sponsors have their own lengthy model form term sheets intended to ensure that deals can be documented quickly whilst at the same time securing as Borrower-friendly a set of terms as possible.

The demand for “certain funds” financing (see further Part II, Clause 4.5 (*Utilisations during the Certain Funds Period*) below) has led to some term sheets being expressed to be fundable in the event that full form documentation is not agreed by the time funding is required (typically, any terms not set out in the term sheet are expressed to be in line with the LMA model form documents or with sponsor precedent). The use of interim loan agreements in auction processes and for public bids had also become very common in the pre-credit crunch market. Interim loan agreements are shorter form loan agreements appended to the commitment letter and term sheet which provide greater certainty of funds. Lenders undertake to fund under the interim loan agreement if full form documentation is not agreed prior to the intended funding date. The intention is usually that Lenders will not be required to advance funds under the interim loan agreement, but rather that it will be replaced by full documentation prior to funding. If full form documentation is not agreed in time, and funds are advanced on the basis of the interim agreement, they will generally be required to be repaid within a short period.

- **Financial Covenants and User Guide:** Historically, the LMA resisted publishing model form financial covenant provisions on the basis that they depend too heavily on the credit and the sector concerned. This remains the case for many investment grade and asset-based financing transactions. However, the types of financial covenant and related definitions appearing in leveraged facility agreements have become increasingly predictable and therefore in October 2006 the LMA published model form financial covenant provisions for use in conjunction with the Leveraged Facilities Agreement plus a related user guide. These stand-alone provisions have now been inserted into the Leveraged Facilities Agreement and appear at Clause 26. They are discussed in some detail in Part II.

Although the LMA model form financial covenants are for use in leveraged transactions, certain of them, and in particular, the detailed definitions, may be useful for adaptation for other transactions. Recognising this, the LMA republished the stand-alone financial covenant provisions in June 2007, deleting the cross-references to provisions of the Leveraged Facilities Agreement.

1.6 Access to LMA Documentation

Printed copies of the Leveraged Facilities Agreement and related documentation can be obtained by contacting the LMA at the Loan Market Association, 10 Upper Bank Street, London E14 5JJ, Tel: +44 (0) 20 7006 6007, Fax: +44 (0) 20 7006 3423, email lma@lma.eu.com. LMA documentation is available electronically only to LMA members.

2. KEY POINTS FOR NEGOTIATION

2.1 Introduction

As is the case with all of the LMA model form documentation, the Leveraged Facilities Agreement is a non-binding recommended form. The intention is that it is used as a starting point for negotiation. Individual parties are free to depart from its terms. It will always need to be tailored and negotiated. This is a particularly important point to emphasise in relation to the Leveraged Facilities Agreement, in part due to the complexity and variety of leveraged transactions. In its User Guide to the Leveraged Facilities Agreement, the LMA stresses this: “it is impossible to use the Leveraged Facilities Agreement without amendment or additions (because of the inclusion of different options and provisions that have been left blank)”.

This section seeks to outline those aspects of the Leveraged Facilities Agreement which, in general terms, are likely to be the subject of negotiation and discussion.

2.2 Acquisition Specific Issues

There will be a number of issues related to the Acquisition which will need to be reflected in the Agreement. For example:

- **Certain funds provisions:** Certain funds provisions will be required if the financing is to be on a “certain funds” basis which, very broadly, means that for an agreed period, the only applicable drawstops are those that would be acceptable for the purposes of a public bid in the United Kingdom to which the City Code on Takeovers and Mergers (the “**Takeover Code**”) applies. Certain funds financing has become common in the financing of private acquisitions as well as public bids in recent years, particularly for auctions and private equity and similar bidders. However, the availability of certain funds financing where it is not required due to the application of the Takeover Code or similar rules may diminish in more difficult financing markets.

The Leveraged Facilities Agreement contains skeleton certain funds provisions, the detail of which will need to be agreed if required. It should not be assumed that the certain funds provisions of the Leveraged Facilities Agreement reflect terms which would be sufficient for the purposes of an offer to which the Takeover Code applies. In particular, the scope of the applicable drawstops will need to be negotiated; the drawstops set out in the Leveraged Facilities Agreement do not, in our view, reflect market norms in certain respects as to the terms of a certain funds facility. See further Clause 4.5 (*Utilisations during the Certain Funds Period*).

- **The extent to which the results of the due diligence exercise impact the provisions of the Facilities Agreement:** The due diligence in relation to the Acquisition will highlight a variety of risks and issues relating to the Target Group which Lenders are likely to want

addressed in the documentation (at least, to the extent material). The manner in which such risks are addressed is likely to be a key aspect of negotiations and is discussed further in the introductory commentary to section 8.

- ***The scope of Lenders' ability to rely on the due diligence reports provided by the Parent's advisers in relation to the Acquisition:*** Reliance letters will need to be agreed with the Report providers (see the introduction to section 8 and Schedule 2 (*Conditions Precedent*)).

2.3 Repayment, Pricing and Fees

Repayment: The repayment provisions in the Leveraged Facilities Agreement cannot be used without amendment: they provide various options and a number of blanks reflecting that they will vary from deal to deal. See Clause 10 (*Repayment*).

Margin Ratchet: The Leveraged Facilities Agreement contemplates that a Margin ratchet will apply to Facility A and to the Revolving Facility. Borrowers may seek to improve the scope and operation of the Margin ratchet. See further Clause 1.1 (*Definitions*) and Clause 14 (*Interest*).

Fees: Fee negotiations are usual on any financing. Key issues in leveraged deals are when fees are payable, the point at which commitment fees start to accrue and “no deal, no fee” arrangements. See further Clause 17 (*Fees*).

2.4 Tax provisions

Leveraged financings typically involve a wider investor base than investment grade financings, making the tax provisions and the extent of the Borrower's gross-up obligation in particular the subject of greater focus and importance. In particular, as a result of changes made to the Leveraged Facilities Agreement in 2008, Borrowers will want to consider carefully the extent of their gross-up obligations to Treaty Lenders. See Clause 18 (*Tax Gross up and Indemnities*).

2.5 Cancellation and Prepayment provisions

Flexibility of cancellation and prepayment provisions: The cancellation and payment provisions are likely to be negotiated. The Leveraged Facilities Agreement provides a variety of options for both mandatory and voluntary prepayment and cancellation. Borrowers will often seek to agree as much flexibility as possible in terms of the application of prepayment amounts as between the various tranches of debt. Additionally, the Leveraged Facilities Agreement envisages that mandatory prepayments will be paid into a holding account, which may not be acceptable to some Borrowers. See Clause 11 (*Illegality, Voluntary Prepayment and Cancellation*) and Clause 12 (*Mandatory Prepayment*).

The scope of mandatory prepayment provisions: The Leveraged Facilities Agreement provides for mandatory prepayment on a Change of Control or Flotation, out of the proceeds of disposals, out of insurance proceeds and out of claims against Report providers or under the Acquisition Documents. The limits of, and exclusions from, mandatory prepayment requirements are often quite extensive. See Clause 12 (*Mandatory Prepayment*).

Excess Cashflow sweep: The Leveraged Facilities Agreement also contemplates mandatory prepayment out of the Group's Excess Cashflow. Borrowers will often seek to limit the amount

of the Group's excess cash applied to mandatory prepayment and will be very focussed on how Excess Cashflow is defined. This issue is discussed at Clause 12 (*Mandatory Prepayment*).

2.6 Financial Covenants

Very broadly, the LMA financial covenant provisions have been quite widely accepted and in the main, are useful from both the Lender and the Borrower perspective. There are two issues in particular for Borrowers to note in relation to the financial covenants:

- **Scope:** The covenants comprise the full suite of financial covenants traditionally seen in leveraged transactions. In the period prior to the credit crunch, deals were agreed with few or very limited financial covenants. The extent to which the individual covenants apply may in certain circumstances therefore be negotiable although, at the time of writing, Lenders are seeking essentially a full set of financial covenants in most circumstances.
- **Equity cure rights:** The financial covenants do not include any equity cure rights. Such rights have become very common in the leveraged market and often a key aspect of negotiations on the financial covenants is the scope of the equity cure rights.

Aside from these two main issues, the devil is in the detail and there are a number of technical issues to consider in relation to the definitions and the operation of the covenants. A number of these points are considered at Clause 26 (*Financial Covenants*).

2.7 Scope of Representations, Undertakings and Events of Default

The Leveraged Facilities Agreement contains a very extensive list of representations, undertakings and Events of Default in Section 8. Not all of them will be appropriate for all deals and some deals will include additional tailored provisions to deal with specific aspects. Examples of key issues for Borrowers are as follows:

- **Scope of application:** Representations are given by each Obligor and many are expressed to apply to the entire Group. Obligors may want to limit the scope of particular representations, for example to apply to themselves and perhaps their Subsidiaries only or by reference to Material Companies only. The definition of Material Company (see Clause 1.1 (*Definitions*)) will need to be agreed.
- **Materiality and other qualifications:** Some of the representations, undertakings and Events of Default contain materiality and other qualifications, but there are many that do not. Appropriate qualifications, for example by reference to the relevant Obligor's knowledge or particular issues disclosed to the Lenders or to materiality, will generally be agreed. In this context, the definition of "**Material Adverse Effect**" is important (see Clause 1.1 (*Definitions*) below). The definition of Material Adverse Effect is also relevant to the MAC Event of Default (see Clause 28.19 (*Material adverse change*)) and will vary from deal to deal.
- **Exceptions, thresholds and baskets:** The restrictive covenants in the Leveraged Facilities Agreement work on the general principle that practically all significant actions of the Group are restricted, save as specified in the Agreement. The Leveraged Facilities Agreement provides skeleton definitions for the covenant exceptions (e.g. "**Permitted Acquisitions**", "**Permitted Disposals**", "**Permitted Distributions**"); the scope of the

exceptions is left for the parties to agree. Appropriate thresholds and baskets will be part of this discussion. These issues are examined at Clause 27 (*General Undertakings*).

- **Repeating Representations:** The timing of repetition and the scope of the Repeating Representations is left in square brackets. Borrowers will want to ensure that only the appropriate representations are repeated and, in particular, are likely to expect that representations dealing with a matter which is also addressed by a covenant are not repeated. See comments at Clause 24 (*Representations*).
- **Grace periods:** Grace periods will need to be agreed in relation to the Events of Default, see Clause 28 (*Events of Default*).
- **Pensions provisions:** The provisions of the Leveraged Facilities Agreement relating to pensions are very wide ranging and may not be acceptable to Borrowers as drafted. In a UK context, as a result of accounting changes, the Pensions Act 2004 and the creation of the office of the Pensions Regulator, pension fund liabilities are often a significant issue in corporate transactions. See further the pensions-related definitions in Clause 1.1 (*Definitions*) and Clauses 24.29, 27.26 and 28.18 (*Pensions*).
- **Insolvency Events of Default:** The insolvency related Events of Default are extremely wide-ranging (see Clauses 28.6 (*Insolvency*), Clause 28.7 (*Insolvency Proceedings*) and Clause 28.8 (*Creditors' Process*)) and Borrowers are likely to want to amend these.
- **COMI representation:** Whether a COMI representation is to be included at all and, if so, the terms of any COMI representation should be considered carefully: see Clause 24.28 (*Centre of Main Interests and Establishments*).
- **"Clean-up" period:** In leveraged transactions, it is very common for a "clean-up" period to be permitted post-Completion, during which time certain Defaults in relation to the Target Group will be suspended, with the intention that, the Company will remedy those Defaults within a certain agreed period. The Leveraged Facilities Agreement contemplates that a clean-up period will apply, although the clean-up provisions are likely to require negotiation. See Clause 28.21 (*Clean-Up Period*).

2.8 Control over Syndicate Composition and Consents

Control over syndicate composition: As a result of the increasing diversity and size of lending syndicates over the last few years (some leveraged transactions have quite literally involved hundreds of lenders), Borrowers have been concerned to try to secure greater control over the identity of their lenders. The Leveraged Facilities Agreement is not particularly Borrower-friendly in this respect; it provides the Parent only with the right to be consulted in relation to assignments and transfers. This issue is discussed in detail at Clause 29 (*Changes to the Lenders*). Borrowers have achieved a range of concessions in this area in recent years, although in the current market, Lenders are generally resisting most of these sorts of restrictions and insisting on considerable flexibility in relation to transfers.

Decisions requiring unanimous Lender consent: A related issue is the extent to which unanimous or other majority Lender consent is required for certain decisions. Borrowers have been making significant progress in this area in recent years to try to make securing consents and waivers easier. This can be particularly important when faced with large syndicates with a

significant proportion of non-bank Lenders. Reduced Lender voting majorities are often agreed in relation to a number of matters not reflected in the Leveraged Facilities Agreement: see Clause 41 (*Amendments and Waivers*) below. Additionally, “snooze and lose” provisions, which permit the disenfranchisement of non-responsive Lenders from particular decisions and “yank-the-bank” provisions, entitling the Borrower to replace Lenders in certain circumstances, are common.

The Leveraged Facilities Agreement includes a “yank-the-bank” clause (see Clause 41.3 (*Replacement of Lender*)) but is not a very Borrower-friendly version. A “snooze and lose” clause was added to the document in the September 2008 update (see paragraph (d) of Clause 41.2 (*Exceptions*)), but its scope will need to be agreed. These issues are discussed further at Clause 41 (*Amendments and Waivers*).

2.8 Debt Buy-back Transactions:

The purchase by Borrowers, members of the Group or related parties (e.g. private equity sponsors and their Affiliates) of participations in Facilities has become the subject of much debate in the loan markets since the onset of the credit crunch, as such transactions give rise to a number of legal and practical issues under LMA-style loan documentation. The most recent amendment to the Leveraged Facilities Agreement is the addition of Clause 30 (*Restrictions on Debt Purchase Transactions/Debt Purchase Transactions*), an optional provision which sets out the circumstances and the terms upon which (if at all), Borrowers, members of the Group and/or “**Sponsor Affiliates**” are permitted to purchase or otherwise invest in participations in the Facilities. Debt buyback transactions and the new LMA provisions are discussed in more detail at Clause 29.1 (*Assignment and Transfers by the Lenders*) and at Clause 30 (*Restrictions on Debt Purchase Transactions/Debt Purchase Transactions*).

2.9 Confidentiality

Whilst there is an established duty of confidentiality between banker and customer under English law, there is doubt as to whether the same duty applies between a Borrower and a Lender which is not a bank. In the light of the ever increasing involvement of non-bank Lenders in the loan markets in recent years, the LMA inserted an express confidentiality undertaking by the Finance Parties into the Leveraged Facilities Agreement in September 2008. This is a welcome development, but there are a number of issues for Borrowers to consider and which are likely to need to be agreed on these detailed provisions. See Clause 42 (*Confidentiality*) and related definitions.

PART II: COMMENTARY ON THE LEVERAGED FACILITIES AGREEMENT

PART II: COMMENTARY ON THE LEVERAGED FACILITIES AGREEMENT

PARTIES

The parties to the Leveraged Facilities Agreement are envisaged to be as follows:

“Parent”: The Parent is the holding company for the Group. It is party to the Agreement as a Guarantor and also acts as the Obligors’ agent (see Clause 2.3 (*Obligors’ Agent*) below) in relation to communications between the Group and the Lenders.

“Original Borrowers”: The Original Borrowers (Borrowers as at the date of the Agreement) will be listed in Part I of Schedule 1 to the Agreement. The **“Company”** is the offeror company, a Subsidiary of the Parent and the entity which will acquire shares in the Target Group. The Company will usually need to be an Original Borrower to fund the Acquisition. Other entities within the Group may need to be Original Borrowers to refinance existing debt of the Group (including the Target Group) (if relevant) and possibly to fund costs relating to the acquisition of the Target Group. If debt within the Target Group is to be refinanced using the Facilities, or if the Facilities include undrawn Facilities which are intended to be used in the future by members of the Target Group, members of the Target Group will need to be named as Borrowers. The relevant members of the Target Group will not be able to accede to the Facility Agreement as Borrowers until Completion (or shortly thereafter) so they will not be Original Borrowers.

“Original Guarantors”: The Leveraged Facilities Agreement contemplates that the Facilities will be cross-guaranteed by members of the Group. The Original Guarantors should be listed in Part I of Schedule 1. Until the Closing Date, the Company will not control the Target Group and so the only Original Guarantors will usually be the Parent and the Company. Members of the Target Group will accede to the Transaction Documents as Additional Guarantors at or shortly after Completion.

See Clause 24.25 (*Obligors*), Clause 27.35 (*Guarantors*), Clause 27.38 (*Conditions Subsequent*), Clause 31 (*Changes to the Obligors*) and Schedule 2 (*Conditions Precedent*) in relation to Guarantor coverage and accession arrangements for Additional Borrowers and Additional Guarantors.

“Obligors”: **“Obligors”** is the collective term used to refer to the Borrowers and the Guarantors.

“Arranger”: The arranging bank or banks.

“Original Lenders”: The members of the original lending group will be listed in Parts II and III of Schedule 1. The Leveraged Facilities Agreement contemplates that primary syndication of the Facilities will take place post-Closing. Syndicate composition is discussed further in relation to the assignment and transfer provisions in Clause 29 (*Changes to the Lenders*).

“Agent”: The agent bank.

“Security Agent”: It is assumed that a Security Agent will hold the Transaction Security on behalf of the Lenders. The Leveraged Facilities Agreement does not contain detailed provisions relating to the appointment and duties of the Security Agent as it is assumed that these will be contained in a separate Intercreditor Agreement. It may not be possible for a security agent to hold security on trust for all Lenders in all jurisdictions. In some jurisdictions, parallel debt

provisions may be required to enable the security to be held by a security agent. In some jurisdictions there may even be issues with parallel debt arrangements and this issue will need to be carefully analysed in the context of the jurisdictions concerned.

“Issuing Banks”: The Leveraged Facilities Agreement includes a letter of credit facility (see Clauses 6 (*Utilisation - Letters of Credit*) and 7 (*Letters of Credit*)). If the Facilities include a letter of credit facility, the bank or banks which are to issue letters of credit will need to be party to the agreement as **“Issuing Banks”**.

SECTION 1: INTERPRETATION

CLAUSE 1: DEFINITIONS AND INTERPRETATION

In this guide, many definitions are discussed in the context in which they are used in the Leveraged Facilities Agreement rather than in this Definitions and Interpretation section. Certain key definitions are discussed below.

Clause 1.1: Definitions

“Acceptable Bank”: Cash and Cash Equivalent Investments (see below) must be deposited with or issued by an **“Acceptable Bank”**. **“Acceptable Bank”** is defined by reference to credit rating or otherwise as approved by the Agent.

Borrower Notes

Borrowers may wish to consider whether the definitions of Cash and Cash Equivalent Investments should be dependent on their being deposited with or issued by an Acceptable Bank. If they are, an appropriate definition must be agreed. Borrowers should consider where the Group’s cash is held and may want to widen this definition to cover all appropriately authorised banks in relevant territories (for example, in the UK, all banks and building societies which are authorised to accept deposits under the Financial Services and Markets Act 2000) or all financial institutions duly authorised under applicable laws to carry on the business of banking. Borrowers are, in any event, likely to want to ensure that banks with which significant existing accounts of the Group are held will qualify as Acceptable Banks unless they are prepared to change those arrangements at Completion. Borrowers may also want to see Finance Parties included as Acceptable Banks.

“Accounting Principles”: This definition is discussed at Clause 24.13 (*Original Financial Statements*).

“Acquisition Costs”: The Term Facilities are usually provided in part to finance Acquisition Costs. Lenders may seek to place a cap on the maximum amount of the Acquisition Costs that can be funded using the Facilities and may require that their total amount is specified and that a breakdown is included in the Funds Flow Statement or the Business Plan. See further Clause 3.1 (*Purpose*).

“Acquisition Proceeds”: This definition is discussed at Clause 12.2 (*Disposal, Insurance and Acquisition Proceeds and Excess Cashflow*).

“Acquisition Purpose”: This definition is discussed at Clause 4.5 (*Utilisations during the Certain Funds Period*).

“Agreed Security Principles”: The Agreed Security Principles define the scope of the security package. These are set out in and discussed at Schedule 14.

“Ancillary Facility”: This definition and the other definitions relating to such facilities are discussed at Clause 9 (*Ancillary Facilities*).

“Availability Period”: This definition specifies the availability period for each of the Facilities, although the period itself is left blank, to be completed according to the transaction.

Borrower Notes

Facilities which are to be used to fund the Acquisition (the **“Term Facilities”**) need to be available from the earliest point at which amounts will be payable by the purchaser (the Company) in relation to the Acquisition.

The Facilities will need to remain available until the Acquisition has been completed in full, to allow for any phased completion arrangements or (in the context of a public offer), until the completion of any statutory “squeeze out” procedure for acquiring minority shares (for example, pursuant to sections 979-985 of the Companies Act 2006).

The Facilities will also need to remain available for a sufficient time after Completion to complete any refinancing of Target Group debt which is proposed or necessary. In many cases the Target Group’s existing debt facilities may be subject to change of control provisions which effectively means that they have to be refinanced at or about Completion.

“Base Case Model”: The Base Case Model is the financial model used to project the Group’s cashflows and financial performance during the life of the Facilities.

Borrower Notes

The definition will need to be tailored to reflect the financial model which has been produced. In particular, the definition envisages that a written business plan will form part of the Base Case Model which will not always be available, particularly on the date when the Agreement is signed. See further Clause 24.12 (*No misleading information*).

“Cash”: This term is used in the definitions of **“Current Assets”**, **“Net Finance Charges”** and **“Total Net Debt”** for financial covenant purposes (see Clause 26.1 (*Financial Definitions*)).

Borrower Notes

Elements of this definition are restrictive and this may be important in the context of calculating the financial covenants using Net Finance Charges and Total Net Debt. Borrowers may want to consider the following:

- whether to delete the requirement in the introductory paragraph that cash is held with an Acceptable Bank;
- whether currency restrictions are appropriate/necessary. Whether this is important is likely to depend on the circumstances of the Group;
- paragraph (a) of **“Cash”**, which requires that to count as **“Cash”**, cash must be repayable on demand or within a specified number of days and paragraph (d), which requires that **“Cash”** must be freely and immediately available to be applied in prepayment or repayment of the

Facilities. These provisions reflect a desire to count only cash which is immediately available to the Group or which the Group is entitled to access in a very short period of time as “**Cash**”. Borrowers may find these requirements too restrictive and may instead seek to define “**Cash**” as cash which is capable of being applied in repayment or prepayment of the Facilities within a specified time period (for example three months) without any condition other than the lapse of time and notice being given;

- whether the qualification in paragraph (c) (no security) by reference to netting or set-off arrangements entered into by members of the Group in the ordinary course of their banking arrangements should also apply to paragraphs (b) and (d) of the definition (no contingent liabilities and cash freely available). Borrowers may also argue that an additional qualification should apply in respect of “**Permitted Security**”;
- whether to refer to additional elements comprising “**Cash**”: for example, cash in transit or receivables due from debit or credit card providers may be relevant for some Borrowers.

“**Cash Equivalent Investments**”, as the name suggests, are the Group’s highly liquid investments. The definition is used within the definitions of “**Permitted Acquisition**” and “**Permitted Disposal**”, in Clause 5.7 (*Clean down*), in the definitions of “**Current Assets**”, “**Net Finance Charges**” and “**Total Net Debt**” for financial covenant purposes (see Clause 26.1 (*Financial Definitions*)) and in Clause 27.10 (*Holding Companies*) and Clause 27.34 (*Cash management*).

Borrower Notes

The LMA User Guide to the Leveraged Facilities Agreement states that this definition is “clearly one which can be subject to change depending on commercial requirements”. The definition encompasses short-term certificates of deposit, investments in marketable debt obligations backed by specified governments, certain commercial paper, sterling bills of exchange, specified money market funds or any other investments approved by Majority Lenders, in each case to which a member of the Group is beneficially entitled, free from encumbrances. Negotiations are likely to centre around the criteria applied to each category (which will vary from Group to Group). The following points, however, are of general application:

- are currency restrictions appropriate/necessary? Whether this is important is likely to depend on the circumstances of the Group;
- Borrowers may wish to extend paragraph (d) to deal with other jurisdictions;
- Borrowers may wish to include other bonds or notes with a specified minimum rating, perhaps having not more than one year to final maturity or a category of “other Cash Equivalent Investments” to capture other short-term highly rated investments which might not fall within any other category;
- some Borrowers may seek inclusion of a “basket” of investments that, whilst not meeting the specified criteria, are still permitted to count as Cash Equivalent Investments.

“Certain Funds Period” and **“Certain Funds Utilisation”**: These definitions will be relevant if the financing is to be provided on a certain funds basis. See Clause 4.5 (*Utilisations during the Certain Funds Period*).

“Change of Control”: This concept is used in Clause 12 (*Mandatory Prepayment*) and is likely to be a key definition for Borrowers and Lenders as it will determine whether changes in the ownership or control of the Group will trigger mandatory prepayment obligations.

Borrower Notes

The definition will need to be tailored to the transaction. See further Clause 12.1 (*Exit*).

“Clean-Up Date”, **“Clean-Up Default”**, **“Clean-Up Representation”**, **“Clean-Up Undertaking”**: These definitions are relevant to Clause 28.21 (*Clean-Up Period*), which provides for the suspension of certain representations, undertakings and Events of Default for a specified period after the Closing Date. The definitions are discussed further at Clause 28.21 (*Clean-Up Period*).

“Company Intra-Group Loan Agreement”: This agreement contains the arrangements for the loan of monies to the Company by members of the Target Group to enable repayment of the Facilities (if that is contemplated).

Borrower Notes

If the Target Company is English, the intra-group loan agreement may need to be whitewashed pursuant to sections 155-158 of the Companies Act 1985. The impending repeal of the Companies Act 1985 restrictions on financial assistance as applicable to private companies (due to take effect on 1st October 2008) is discussed in more detail at Clause 27.31 (*Financial Assistance*).

“Confidential Information” is discussed at Clause 42 (*Confidentiality*).

“Debt Purchase Transactions” is used in Clause 30 (*Restrictions on Debt Purchase Transactions/Debt Purchase Transactions*), the optional provision added to the Leveraged Facilities Agreement very recently in order to set out the circumstances and the terms upon which (if at all), Borrowers, members of the Group and/or **“Sponsor Affiliates”** are permitted to purchase or otherwise invest in participations in the Facilities. This definition is discussed at Clause 30 (*Restrictions on Debt Purchase Transactions/Debt Purchase Transactions*).

“Default”: A default is an Event of Default or any event or circumstance specified in Clause 28 (*Events of Default*) which, with the expiry of a grace period, the giving of notice or the making of any determination constitutes an Event of Default.

Borrower Notes

Borrowers may find the reference to the making of a determination here too vague and may, for example, wish to make clear that any such event or circumstance which requires the satisfaction of a condition as to materiality before it becomes an Event of Default shall not be a Default unless that condition is satisfied.

“Disposal Proceeds”: This definition is discussed at Clause 12.2 (*Disposal, Insurance and Acquisition Proceeds and Excess Cashflow*).

“Excess Cashflow”: Excess Cashflow is intended to comprise Cashflow not required for debt service. The definition is discussed at Clause 26.1 (*Financial definitions*) in the context of the financial covenants. The definition of Excess Cashflow also determines the level of any applicable cash sweep to mandatory prepayment (see Clause 12.2 (*Disposal, Insurance and Acquisition Proceeds and Excess Cashflow*)).

“Excluded Acquisition Proceeds”, “Excluded Disposal Proceeds” and “Excluded Insurance Proceeds” are discussed at Clause 12.2 (*Disposal, Insurance and Acquisition Proceeds and Excess Cashflow*).

“Finance Document”: This is a key definition. Breach of the terms of a Finance Document is likely to trigger an Event of Default (usually after the expiry of a grace period) and the Transaction Security will usually secure obligations of the Obligors under the Finance Documents.

Borrower Notes

Borrowers should consider on a case by case basis whether it is appropriate for the Mandate Letter to be included as a Finance Document. Many of the provisions of the Mandate Letter will be superseded by the Agreement. Syndication provisions which need to remain in effect after Closing, such as the clear market, market flex and reverse flex provisions and syndication obligations will often appear in a separate syndication side letter. See further Clause 27.37 (*Syndication*).

“Financial Indebtedness”: The definition of Financial Indebtedness follows a similar format to the definition used in the Investment Grade Documents but overall, is slightly narrower and therefore slightly more Borrower-friendly. It is surprising that the definitions are not consistent, as there is no obvious reason why the definitions should differ according to credit rating.

The definition of Financial Indebtedness is primarily used in the Leveraged Facilities Agreement in the negative undertakings (the negative pledge at Clause 27.15 and the covenants restricting loans and Financial Indebtedness (Clauses 27.18 and 28.5 respectively)) and in the cross-default Event of Default (Clause 28.5). Note also that the definition of **“Borrowings”** for financial covenant purposes (see Clause 26.1 (*Financial Definitions*)) is based on the definition of Financial Indebtedness, narrowed down in certain respects.

Borrower Notes

Moneys borrowed

Paragraph (a) sets out the primary function of the definition: any indebtedness in respect of moneys borrowed or debit balances at banks or other financial institutions.

Acceptance credits etc.

Paragraph (b) catches payment obligations in relation to any acceptance under an acceptance credit facility, or bill discounting or dematerialised equivalent.

Bonds etc.

Paragraph (c) includes the issue of bonds, debentures, medium term notes, commercial paper and so on. Paragraph (c) contains an option to exclude “**Trade Instruments**”, defined as those used in the ordinary course of the trading cycle of the issuing member of the Group. This exclusion may not be wide enough for all purposes (see also paragraph (c) of “**Borrowings**” at Clause 26.1 (*Financial Definitions*)).

Leasing

Paragraph (d) targets finance and capital leases, such as sale and leaseback or hire purchase arrangements. Under IAS 17, some leases which would have been off balance sheet under UK GAAP as operating leases, will be on balance sheet as finance leases, which may increase Financial Indebtedness under this heading in some circumstances.

Discounting or factoring on recourse terms

Paragraph (e) targets receivables discounting and debt factoring on recourse terms. Receivables discounting and debt factoring on recourse terms often takes the form of an assignment of debts, in return for which the borrower is allowed to draw funds at agreed intervals. 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 from paragraph (e) as is customary. 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.

As most “non-recourse” discounting or factoring involves recourse in certain circumstances, for example, if the receivable is not a valid receivable or the counterparty has a counterclaim or set-off right, Borrowers who contemplate non-recourse discounting or factoring may wish to clarify the meaning of non-recourse for these purposes to ensure that any proposed transactions fall within this exclusion.

Paragraph (e) contains an option to impose additional criteria on non-recourse discounting or factoring in order for it to be excluded, the satisfaction of any requirements for de-recognition

under the Accounting Principles. Borrowers may wish to resist this additional criteria if there is any concern about the extent to which non-recourse factoring may satisfy such requirements.

Derivatives

Paragraph (f) catches Treasury Transactions at either their marked-to-market value or the value of any actual amount due if terminated or closed out. “**Treasury Transactions**” comprise derivatives transactions whether their purpose is “protection” or “benefit” from movements in a rate or a price, and so the definition covers arbitrage as well as hedging. Post IFRS, the main concern about the inclusion of derivatives in the Financial Indebtedness calculation is that they introduce volatility into the calculation which does not necessarily reflect accurately the Group’s exposure: the effectiveness of the hedge and the availability of hedge accounting is not taken into account. Further, in a typical leveraged transaction, the Group is not allowed to enter into hedging arrangements for speculative purposes (see Clause 27.33 (*Treasury Transactions*)) and the hedging arrangements relating to the Facilities may well be subject to controls by the Lenders (as counterparties or affiliates of counterparties) in any event. See further Clause 27.33 (*Treasury Transactions*).

The LMA has accepted that Treasury Transactions should generally be excluded from “**Borrowings**” for financial covenant purposes (see Clause 26.1 (*Financial definitions*) below), but derivatives remain in the Financial Indebtedness definition. It is perhaps more difficult to argue that Treasury Transactions should be excluded for the purposes of the cross-default Event of Default, but if any thresholds or limits in the Agreement are defined by reference to Financial Indebtedness (for example, any agreed baskets within the definitions of Permitted Financial Indebtedness or Permitted Security), Borrowers may wish to exclude Treasury Transactions from the definition of Financial Indebtedness. If Treasury Transactions are included, Borrowers may wish to make clear that it is the net marked-to-market value/net amount due on termination that is relevant for these purposes.

Counter-indemnity obligations

Paragraph (g) captures counter-indemnity obligations in respect of bonds, guarantees, letters of credit etc. There is an optional exclusion for Trade Instruments (see comments on paragraph (c) above). Paragraph (g) contains optional wording to include specifically counter-indemnity obligations in respect of credit support for the liabilities of any member of the Group in relation to any post-retirement benefit scheme. This is most likely intended to address the situation where a member of the Group has agreed with the Pension Protection Fund (the “**PPF**”) to provide additional credit support for the liabilities of a defined benefit pension scheme within the Group for the purposes of reducing PPF levies applicable to any funding deficit. Borrowers may seek to exclude pensions-related liabilities from the Financial Indebtedness definition on the basis that they are not financial debts. This point also applies to the definition of “**Borrowings**”: see Clause 26.1 (*Financial Definitions*).

Redeemable preference shares

Paragraph (h) is an optional paragraph designed to catch redemption obligations in relation to redeemable preference shares. This paragraph is included in (and originated from) the definition of “**Borrowings**” in Clause 26.1 (*Financial Definitions*). If the Group has outstanding redeemable preference shares it is preferable to deal with them specifically in the definition of

Financial Indebtedness. The issue arises because redeemable preference shares are treated as borrowings under IFRS. If this paragraph is not included, there is a risk that all redeemable preference shares classified as borrowings under the Accounting Principles will be included as Financial Indebtedness (as a result of the catch-all in paragraph (k)). Lenders should only be concerned to include redeemable preference shares as “**Financial Indebtedness**” if the shares are redeemable prior to repayment of the Facilities. From the Borrower’s perspective, if this optional provision is used, it should be amended to limit its application to preference shares which may be compulsorily redeemed prior to repayment of the Facilities. Consideration should also be given as to whether paragraph (h) should be widened beyond redeemable shares in case the Group has any other outstanding equity instruments that may be classified as borrowings under the Accounting Principles and thus fall within paragraph (k).

Advance or deferred purchase agreements

Paragraph (i) includes amounts owed under advance or deferred purchase agreements. Borrowers should clarify that the primary reason for the transaction (rather than “one of the primary reasons”) must be to raise finance and that the transaction must be treated as a borrowing under the Accounting Principles (which is consistent with the rest of the definition of “**Financial Indebtedness**”).

Other issues

Paragraph (j) is blank for the parties to insert any other specific categories of Financial Indebtedness.

Paragraph (k) is a sweep-up provision, including as Financial Indebtedness transactions “having the commercial effect of a borrowing [or otherwise classified as borrowings under the Accounting Principles]”. “Transactions having the commercial effect of a borrowing” is probably the most commonly used formulation here without the optional reference to the Accounting Principles as an alternative test. In the interests of clarity Borrowers may prefer to refer to “borrowings under the Accounting Principles” and to delete “transactions having the commercial effect of a borrowing”. It is also advisable to make clear that the paragraph applies only to transactions of a type not mentioned in any other paragraph of the definition of Financial Indebtedness.

Paragraph (l) covers the amount of any guarantee or indemnity given in support of any of the arrangements described in the other paragraphs of the definition.

The primary purpose of the definition of Financial Indebtedness is to capture financial debt, not trade or intra group debt. Many Borrowers will therefore seek to insert a general exclusion in respect of intra-group debt and debt incurred in the course of day to day trading.

“**Funds Flow Statement**”: This is the document which will set out the sources and uses of financing for the Acquisition, both debt and equity.

“**Group**” and “**Subsidiary**”: These definitions reflect the equivalent provisions in the Investment Grade Documents save for the reference to the Target. The Agreement contemplates that the parties will select an appropriate definition of Subsidiary, choosing between the statutory

definitions of a “subsidiary” and a “subsidiary undertaking”. Borrowers will be aware that a “subsidiary undertaking” includes a wider range of entities than a “subsidiary” (which remains the case under the Companies Act 2006). The importance of the definition of Subsidiary in the context of the 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.

Borrower Notes

Lenders may argue that any subsidiary undertaking should be included in the “**Group**” for the purposes of the Agreement, as its accounts are required to be consolidated with those of the parent undertaking. Borrowers may argue that whilst this may be appropriate for the purposes of the information and financial covenants, it does not follow that the subsidiary undertaking should have to be included in the Group for the purposes of all of the representations, covenants and Events of Default, in particular where the Parent or the Company has subsidiary undertakings over which it cannot exercise full control.

Borrowers commonly seek to amend the definition of Group to provide expressly that the Target and its Subsidiaries will only be included as part of the Group from the Closing Date (or perhaps the first Utilisation Date). It is also advisable to make clear that the Target will not be treated as a Subsidiary of the Company prior to such date. This is important for the purposes of the representations and covenants in the Agreement, which, to the extent they apply to the Target and its Subsidiaries, should only apply from Completion. This issue is discussed further at Clause 24 (*Representations*).

“**IFRS**”: This definition is discussed at Clause 24.13 (*Original Financial Statements*).

“**Insurance Proceeds**” is discussed at Clause 12.2 (*Disposal, Insurance and Acquisition Proceeds and Excess Cashflow*).

“**Information Memorandum**” and “**Information Package**” are discussed at Clause 24.12 (*No misleading information*).

“**Intellectual Property**”: This definition is used in the representation and covenant relating to Intellectual Property in the Leveraged Facilities Agreement (see Clause 24.23 (*Intellectual Property*) and Clause 27.29 (*Intellectual Property*)).

Borrower Notes

In September 2008, the definition of “**Intellectual Property**” in the Leveraged Facilities Agreement was amended to include intellectual property rights which “may now or in the future subsist”. Borrowers should delete the reference to future rights on the basis that it is not possible to give a representation or to comply with an undertaking in relation to Intellectual Property Rights which may not (at the time the representation/covenant is tested) exist.

“**Intercreditor Agreement**”: In order to record and protect the Finance Parties’ agreement as to

the ranking and priority of the Facilities, the Finance Parties and all other lenders to the Group will usually enter into an Intercreditor Agreement.

Borrower Notes

It is understood that the LMA is working on a model form of intercreditor agreement for use in conjunction with the Leveraged Facilities Agreement. The timetable for publication is not currently known.

“Investors”: The Investors are the ultimate owners of the Parent and their transferees and assignees. They may be private equity funds. They are not usually party to the Finance Documents (and will usually want to avoid assuming obligations under the Finance Documents) except that they may be party to the Intercreditor Agreement to effect the subordination of any shareholder debt or to a letter dealing with what happens to the proceeds of claims made by the Investors against the providers of the Reports.

“Key man policy”: This optional provision is relevant for the purposes of paragraph (d) of the covenants relating to insurance cover in Clause 27.25 (*Insurance*), which require such cover to be taken out or maintained.

Borrower Notes

This definition contemplates that the **“Key man policies”** will be in a form and with an insurer reasonably acceptable to the Agent. If these concepts are retained, Borrowers will need to ensure that this definition reflects the commercial agreement on the terms and scope of such cover (if any).

“Legal Reservations”: This definition is discussed at Clause 24.3 (*Binding obligations*) below.

“Major Default” and **“Major Representation”**: These terms define the drawstops applicable during the Certain Funds Period. They are discussed at Clause 4.5 (*Utilisations during the Certain Funds Period*).

“Majority Lenders”: This definition is discussed at Clause 41.1 (*Required consents*).

“Margin”: The Margin applicable to many leveraged facilities will be subject to a ratchet dependent on a specified financial ratio, usually the leverage ratio. The definition of Margin includes an optional ratchet which provides for the Margin to change according to certain financial ratios.

Borrower Notes

There are a number of issues for Borrowers to consider in relation to this provision:

- The Margin ratchet as drafted is expressed only to apply to the Facility A and the Revolving Facility. The reason for this is that the sorts of non-bank Lender to whom Facilities B and C appeal will generally want to know what the pricing and therefore their return on these

Facilities will be whilst they remain outstanding. Notwithstanding this, it has become common for the Margin ratchet to extend to Facility B. The Margin ratchet will generally not extend to Facility C.

- The Margin ratchet will often not apply until the expiry of a specified period, for example, twelve months after Completion.
- Borrowers may wish to be able to obtain the benefit of any increase or decrease in the Margin with effect from the date of the relevant Compliance Certificate. As drafted, the Borrower is only given the benefit of any applicable Margin reduction with effect from a specified number of Business Days after the Compliance Certificate or the beginning of the next Interest Period.
- The drafting contemplates a retrospective upwards adjustment to the Margin for a particular period if the annual audited accounts do not confirm the basis for any reduced Margin applied during the period. This is a common provision. Borrowers should seek reimbursement if the audited accounts confirm that a lower Margin should have applied. This is commonly achieved via a reduction in future interest payments. This is discussed further in relation to paragraph (b) of Clause 14.2 (*Payment of Interest*).
- Optional paragraph (iv) provides for the Margin to revert to the highest level whilst a Default or Event of Default is continuing. Borrowers will generally want to see Event of Default rather than Default specified here.
- Borrowers will generally want to delete the limitation in paragraph (ii) that the Margin can only move by one level on each reset date.

As noted in the LMA's User Guide, tax advice should be sought on the implications of a Margin ratchet.

“Material Adverse Effect”: This is an important definition as the term is used as a qualification to many provisions in the Leveraged Facilities Agreement, in particular, many of the representations, undertakings and Events of Default.

This is quite a Lender-friendly definition as framed:

- the existence of a **“Material Adverse Effect”** is determined in the reasonable opinion of the Majority Lenders;
- the definition includes the “prospects” of the Group in paragraph (a);
- it includes all obligations of the Obligors under the Finance Documents in paragraph (b); and
- it includes a material adverse effect on the validity, enforceability, effectiveness and ranking of the Security and the Finance Documents in paragraph (c).

Borrower Notes

The definition of “**Material Adverse Effect**” will often be negotiated down to something much narrower. For example:

- Borrowers commonly delete the subjective element of this test. It is rare to see an opinion of the Majority Lenders referred to in this definition, certainly in larger deals (although it is sometimes incorporated in the terms of a MAC Event of Default: see Clause 28.19 (*Material adverse change*)).
- Borrowers may seek to delete paragraph (a) in its entirety or to merge paragraph (a) with paragraph (b) so there will only be a Material Adverse Effect if there is a material adverse effect on the business, operations etc. of the Group which in turn affects the ability of the Obligors (taken as a whole) to perform their payment obligations under the Finance Documents or, possibly, to comply with the financial covenants. This amendment became quite common before the credit crunch, but is more difficult to achieve currently.
- There is a good argument that an event which would have a Material Adverse Effect if uninsured or otherwise covered by a claim against some third party should not be treated as having a Material Adverse Effect to the extent that any loss is covered by the proceeds of insurance or some other claim (for example a claim against the Vendor under the Acquisition Documents). This argument is often accepted by Lenders, although clearly the proceeds of any such claim are only useful to the extent that the claim is likely to succeed and the provider of such proceeds is creditworthy. A related point Borrowers may wish to make is that equity commitments provided by shareholders to deal with the consequences of an event which would otherwise have a Material Adverse Effect should be treated in the same way.
- Lenders often resist deletion of paragraph (c), a material adverse effect on the validity and enforceability of the Finance Documents and the rights and remedies of the Finance Parties. Borrowers might argue in response that the invalidity or unenforceability should be required to have an impact on the Lenders being repaid (or on the financial covenants) in order to qualify as having a Material Adverse Effect. A compromise might be to provide that as well as the effect being materially adverse in terms of validity and enforceability, it must be materially adverse to the interests of the Lenders under the Finance Documents.

“**Material Company**”: This is a key definition from the Borrower’s perspective as it can be used to limit the scope of provisions (representations, covenants and Events of Default) which otherwise would apply to all members of the Group. The Leveraged Facilities Agreement contemplates, as optional drafting, that the scope of the following provisions might be limited to Material Companies: the provisions defining which members of the Group are required to be Guarantors (Clause 24.25 (*Obligors*) and Clause 31.4 (*Additional Guarantors*)), the requirement to deliver solus financial statements for Group companies (Clause 25.1 (*Financial statements*)), the undertaking in relation to service contracts (Clause 27.28 (*Service contracts*)) and certain Events of Default (Clause 28.8 (*Creditors’ process*) and Clause 28.12 (*Change of ownership*)).

The list of Material Companies which qualify as such at the date of the Agreement is usually agreed and included as a Schedule (see Schedule 13). Going forward, the LMA drafting

envisages that the identity of the Material Companies will be confirmed in the Compliance Certificates (see Clause 25.2 (*Provision and contents of Compliance Certificate*)).

Borrower Notes

- Borrowers may wish to delete paragraph (c)(i) which establishes a list of companies as Material Companies. Its effect is that companies on the list will be Material Companies throughout the life of the Facilities regardless of whether they satisfy the EBITDA/asset threshold in paragraph (c)(ii).
- Paragraph (c)(ii) defines “**Material Companies**” by reference to an agreed percentage threshold of EBITDA, gross assets, net assets or turnover. This paragraph is sometimes amended to refer only to a test based on EBITDA and gross assets and qualification is usually based on a percentage threshold, for example, members of the Group whose EBITDA/gross assets comprise 5%, 7.5% or 10% of the Group’s total EBITDA/gross assets will be Material Companies.
- Borrowers will often resist the requirement in this definition for qualification as a Material Company to be certified by the Group’s auditors. This requirement is an additional cost for the Borrower and the auditors are unlikely to be willing to certify Material Companies in these terms, although they may be willing to comment on the extraction of numbers from the relevant accounts used for the purposes of arriving at a list of Material Companies.

“**Original Financial Statements**”: This definition is discussed at Clause 24.13 (*Original Financial Statements*).

“**Pensions Regulator**”, “**Contribution Notice**” and “**Financial Support Direction**”: These definitions are used in the pensions related provisions of the Leveraged Facilities Agreement, inserted into the document in 2005, when, in the UK context, defined benefit pension liabilities were pushed to the fore in corporate transactions as a result of the Pensions Act 2004 (the “**Pensions Act**”). The Pensions Act created the office of the Pensions Regulator, empowered to take action in relation to underfunded pension schemes, including requiring support for schemes from recipients of a Contribution Notice or a Financial Support Direction.

As a result of the Pensions Act and the impact of FRS17/IAS19, Lenders and Borrowers are likely to focus closely on any defined benefit pension liabilities within the Target Group. The Company will need to ensure that appropriate pensions due diligence is undertaken and that contractual protection is sought in the Acquisition Agreement in relation to defined benefit pension liabilities. Borrowers need to be aware of the legislative background to these issues. A brief outline is set out below. These issues are discussed further in context at Clauses 24.29 (*Pensions*), 27.26 (*Pensions*) and 28.18 (*Pensions*).

The significance of defined benefit pension liabilities

As mentioned above, defined benefit pension liabilities can now be a key aspect of due diligence in leveraged transactions. Pension scheme trustees and the Pensions Regulator are now often involved in negotiations, as they will be concerned to ensure that the proposed

increase in leverage and the security granted will not have an adverse impact on the rights of the (normally unsecured) pensions creditor. In a number of high profile transactions, defined benefits pension liabilities have resulted in additional contributions to the pension scheme being agreed to enable the transaction to go ahead. In some transactions, the pensions creditor has been granted rights to share in the security package or extracted other forms of credit support from the employer Group.

Borrower Notes

Pensions related provisions vary from deal to deal. There is not yet any accepted market practice, despite the representation (see Clause 24.29), covenant (see Clause 27.26) and Event of Default (see Clause 28.18) in the Leveraged Facilities Agreement. Requirements will primarily depend on the extent of any Target Group defined benefit pension scheme liabilities:

- if there are no defined benefit pension schemes, Lenders may require a simple representation to that effect to confirm the due diligence (see Clause 24.29);
- if defined benefit pension schemes exist:
 - the level of any applicable deficit must be determined;
 - the parties will need to consider, in conjunction with the pension scheme trustees, what action (if any) is to be taken in relation to the deficit in advance of the transaction, including the extent to which the Pensions Regulator should be involved (see “*Applications for Clearance*” below); and
 - Lenders are likely to seek contractual protection in respect of any deterioration in pension scheme funding (see Clauses 27.26 and 28.18 below).

Pensions Act 2004 – Moral Hazard provisions

The “Moral Hazard” provisions of the Pensions Act empower the Pensions Regulator to impose liability for defined benefit pension scheme deficits upon persons “connected” or “associated” with the scheme employer in certain circumstances. The definition of “connected” or “associated” for these purposes is very wide and can extend potential liability beyond a corporate group and through chains of one-third controllers. Companies can become connected with each other by virtue of sharing common directors for example. Lenders are likely to be keen to ensure that no such liabilities are likely to be imposed on the Group during the life of the Facilities.

Liability under the Moral Hazard provisions is imposed by means of a “**Contribution Notice**” or a “**Financial Support Direction**”.

Contribution Notices

Contribution Notices are aimed at persons who deliberately seek to avoid, reduce or render irrecoverable a statutory debt which was, or might become, due from the scheme employer under s75 of the Pensions Act 1995. A “s75 debt” calculated on the buy-out basis arises, in

broad terms, when a pension scheme is wound up, when a scheme employer enters insolvency proceedings or when an employer leaves a multi-employer scheme (which could be relevant on an acquisition of a Target Company which participates in a Vendor-retained group scheme). For the Pensions Regulator to impose liability via a Contribution Notice, it must be reasonable for it to do so and deliberate action (or inaction) is required on the part of the recipient. Hence, the bar is quite high in terms of when liability will be imposed and the Contribution Notice provisions have in practice been of limited significance to bona fide commercial transactions.

Financial Support Direction

A Financial Support Direction requires financial support of some kind (most likely a guarantee) to be provided to the relevant pension scheme by the recipient if any scheme employer is a service company or has insufficient resources to support the scheme (that is, does not have sufficient resources to meet 50 per cent. of its share of the “buy-out” deficit in circumstances where one of the “connected” or “associated” persons would have sufficient resources to make up the difference). The Pensions Regulator is required to consider the reasonableness of imposing such liability before serving a Financial Support Direction. No deliberate action or inaction on the part of the recipient is required: the key determinant is likely to be that the pension scheme is underfunded to the relevant extent and that a “connected” or “associated” person with sufficient resources to improve the situation exists.

Applications for Clearance

Parties to corporate transactions concerned about the potential impact of these provisions have made extensive use of the clearance procedure under sections 42 and 46 of the Pensions Act. The clearance procedure involves a request to the Pensions Regulator for confirmation that the occurrence of the events in respect of which clearance is requested will not result in any exercise of the Pensions Regulator’s powers under the Moral Hazard provisions.

The Pensions Regulator has issued guidance on the circumstances in which clearance may be appropriate, which has recently been revised. The publication of the revised guidance (which was not intended to result in a change in practice, but rather to update the previous guidance and bring it into line with existing practice) reflects, amongst other matters, a statement by the Pensions Regulator in May 2007. In the May 2007 statement, the Pensions Regulator indicated that highly leveraged transactions should be considered for clearance regardless of the funding position of the relevant pension scheme. In addition, it urged pension trustees to consider whether to seek additional funding support in such circumstances, in excess of FRS17/IAS19 requirements. This may result in an increased number of applications for clearance, or at least in pension trustees pushing more strongly for increased funding or a share in the security package on a leveraged transaction.

The Pensions Regulator’s guidance on clearance applications is available from the Pension Regulator’s website, www.thepensionsregulator.gov.uk.

Borrower Notes

The issue of clearance under the Pensions Act is not currently reflected in the Leveraged Facilities Agreement (as it is a voluntary rather than a mandatory process) but will need to be

considered on a case by case basis.

On 14th April 2008, the Department for Work and Pensions (the “DWP”) announced its intention to widen the scope of the Pensions Regulator’s “Moral Hazard” powers. A consultation document was published on 25th April 2008. The key proposed changes are as follows:

- the extension of the Pensions Regulator’s power to issue Contribution Notices to include cases where the effect of an act (or series of acts or a “course of conduct”) is materially detrimental to a scheme’s ability to pay members’ current and future benefits;
- the removal of the existing provisions of the Pensions Act which prevent Contribution Notices being issued where a party has acted in good faith; and
- the amendment of the criteria for the imposition of Financial Support Directions, to ensure that the resources of the whole group of companies may be considered when there is an under-resourced employer, rather than the Pensions Regulator being required to identify one single “person” which is sufficiently resourced.

Perhaps most significant are the proposed changes to the Contribution Notice regime, which mean that the Pensions Regulator will not have to demonstrate deliberate intent in the context of issuing a Contribution Notice. This is the reason for the inclusion of a new statutory defence as part of the proposals in relation to Contribution Notices, which will apply if a party can demonstrate that it could not reasonably have foreseen that its action would have a materially detrimental effect on the security of members’ benefits.

The DWP’s original intention was that the proposed changes, when (and if) enacted, should have retrospective effect to the date of the April announcement, which caused great concern amongst parties to corporate and financing transactions (apart from the “course of conduct amendment” which will be effective back to 27th April 2004). The DWP has since recognised the uncertainty that this could create in a statement published on 25th April 2008, although the terms of the statement are such that it is questionable how much comfort can be drawn from it.

The text of the draft legislation is not available at the time of writing. Parties “connected” or “associated” with a defined benefit scheme, or who will or expect to become so “connected” or “associated” with such a scheme, should take advice on the current status of the law in this potentially significant area.

“Notifiable Events”

The final aspect of the Pensions Act that should be noted is the requirement for scheme employers and scheme trustees to provide information to the Pensions Regulator upon the occurrence of specified “notifiable events”. The “notifiable events” regime is intended to provide the Pensions Regulator with an early warning as to the existence of events which could impact the pensions creditor. Notifiable events include a deterioration in credit rating of the scheme employer and a breach of applicable covenants.

Borrower Notes

The detail of the Notifiable Events regime is beyond the scope of this guide, but Borrowers should be aware of and take advice in relation to these potential notification obligations when entering into a leveraged transaction involving a Group with defined benefit pension scheme liabilities.

“Permitted Acquisition”, “Permitted Disposal”, “Permitted Distribution”, “Permitted Financial Indebtedness”, “Permitted Guarantee”, “Permitted Joint Venture”, “Permitted Loan”, “Permitted Payment”, “Permitted Security” and “Permitted Share Issue”: These definitions are used as exceptions to the general undertakings in Clause 27 (*General Undertakings*) and are discussed in detail in relation to the undertaking (or undertakings) to which they relate.

Borrower Notes

These are key definitions which shape the scope of the restrictive covenants in Clause 27 and are usually heavily negotiated - they must be tailored to the relevant transaction.

“Permitted Transaction”: This definition is used as an exception to various restrictive covenants and Events of Default.

Borrower Notes

According to the LMA User Guide, the definition of **“Permitted Transaction”** is intended to capture transactions required for the ongoing business of the Group, which will be excepted from the restrictive covenants.

Borrowers should note that the general exception in paragraph (c), is limited. It applies only to transactions in the ordinary course of trading on arms’ length terms, and does not apply to permit disposals, the granting of Security or the incurrence of Financial Indebtedness. The concept of transactions in the “ordinary course of trading” is likely to include disposals of stock and the acquisition of raw materials, for example, but it may not usually include acquisitions or disposals of fixed assets, companies or businesses particularly if these are relatively unusual events for the Group. The concept of transactions in the “ordinary course of business” is wider. The usefulness of this provision is therefore likely to be limited, and Borrowers will need to focus on the definitions of Permitted Disposal, Permitted Security and Permitted Financial Indebtedness to ensure appropriate exceptions are agreed.

The remaining paragraphs of this definition relate to transactions arising under the Finance Documents, group reorganisations, payments and transactions contemplated by the **“Structure Memorandum”** (which will usually set out the debt and equity structure for the financing).

The scope of this definition will need to be negotiated in conjunction with the other covenant exceptions referred to above.

“**Recovery Claims**” are discussed at Clause 12.2 (*Disposal, Insurance and Acquisition Proceeds and Excess Cashflow*).

“**Related Fund**”: This definition was added as part of the September 2008 package of amendments which acknowledge that certain Lenders are not banks with a typical corporate structure and “**Affiliates**”. The definition operates as an exception to the requirement for Lenders to consult with the Parent on transfer/assignment and to pay a transfer fee (see Clause 29.2(a)(ii) (*Conditions of assignment or transfer*) and Clause 29.3 (*Assignment or transfer fee*)): Lenders who are funds can transfer their participations to Related Funds. The commitments of Related Funds will also be aggregated with the transferring Lender’s on a sale of part to determine whether the minimum hold requirement is satisfied (see paragraph (c) of Clause 29.2). Disclosure of Confidential Information to Related Funds is also permitted (see Clause 42 (*Confidentiality*)).

“**Relevant Jurisdictions**” is discussed at Clause 24.6 (*Validity and admissibility in evidence*).

“**Reliance Parties**” is discussed in the definition of “**Reports**” below.

“**Repeating Representation**” is discussed in the introductory commentary to Clause 24 (*Representations*) and at Clause 24.32 (*Times when representations made*).

“**Reports**”: These are the due diligence reports prepared for the purposes of the Acquisition for the Investors by their advisers. They are referred to at a number of points in the Leveraged Facilities Agreement. The Reports will usually be delivered to the Lenders and, in a European context, the Lenders will usually be entitled to rely on them subject to limitations (including often caps on liability) pursuant to reliance letters which are to be provided as conditions precedent (see Schedule 2 (*Conditions Precedent*)). Proceeds of claims against Report providers are likely to be required to be applied to mandatory prepayment (see Clause 12.2 (*Disposal, Insurance and Acquisition Proceeds and Excess Cashflow*)). The content of the Reports may also operate to qualify the representations in the Agreement (see Clause 24 (*Representations*)).

Borrower Notes

The definitions of each Report (see “**Accountants’ Report**”, “**Environmental Report**”, “**Insurance Report**”, “**Legal Due Diligence Report**”, “**Market Report**”, “**Pensions Report**”, “**Certificates of Title/Reports on Title**” and “**Structure Memorandum**”) refer to the Report being in a form “capable of being relied upon by the “**Reliance Parties**”.

This definition was inserted into the document in September 2008. The “**Reliance Parties**” are defined as “the Agent, the Arranger, the Security Agent, the Issuing Bank, each Hedge Counterparty, each Ancillary Lender, each Original Lender and each person which becomes a Lender as part of the primary syndication of the Facilities”. The definition of “**Reliance Parties**” is an acknowledgment by the LMA that market practice is to limit reliance on the Reports to Lenders who become Lenders as part of the primary syndication process.

However, the definition of “**Reliance Parties**” may still be too wide to be acceptable to Report-providers, as it is contemplated that reliance extends to the Agent, Arranger, Issuing Bank, Security Agent and each Ancillary Lender from time to time. Report providers will commonly

permit reliance only by the mandated lead Arrangers, Lenders who become Lenders prior to the Syndication Date as part of the primary syndication process and the Agent and Security Trustee on behalf of those Lenders.

“**Representatives**” is discussed in Clause 42 (*Confidentiality*).

“**Sponsor Affiliates**” is used in Clause 30 (*Restrictions on Debt Purchase Transactions/Debt Purchase Transactions*), the optional provision added to the Leveraged Facilities Agreement very recently in order to set out the circumstances and the terms upon which (if at all), Borrowers, members of the Group and/or Sponsor Affiliates are permitted to invest in participations in the Facilities. This definition is discussed at Clause 30 (*Restrictions on Debt Purchase Transactions/Debt Purchase Transactions*).

“**Structural Intra-Group Loan**”: This is not to be confused with the Company Intra-Group Loan used for upstreaming cash for debt service described above. “**Structural Intra-Group Loans**”, as noted in the LMA’s User Guide, are those loans made by the Parent to the Company and any other loans made by members of the Group as part of the distribution of the sums to be used at Completion to pay the purchase price for the Acquisition and for the refinancing of any debt to be made at that time and other permanent intra-group funding arrangements to be subordinated under the Intercreditor Agreement.

“**Subsidiary**”: See comments above in relation to the definition of “**Group**”.

“**Syndication Date**” is discussed in the context of Clause 24.12 (*No misleading information*).

“**Termination Date**”: This is the final maturity date for each of the Facilities, which is left blank for the parties to insert. Termination Dates vary but common maturities in the European market are 7 years for Facility A, 8 years for Facility B and 9 years for Facility C. Second lien debt often has a 9.5 year maturity. Maturities for capital expenditure and acquisition facilities vary but they will commonly follow Facility A. The Revolving Facility usually matures on the same date as Facility A.

“**Trade Instruments**”: See comments in relation to paragraph (c) of the definition of “**Financial Indebtedness**” above.

“**Transaction Security**” and “**Transaction Security Documents**”: In a leveraged transaction, Lenders will usually seek the most extensive security package they can obtain within legal and practical limits. Implementation of the security package is usually phased. Prior to the Closing Date, the only security that the Group is able to provide is usually security over the shares in the Company and over the Company’s rights under the Acquisition Documents. From the Closing Date, security over shares in the Target will then usually be granted to the Lenders. Generally, within an agreed period following the Closing Date, the remainder of the Transaction Security will be provided by reference to a set of Agreed Security Principles (see Schedule 14) although it is sometimes possible for the Lenders to require security to be in place at Closing, in which case, in a UK context financial assistance whitewashes will also need to be undertaken at Closing (in relation to financial assistance given prior to 1st October 2008, see further Clause 27.31 (*Financial Assistance*) where the impending repeal is discussed in more detail). It is important that the Agreement clearly indicates the scope of the Transaction Security and the

timetable for implementation. This is discussed further below at the appropriate points in the Agreement: Clause 27.38 (*Conditions subsequent*), Schedule 2 (*Conditions Precedent*) and Schedule 14 (*Agreed Security Principles*).

“**Treasury Transactions**” comprise derivatives contracts, entry into which is usually restricted in leveraged facility agreements. See further Clause 27.33 (*Treasury Transactions*). This definition is also used in the financial covenants (see Clause 26 (*Financial Covenants*)).

Clause 1.2: Construction

This clause contains a variety of further defined terms used throughout the Agreement.

Borrower Notes

“**agreed form**”: Borrowers may wish to amend this definition so that it refers to documents either that are in a form initialled by or on behalf of the Parent and the Agent on or before signing of the Agreement or otherwise in a form in substance satisfactory to the Agent (acting reasonably) and initialled by or on behalf of the Agent for the purposes of identification or in a form set out in the schedule to the Agreement.

“**guarantee**”: the definition of “**guarantee**” is very wide. From the Borrower’s perspective, the main impact of this broad definition is on the scope of the covenants restricting guarantees (Clause 27.19 (*No guarantees or indemnities*)) and the provision of credit support for joint ventures (Clause 27.9 (*Joint ventures*)). Borrowers should bear this definition in mind when negotiating the exceptions to these covenants, including the scope of the definition of “**Permitted Guarantees**”.

“**regulation**”: Borrowers may wish to qualify the reference to any “request or guideline (whether or not having the force of law)” in this definition by including reference to something like “but if not having the force of law with which it is the practice of the relevant person to comply”.

“**continuing**”: Borrowers will want an Event of Default to be defined as continuing if it has not been remedied or waived. The issue of whether or not an Event of Default is continuing arises, for example, in Clause 28.20 (*Acceleration*), where the Agent has the discretion to declare all the Loans immediately due and payable, if there is an Event of Default which is continuing. If “**continuing**” is defined narrowly to mean that the Event of Default has not been waived, then the fact that it may have been remedied will not assist the Borrower, 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 generally unacceptable to Borrowers. Utilisations are likewise dependent on there being no Default which is continuing (Clause 4.2 (*Further conditions precedent*)) and whether an Event of Default is continuing may have an impact on the Lenders’ ability to assign or transfer participations without Borrower-side input (see paragraph (a)(iii) of Clause 29.2 (*Conditions of assignment and transfer*)). Borrowers usually obtain the more favourable version of the definition.

Borrowers may also wish to make reference in this definition to Events of Default in respect of the financial covenants being cured in accordance with any equity cure rights or deemed remedy provisions (see further Clause 26 (*Financial Covenants*) below).

“repaying or prepaying” and **“cash cover”**: See comments at Clause 7.1 (*Immediately Payable*) and Clause 17.5 (*Fees payable in respect of Letters of Credit*).

Clause 1.3: 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 (a “third party”) 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 CRTPA is not mandatory, and accordingly the Agreement offers a choice. The first option excludes the CRTPA completely: this is likely to 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, but contemplates an exemption where expressly provided to the contrary in the Finance Documents. In terms of the Agreement, this may operate to permit employees of the Agent etc. to enforce Clause 32.9 (*Exclusion of liability*) directly.

SECTION 2: THE FACILITIES

CLAUSE 2: THE FACILITIES

Clause 2.1: The Facilities

The Facilities comprise A, B and C Term Facilities and a Revolving Facility. The Revolving Facility incorporates a letter of credit facility and Ancillary Facilities (see Clause 9 (*Ancillary Facilities*) below). In this respect, the Leveraged Facilities Agreement reflects the traditional senior debt structure often seen in the European leveraged market.

Borrower Notes

Leveraged facilities may incorporate other types of facility and other tranches of debt not contemplated in the Leveraged Facilities Agreement. For example, many leveraged facilities entered into over the last few years have included a second lien tranche or “stretched senior” which, in the European context, is commonly documented in the senior facilities agreement. Second lien can be attractive to Borrowers as it is cheaper than mezzanine debt and can enable leverage multiples to be pushed upwards. The second lien tranche is usually structured as “Tranche D” and ranks *pari passu* with the senior debt in terms of payment, but ranks after the senior debt on enforcement. Since the onset of the credit crunch much less second lien debt is being seen in new deals as arrangers revert to the more traditional LBO structures.

If the Group’s Business Plan contemplates capital expenditure and/or bolt-on acquisitions being made which cannot be financed out of cashflow, Borrowers often seek to incorporate dedicated funding for these purposes as part of the Facilities. Lenders will usually subject such facilities to quite tightly defined purposes.

Capital expenditure facilities are usually multiple advance term facilities which may or may not amortise. Drawings conditions vary, but utilisation might be subject to agreement with the Lenders as to the application of the advance, or to application of the advance to pre-agreed capital expenditure as set out in the Business Plan. Advances may also be subject to the Group’s continuing compliance with financial ratios and/or the Business Plan or other conditions.

Acquisition facilities are likewise usually multiple advance term facilities and will usually amortise on a similar basis to Facility A. Drawings are often subject to satisfaction of pre-agreed acquisition criteria, which vary but might include the Borrower being able to demonstrate to Lenders that the financial covenants will continue to be complied with following the acquisition, or the provision of due diligence materials to the Lenders. If bolt-on acquisitions are contemplated, Borrowers should ensure that an appropriate mechanism for including the results of the acquired entity in the financial covenant calculations is included in the Agreement (see Clause 26 (*Financial Covenants*)).

Clause 2.3: Obligors’ Agent

These provisions appoint the Parent as the Obligors’ Agent in relation to the Facilities, enabling the Parent to give notices and instructions on behalf of the other Obligors and giving the

Lenders a sole point of contact with the Obligors. Note that these provisions will not work in all jurisdictions and/or may need to be modified for particular jurisdictions. Local advice will need to be taken on this.

CLAUSE 3: PURPOSE

Clause 3.1: Purpose

This provision sets out the purposes to which each of the Facilities may be applied.

Paragraph (a) contemplates that the Term Facilities will be applied towards payment of the purchase price for the Acquisition, the Acquisition Costs and the refinancing of any indebtedness of the Target Group as described in the Funds Flow Statement (which the Agreement contemplates being provided as a condition precedent document).

Paragraph (b) provides that the proceeds of the Revolving Facility are to be applied for general corporate and working capital purposes. Sometimes this Clause will preclude specifically the Borrowers from using the Revolving Facility towards financing acquisitions of companies, businesses or undertakings and the Leveraged Facilities Agreement contains optional wording to this effect.

Borrower Notes

- Much of this Clause 3.1 is in square brackets reflecting that it will need to be tailored to reflect the circumstances of the relevant transaction.
- An issue that is sometimes debated is the scope of the costs to be financed from the proceeds of the Term Facilities:
 - Lenders will often seek to place a cap on the costs they are to fund.
 - The inclusion of costs and expenses payable to the Investors such as deal fees can sometimes require negotiation, Lenders generally being wary of the extent to which funding they provide is used to pay such amounts.
 - If proceeds of the Facilities are to be applied to refinance indebtedness of the Target Group, Borrowers will want to ensure that any refinancing costs and fees (such as prepayment penalties, break costs and possibly hedging termination amounts, make whole payments and similar) are expressly included.
 - If any post-Completion reorganisation or debt pushdown is contemplated, Borrowers may also seek to include the costs of implementation of the same.
- In some circumstances, Lenders have been willing to permit more flexible use of the Revolving Facility, even to service other tranches of debt (within the limits of applicable financial assistance rules) and Borrowers should consider whether this level of flexibility is necessary.
- If the Facilities comprise dedicated acquisition or capital expenditure facilities, their purpose

is likely to be quite tightly defined (in particular in the current market). See Clause 2.1 (*The Facilities*) above.

CLAUSE 4: CONDITIONS OF UTILISATION

Clause 4.1: Initial conditions precedent

The initial conditions precedent are divided into two categories: those to be provided prior to signing the Agreement (listed in Part 1A of Schedule 2) and those to be provided prior to first Utilisation (listed in Part 1B of Schedule 2). This provision differs from the equivalent provision in the Investment Grade Documents, which does not require that any initial conditions precedent are satisfied prior to signing of the Agreement. The principal reason for this is that many leveraged acquisition facilities are provided on a “certain funds” basis, meaning that as many conditions precedent to Utilisation as possible need to be satisfied at the outset. In relation to certain funds requirements, see Clause 4.5 (*Utilisations during the Certain Funds Period*).

The documentary conditions precedent are discussed in more detail at Schedule 2 (*Conditions Precedent*).

Borrower Notes

Borrowers will often seek to require that the reference to the conditions precedent in form and substance satisfactory to the Agent is qualified, for example by adding the requirement that the Agent act reasonably in forming such a view (although since the onset of the credit crunch this has been more difficult to achieve).

Clause 4.2: Further conditions precedent

These are additional conditions precedent to Utilisation (other than a Certain Funds Utilisation if applicable: see Clause 4.5 (*Utilisations during the Certain Funds Period*)). The further conditions precedent are that no Default/Event of Default is continuing or would result from the proposed Utilisation and that there is no breach of any applicable representation.

Borrower Notes

In the equivalent Clause in the Investment Grade Documents, certain Borrower-friendly concessions are included as standard provisions. In the Leveraged Facilities Agreement (reflecting the sub-investment grade status of the Borrower), these concessions are not included as standard, although they are presented as optional provisions.

Borrowers may therefore need to negotiate the inclusion of a materiality qualification in relation to the misrepresentation condition. Lenders may resist this, on the basis that many of the representations themselves are subject to materiality qualifications and to include a further qualification in Clause 4.2(b) is to provide a double materiality test which is potentially confusing. There is some merit to this argument. Nonetheless, the compromise is sometimes reached that in relation to the first Utilisation (or any Utilisation on the Closing Date), all of the representations must be true, and in relation to all subsequent Utilisations, the materiality

qualification applies, so the Repeating Representations need only be true in all material respects (although a different analysis applies during the Certain Funds Period, see Clause 4.5 (*Utilisations during the Certain Funds Period*) below).

Borrowers will also need to address the conditions to utilisation of Rollover Loans – broadly the rolling over of existing advances under the Revolving Facility as opposed to advances of new money. Borrowers will often seek to provide that such Utilisations should be subject to no Event of Default continuing (as opposed to the tougher test of no Default continuing). A more Borrower-friendly adjustment to this provision is to require that the condition to utilisation of a Rollover Loan is that the Agent has taken no action pursuant to Clause 28.20 (*Acceleration*) to accelerate the Facilities so that the Borrower can continue to roll the Revolving Facility until the Agent accelerates.

Clause 4.3: Conditions relating to Optional Currencies

The Leveraged Facilities Agreement contemplates that only the Revolving Facility will be multi-currency (the Term Facilities are usually drawn on, or relatively soon after, the Closing Date so there will quite often be no need for currency switching provisions). If Term Facilities are required in Optional Currencies or a currency switching mechanism is required, drafting can be adapted from the Investment Grade Documents.

The conditions specified in relation to qualification of a currency as an Optional Currency are substantially similar to those in the Investment Grade Documents and may not be particularly attractive from a Borrower's perspective.

Borrower Notes

Borrowers may feel that the criteria for a currency to qualify as an Optional Currency are rather restrictive: the currency in question has either to be listed at the outset, or approved by all (not just Majority) Lenders. In addition, it must be readily available and freely convertible.

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 the Borrower requires 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.

Borrowers can point out that, in the event of an Optional Currency not being available, the Lenders have the protection provided by Clause 8.2 (*Unavailability of a currency*).

For further background to these provisions, see commentary under the heading "Currencies" in the "Introduction to Loan Finance" section of the Handbook.

Clause 4.4: Maximum number of Utilisations

The maximum number of Utilisations will usually be limited, mainly for the administrative convenience of the Agent and the Lenders. By way of background, see comments under “Availability” in the “Introduction to Loan Finance” section of the Handbook.

Clause 4.5: Utilisations during the Certain Funds Period

Introduction to “Certain Funds”

The Leveraged Facilities Agreement contains various optional provisions to provide the draftsman with the mechanics for the Facilities to be provided on a “certain funds” basis. Clause 4.5 is the key mechanic.

The concept of a bidder for a target company having to evidence that it has sufficient funds available to complete the acquisition, or “certain funds”, originates from the requirements of the City Code on Takeover and Mergers (the “**Takeover Code**”) in relation to UK public takeovers whether by way of public offer or by scheme of arrangement.

General Principle 5 of the Takeover Code states “An offeror must announce a bid only after ensuring that he/she can fulfil in full any cash consideration if such is offered, and taking all reasonable measures to secure the implementation of any other type of consideration”. Rule 24.7 of the Takeover Code provides that “when the offer is for cash or includes an element of cash, the offer document must include confirmation by an appropriate third party (usually the offeror’s bank or financial adviser) that resources are available to the offeror sufficient to satisfy full acceptance of the offer. (The party confirming that resources are available will not be expected to produce the cash itself if, in giving the confirmation, it acted responsibly and took all reasonable steps to assure itself that the cash was available.)”. This is sometimes referred to as the “cash confirmation” requirement.

The result of these provisions is that the terms of a financing which is to be used to fund the cash element of a public offer to which the Takeover Code applies must be sufficiently certain to enable the offeror’s bank or financial adviser to provide the required Rule 24.7 cash confirmation. The Takeover Code does not specify the financing terms necessary to satisfy the “certain funds” requirement: what is required is determined by market practice.

This generally means that:

- most of the conditions precedent to the financing must be satisfied when the Agreement is signed and before a firm intention to make the offer is publicly announced. Any conditions precedent that remain to be satisfied after the announcement must either be entirely within the control of the offeror or must be conditions that depend on the offer proceeding which cannot be satisfied upfront but will be satisfied if the offer succeeds (such as a level of acceptances having been achieved or the scheme of arrangement having become effective);
- there will be very limited breaches of representations, covenants and Events of Default that can result in the Facilities being unavailable to fund the offer. The “**Major Representations**” and “**Major Defaults**” are likely to be determined based on market

practice. The Major Representations are likely to include, broadly, only the fundamental representations that go to the validity of the Borrower's obligations under the Finance Documents. The Major Defaults are likely to include breach of fundamental covenants that are entirely within the offeror's control and do not relate to the Target Group (this might include covenants not to make disposals or incur additional indebtedness or grant security) and Events of Default relating to the insolvency of the offeror (see further "Borrower Notes" below).

Certain funds provisions are not limited to transactions subject to the Takeover Code. Many overseas jurisdictions impose similar requirements for public offers. In recent years, certain funds provisions have also become common in private acquisitions, particularly in auctions where bidders are often keen for their bids (including the financing of their bids) to look as certain and capable of quick implementation as possible. In particular, private equity funds, hedge funds and similar debt investors have been keen to demonstrate certainty of funding to counter sellers' concerns about contracting with special purpose vehicles (often newly incorporated) which may have no assets until the debt and equity financings from which they are intended to benefit are provided.

Certain Funds provisions in the Leveraged Facilities Agreement

If the Facilities are to be provided on a certain funds basis, the following provisions of the Leveraged Facilities Agreement will be relevant:

- A "**Certain Funds Utilisation**" is a utilisation of a Term Facility for an "**Acquisition Purpose**" within the "**Certain Funds Period**".
- Clause 4 contemplates that the conditions precedent will be divided into initial conditions precedent applicable to any Utilisation and further conditions precedent, applicable to Utilisations other than Certain Funds Utilisations.
- Clause 4.5 (*Utilisations in the Certain Funds Period*) provides that a Lender shall only be entitled to refuse to advance a Certain Funds Utilisation or take any other action which would operate to prevent a Certain Funds Utilisation if:
 - the illegality provisions in Clause 11.1 (*Illegality*) apply;
 - the mandatory prepayment triggers in Clause 12.1 (*Exit*) apply (i.e. Flotation, Change of Control or a sale of all or substantially all of the assets of the Group);
 - the Parent has failed to provide the initial conditions precedent (see Clause 4.1 (*Initial conditions precedent*) above);
 - a "**Major Default**" is continuing or would result from the proposed Utilisation; or
 - there is a breach of a "**Major Representation**".
- Upon the expiry of the Certain Funds Period, any rights accruing to the Lenders during that period which they have been unable to exercise as a result of Clause 4.5 will become exercisable (for example, in relation to an Event of Default occurring during the Certain Funds Period which is not a Major Default).

Borrower Notes

A Certain Funds Utilisation may only be applied for an “**Acquisition Purpose**”, the definition of which is in square brackets for parties to agree. Borrowers may wish to consider extending the Utilisations to which the certain funds provisions apply beyond the consideration payable by the Company for the acquisition of Target Shares to include (for example) the refinancing of financial indebtedness of the Target Group and any transaction costs associated with the same.

Key definitions in the context of the certain fund provisions are the definitions of “**Certain Funds Period**” (left blank in the Leveraged Facilities Agreement), “**Major Default**” and “**Major Representation**”.

The length of the Certain Funds Period varies but in the context of a UK public takeover it will need to be sufficient to complete the offer or scheme of arrangement and any statutory “squeeze out” of minority shareholders. What period is appropriate will depend in part on the likely timing of the completion of the Acquisition itself including any competition clearances or other regulatory approvals. Lenders will usually want to see the Certain Funds Period come to an end if the takeover offer or scheme of arrangement lapses or is withdrawn and otherwise upon reaching a longstop date after signing of the Agreement.

The definitions of “**Major Default**” and “**Major Representation**” are important as they are the main drawstops applicable during the Certain Funds Period. These definitions are in square brackets and will require tailoring to reflect current market practice and the circumstances of the transaction.

When the certain funds language was inserted into the Leveraged Facilities Agreement, it provided that specified Events of Default rather than Defaults would be the basis upon which Lenders could refuse to fund, and the defined term was “Major Event of Default”. The defined term was altered to “Major Default” in September 2008 and amended to operate by reference to specified Defaults having occurred.

In the context of a public bid subject to the Takeover Code, the LMA's change could have an impact on the availability of the required cash confirmation from the financial adviser, on the basis that it is contrary to prevailing market practice, which remains that specified Events of Default (rather than Defaults) should operate as drawstops for certain funds purposes. The change could make a material difference to certainty of funding e.g. on the availability of grace periods or exceptions agreed in relation to the insolvency Events of Default (see Clauses 28.6 to 28.8). As the change has the effect of making a certain funds facility less certain, it may also prejudice the Borrower in a private transaction where, in any event, it is also not common market practice.

Accordingly, Borrowers should seek to amend the definition of “**Major Default**” (and the related provisions of Clause 4.5) such that Events of Default rather than Defaults operate as drawstops for certain funds purposes, reverting to the LMA's original concept of a “Major Event of Default”.

The definition of “Major Event of Default” should usually comprise:

- a non-payment Event of Default (sometimes only if this occurs after the first Utilisation);

- a breach of the key undertakings which should essentially be in the control of the Company and the Parent, for example undertakings restricting the grant of security, acquisitions and disposals, financial indebtedness and possibly the pari passu undertaking other than in relation to any member of the Target Group;
- in relation to a public bid, a breach of certain of the offer or scheme related covenants (see Clause 27 (*General Undertakings*) below);
- the breach of representation Event of Default (but only insofar as it relates to a Major Representation);
- certain insolvency related Events of Default; and
- (sometimes, and to the extent they apply) the “unlawfulness and invalidity” and “repudiation and rescission” Events of Default,

in each case other than in relation to any member of the Target Group.

The definition of “**Major Representation**” will usually comprise the representations as to:

- status;
- binding obligations;
- non-conflict with other obligations;
- power and authority; and
- (sometimes) validity and admissibility in evidence,

again insofar as they apply to the Parent and the Company but not to any member of the Target Group.

The operation of the illegality provisions is a customary drawstop in certain funds facilities. The reference to Clause 12.1 (*Exit*) was added to paragraph (b) of Clause 4.5 as an additional drawstop in September 2008. Clause 12.1 specifies certain events the occurrence of which require mandatory prepayment and cancellation of the Facilities, namely, a Flotation, a Change of Control or a sale of all or substantially all of the assets of the Group. These events and the manner in which they are defined is discussed in more detail at Clause 12.1. The point to note is that it is not the case that these events should always be included as certain funds drawstops, although there may be particular circumstances where a Change of Control might possibly be relevant, for example, in the context of a private equity bid where there is a Change of Control of the private equity investors of the bidder. Borrowers may wish to clarify specifically in paragraph (b) that these mandatory prepayment triggers will not apply during the Certain Fund Period.

SECTION 3: UTILISATION

CLAUSE 5: UTILISATION - LOANS

Clause 5.1: Delivery of a Utilisation Request

The form of Utilisation Request is set out in Schedule 3.

A Borrower or the Parent on its behalf is required to deliver to the Agent a duly completed Utilisation Request no later than the Specified Time. The Specified Time is set out in the timetable in Schedule 11. The Leveraged Facilities Agreement requires that the Utilisation Request be delivered by 9.30am on the third Business Day prior to the Utilisation Date (for advances in euro and other non-sterling currencies) and by 9.30am on the Business Day prior to the Utilisation Date (for sterling advances).

Borrower Notes

This timing for delivery of Utilisation Requests may need to vary depending on syndicate size and the logistical requirements of notifying all of the Lenders who are to participate in the advance. See further "Availability" in the "Introduction to Loan Finance" section of the Handbook.

Borrowers may want to make provision for the Agent to agree shorter periods for Utilisations made on the Closing Date.

Clause 5.2: Completion of a Utilisation Request for Loans

Clause 5.2(a)(ii): A Utilisation Request may only be delivered on a Business Day within the Availability Period.

A "**Business Day**" for these purposes requires banks to be open for general business in London and the principal financial centre of the relevant currency or, in relation to euro, a TARGET Day. A "**TARGET Day**" is any day on which the TARGET2 system is open for the settlement of payments in euro. TARGET2 is open on all weekdays every year except New Year's Day, Good Friday, Easter Monday, the first Monday in May, Christmas Day and Boxing Day. Note that this means TARGET2 is open on the last Mondays in May and August, which are bank holidays in England.

Clause 5.2(b): Although after the Closing Date only one Loan may be requested in each Utilisation Request, there is no limit on the number of Utilisation 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 Utilisations*)).

Clause 5.3: Currency and amount

The Leveraged Facilities Agreement assumes that the Term Facilities will be available and will remain outstanding in the Base Currency (see also Clause 4.3 (*Conditions relating to Optional*

Currencies) above). If this is not what is intended, appropriate amendments will need to be made to the Agreement.

Lenders are likely to want to specify a minimum amount for utilisations to avoid the administrative hassle of small drawings. These amounts will need to be negotiated according to the circumstances of the transaction to ensure that the Company has sufficient flexibility to fund smaller amounts that it may be required to pay, for example, the consideration for further shares in the Target in connection with a public offer after the offer has been declared unconditional.

Clause 5.5: Limitation on Utilisations

Clause 5.5(a) provides that the Revolving Facility shall not be utilised unless each Term Facility has been utilised. This is designed to ensure that the Company does not use the Revolving Facility before the Acquisition has completed and been funded. The Lenders are providing the Revolving Facility in conjunction with the Term Facilities and do not want to find that the Revolving Facility is drawn and the Term Facilities are not.

Clause 5.5(b) provides that a Term Facility may only be utilised on the Closing Date and only if all of the Terms Facilities are utilised *pro rata* on that date. The requirement to use the Facilities *pro rata* is intended to ensure that the Facilities are not used selectively (to obtain a pricing benefit or otherwise) and any amounts drawn under the Term Facilities are spread across the Term Facilities in the proportion intended by the Lenders. Whether it is appropriate for a Term Facility only to be capable of being utilised on the Closing Date will depend on the circumstances of the transaction.

Borrower Notes

Paragraphs (c) and (d) are limits on the aggregate amount of the Revolving Facility comprising Letters of Credit or Ancillary Commitments. The appropriate limits will depend on the Group's requirements in relation to these ways of utilising the Revolving Facility.

Clause 5.6: Cancellation of Commitment

This provides for the automatic cancellation of unused commitments at the end of the relevant Availability Period.

Clause 5.7: Clean down

The intention of this Clause is to provide evidence to the Lenders that the working capital facilities are being used for working capital purposes and not for permanent financing. Hence the Clause requires that for a certain period of days every year or half year, amounts outstanding under the Revolving Facility and the cash element of the Ancillary Facilities are reduced to a specified level (potentially zero) when netted off against the Group's freely available cash resources.

Borrower Notes

This provision is optional. Many Groups will not be able to reduce the balance on the Revolving

Facility to zero in each year and many stronger Borrowers successfully resist the inclusion of a clean down requirement.

Where this provision is included, Borrowers may wish to delete the requirement that compliance with this test is certified by two authorised signatories or a director of the Parent and to limit the test to one period in each financial year for the first few financial years following the Closing Date, rather than a six-monthly test applicable for the duration of the Facilities.

CLAUSES 6 and 7: UTILISATION – LETTERS OF CREDIT AND LETTERS OF CREDIT

The Revolving Facility may be utilised by way of Letters of Credit. Clauses 6 and 7 set out the procedure and particular terms applicable to utilisations by way of Letters of Credit.

Letters of Credit must be substantially in the form set out in Schedule 12 or in a form agreed with the Issuing Bank and the Agent (see definition of “**Letter of Credit**”). Note that in this respect, the Leveraged Facilities Agreement is more Borrower-friendly than the LMA Letter of Credit Option which requires Borrowers to obtain Majority Lender consent for an alternative form.

The provisions of Clauses 6 and 7 and Schedule 12 are substantially based on the LMA’s Letter of Credit Option, published as part of its suite of Investment Grade Documents.

These Clauses envisage that Letters of Credit will be issued by way of collateral, to support the Borrowers’ obligations, i.e. they will be Standby Letters of Credit. Under a Standby Letter of Credit, the Issuing Bank’s payment obligation is akin to a guarantee, in that the obligation to pay is triggered by the failure of the Borrower to pay the beneficiary. It is possible for these provisions to be adapted for the issue of documentary credits, in which the Issuing Bank is the beneficiary’s first port of call for payment.

The Letters of Credit are fronted by one or more banks (the “**Issuing Banks**”), and backed by indemnities from the Borrowers and the other Lenders; these provisions will not be appropriate where a Borrower needs unfronted Letters of Credit, issued by each member of the syndicate rather than any one Lender (which would in general be an unusual requirement in the context of leveraged facilities). The Leveraged Facilities Agreement assumes that one or more Lenders commits at the outset to be an Issuing Bank.

The indemnities in Clause 7 follow the usual approach: after the Issuing Bank has received a demand for payment, the Agent demands payment from the relevant Borrower. The other Lenders (in Clause 7.3(b)) also give an “on demand” indemnity, to reimburse the Issuing Bank where the Obligors fail to do so, pro rata. They have a matching indemnity from the Borrowers (see paragraph (d) of Clause 7.3). A drawing made by a Borrower under the Revolving Facility in the same currency and amount as the Letter of Credit to fund its obligation to pay the Issuing Bank is regarded as a Rollover Loan.

The Agreement contemplates payment by the Borrowers of a fronting fee (typically 0.125% of the Letter of Credit amount) to the Issuing Bank(s) and a letter of credit fee being payable on outstanding Letters of Credit to all the Lenders; the letter of credit fee usually accrues at the

same rate as the Revolving Facility Margin (see Clause 17.5 (*Fees payable in respect of Letters of Credit*)).

Note that the Issuing Bank's consent is required for all Lender transfers involving the Revolving Facility (see further paragraph (b) of Clause 29.2 (*Conditions of assignment and transfer*)).

CLAUSE 6: UTILISATION - LETTERS OF CREDIT

Clause 6.3: Completion of a Utilisation Request for Letters of Credit

This provision sets out the requirements for a valid Utilisation Request for Letters of Credit.

Borrower Notes

Borrowers may wish to consider the following:

- Clause 6.3(c) requires that the Utilisation Request identifies the Issuing Bank which has agreed to issue the Letter of Credit. Borrowers may wish to delete or amend this clause so that it is clear the specified Issuing Bank is required to issue the Letter of Credit where it is requested to in accordance with the provisions of Clause 6.
- Clause 6.3(g) requires that the Expiry Date of a Letter of Credit must fall on or before the Termination Date applicable to the Revolving Facility. Borrowers may wish to make provision for Letters of Credit to be capable of having an Expiry Date after the Termination Date so that after such time, Letters of Credit will continue as between the Issuing Bank and the relevant member of the Group on a bilateral basis. If this is proposed, the interaction between such Letters of Credit and the Transaction Security after the Termination Date will need to be addressed.
- Clause 6.3(j) contemplates that the identity of the beneficiary of the Letter of Credit is specified or has been approved by the Lenders or the Majority Lenders. Borrowers are likely to need more flexibility in terms of pre-approved beneficiaries of Letters of Credit. This issue can be addressed in a number of ways. The Agreement might, for example, be amended to replace this test with a requirement that an Issuing Bank will not be obliged to issue a letter of credit if as a result, the Issuing Bank would breach any law or regulation applicable to it.

Clause 6.4: Currency and amount

Letters of Credit usually have to be issued in the Base Currency or an Optional Currency. In relation to Letters of Credit issued in an Optional Currency, see Clause 6.7 (*Revaluation of Letters of Credit*) below.

Clause 6.5: Issue of Letters of Credit

Paragraph (b) ensures that the same conditions have to be satisfied for a Letter of Credit to be issued as for a Loan to be made: there must be no Default continuing or resulting, and the

Repeating Representations must be true in all material respects (the materiality qualification is optional).

Paragraphs (c) and (d) apply the certain funds provisions in relation to drawings under the cash facilities, see Clause 4.5 (*Utilisations during the Certain Funds Period*) above, to drawings by way of Letter of Credit.

Borrower Notes

These provisions should be consistent with those applicable to Utilisations under the Revolving Facility by way of Loan, see comments at Clause 5 (*Utilisation – Loans*) above. In this regard note that the renewal of a Letter of Credit (see Clause 6.6 (*Renewal of a Letter of Credit*) below) is treated like a Rollover Loan.

Clause 6.6: Renewal of a Letter of Credit

This is an optional provision providing for Letters of Credit to be renewed when they reach their original Expiry Date. Clause 6.5 (*Issue of Letters of Credit*) applies.

Clause 6.7: Revaluation of Letters of Credit

This provision is applicable only where Letters of Credit can be issued in an Optional Currency. It addresses the issue of exchange rate fluctuations by requiring the Base Currency Amount of all Letters of Credit denominated in an Optional Currency to be recalculated at fixed intervals. If the calculation indicates that the Base Currency Amount of the Revolving Facility Utilisations then exceeds the Total Revolving Facility Commitments, the Borrower must prepay the excess. (As explained at Clause 7.1 (*Immediately payable*) below, the requirement to “prepay” permits the Borrower to put up cash cover in respect of the Letter of Credit). On the other hand, the Borrower may benefit from increased headroom under the facility if the Base Currency Amount has decreased.

Borrower Notes

A provision of this sort is not unusual, but is not always required, and Borrowers may want to resist it. They may be able to argue that it is not needed at all in the context of short-term letters of credit.

The Lenders' justification is likely to be that in relation to a Revolving Facility Loan, the Base Currency Amount of a Loan in an Optional Currency remains fixed only for the Interest Period of that Loan, at the end of which the Loan is repaid. The Lenders' exposure to exchange rate fluctuations is therefore the same as the relevant Interest Period. By contrast, the term of a Letter of Credit may be much longer, and the amount in the Optional Currency is fixed, as a requirement of the beneficiary. As a result, the amount of the Optional Currency at the time a demand is made could be more - or less - than the Base Currency Amount at the time the Letter of Credit was issued, and hence Revolving Facility Utilisations could exceed Revolving Facility Commitments.

Borrowers may, whilst appreciating the need for revaluation in theory, object to the severity of

this provision, especially given that the secondary nature of a Standby Letter of Credit means that the Issuing Bank and Lenders may never be called to pay out on it. It is not a routine feature of all facility documentation, and can be particularly onerous in relation to short term Letters of Credit. Lenders are, after all, being paid fees on the basis of the credit exposure. If Borrowers have to accept its inclusion, they may want to insist on a “cushion”, so that the requirement to prepay (or put up cash collateral) is triggered only if the calculation shows that Revolving Facility Utilisations exceed Total Revolving Facility Commitments by (say) 5% or more.

The parties have to agree when the revaluations will be carried out. Various options are offered: every six months from the date of the Agreement, or from the date of each Letter of Credit, or a fixed period after the end of each of the Borrower’s financial years or half years. Given that exchange rates might move either way, it is not necessarily in the Borrower’s interest to argue for longer periods between each re-set.

CLAUSE 7: LETTERS OF CREDIT

Clause 7.1: Immediately payable

This Clause provides that if a Letter of Credit or any amount outstanding under a Letter of Credit is expressed to be immediately payable, the relevant Borrower is required to prepay or repay such amount immediately.

Paragraph (f) of Clause 1.2 (*Construction*) provides that “**repaying**” or “**prepaying**” a Letter of Credit means that the Borrower must either provide “**cash cover**”, or reduce or cancel the amount of the Letter of Credit, or satisfy the Issuing Bank that it has no further liability under it.

“**cash cover**” is defined in paragraph (d) of Clause 1.2. The Borrower must deposit funds in the currency of the Letter of Credit in an account with the Agent or, where the cover is for one Lender, that Lender, and withdrawals are permitted from the account only for the purpose of paying amounts due and payable under the Agreement in relation to that Letter of Credit. The account must be the subject of a first-ranking charge. It must also be interest-bearing.

Borrower Notes

In relation to the definition of “**cash cover**”, Borrowers may wish to add a further requirement that interest will accrue at the rate normally offered to corporate depositors on similar deposits by the Finance Party in question.

Borrowers may wish to consider amending Clause 7.1 to enable claims under Letters of Credit to be met by Loan advances under the Revolving Facility automatically (in a similar manner to the way in which Ancillary Outstandings can be refinanced using the Revolving Facility, see Clause 9.4 (*Repayment of Ancillary Facility*)). This will usually involve the inclusion of a provision that on receipt of a demand for repayment or prepayment under Clause 7.1, the relevant Borrower shall be deemed to have delivered to the Agent a duly completed Utilisation Request, requesting a Loan under the Revolving Facility in a currency and amount equal to the relevant claim (if applicable, net of any available cash cover), the Utilisation Date being the date of receipt of the relevant demand or notification. This mechanism will require that the Borrower

is given a period of time to repay or prepay the Letter of Credit so the references in Clause 7.1 and 7.2(b) to “immediately on demand” will need to be amended, to something like three Business Days after demand.

Clause 7.3: Indemnities

This Clause sets out the indemnity arrangements between the Borrower, Issuing Bank and Lenders. The Borrower indemnifies the Issuing Bank against any costs and losses it may suffer in acting as Issuing Bank. The Lenders indemnify the Issuing Bank likewise, chiefly in case the Borrower fails to pay the Issuing Bank. The Borrower then has to indemnify the Lenders for any payment they have to make under their indemnity.

Borrower Notes

Certain US Lenders are not able to give indemnities of the kind set out in this Clause. Paragraph (c) will then be appropriate.

Borrowers may wish to consider whether the references to “immediately on demand” in Clause 7.3 should be modified to something like “promptly after demand” and whether the gross negligence test in 7.3(a) and (b) is acceptable to them.

CLAUSE 8: OPTIONAL CURRENCIES

See Clause 4.3 (*Conditions relating to Optional Currencies*) in relation to Optional Currencies.

If a Lender is unable to participate in a particular Loan in the required currency, Clause 8.2 (*Unavailability of a currency*) requires that Lender to participate in the Loan in the Base Currency and such participation will be treated as a separate Loan.

Borrower Notes

Where separate loans are made as a result of the operation of Clause 8.2, Borrowers may wish to make clear that the limit on the number of loans or currencies outstanding at any one time will apply to such separate loans as a single loan and that a loan under the Revolving Facility will still be treated as a Rollover Loan if it is not denominated in the same currency as the maturing loan under the Revolving Facility, by reason only of the operation of Clause 8.2 (*Unavailability of a Currency*).

CLAUSE 9: ANCILLARY FACILITIES

Ancillary Facilities comprise those types of working capital facility which are more appropriately provided on a bilateral rather than a syndicated basis, for example, overdraft, derivatives, foreign exchange or guarantee or bonding facilities (although the latter two are sometimes provided on a syndicated basis).

The Leveraged Facilities Agreement makes provision for Lenders (or, optionally, their Affiliates) to provide Borrowers (and again optionally, their Affiliates) with Ancillary Facilities bilaterally, the amount of any Ancillary Commitments being deducted from that Lender's Revolving Facility Commitments (and capped at an amount which would not cause the relevant Ancillary Lender to exceed its Available Commitment in relation to the Revolving Facility).

Borrower Notes

Whilst the terms of any Ancillary Facilities are to be agreed between the relevant parties and documented separately to the Facilities, the Leveraged Facilities Agreement does prescribe the terms that may be agreed to some extent. For example, paragraph (b)(i) of Clause 9.3 (*Terms of Ancillary Facilities*) provides that those terms must be based upon "normal commercial terms" and further, fees, interest and commission payable on Ancillary Facilities must be based on "normal market rates and terms" (Clause 17.6 (*Interest, commission and fees on Ancillary Facilities*)). These requirements are vague, and some Borrowers may prefer to refer to Ancillary Facilities being provided on normal commercial terms offered by the relevant Lenders.

The Ancillary Commitments must expire and all Ancillary Outstandings must be repaid no later than the Revolving Facility. Note that Ancillary Outstandings can be refinanced using the Revolving Facility (Clause 9.4 (*Repayment of Ancillary Facility*)).

Clause 9.6 (*Adjustment for Ancillary Facilities upon acceleration*) is an optional mechanism which provides for loss-sharing amongst Lenders and Ancillary Lenders upon acceleration of the Facilities. A footnote points out that if loss sharing is appropriate, sharing arrangements between Lenders and Ancillary Lenders in relation to remuneration may also be appropriate.

This Clause will need to be considered on a case by case basis depending on the Group's working capital requirements.

SECTION 4: REPAYMENT, PREPAYMENT AND CANCELLATION

CLAUSE 10: REPAYMENT

Clause 10.1: Repayment of Term Loans

Clause 10.1 contains the repayment provisions in relation to each of the Term Facilities.

Borrower Notes

Much of Clause 10.1 is blank or in square brackets for the parties to complete to reflect whatever is agreed. Optional drafting is provided to cater for bullet repayment or amortisation of each of the Term Facilities.

In the European leveraged finance market, Facility A will usually be amortising and Facilities B and C will usually be subject to bullet repayment. If included, Tranche D (the second lien) is also usually subject to bullet repayment. Capital expenditure and acquisition facilities will typically amortise (although an initial repayment holiday often applies) but will also sometimes be subject to bullet repayment.

Prior to the credit crunch, there had been a strong market trend away from amortising facilities and it had become common for Borrowers to try to remove or reduce the A tranche from leveraged facilities, often opting instead for so-called “B Loans” with a single non-amortising B tranche. B Loans and financings without amortising debt have for the time being pretty much disappeared as Lenders revert to more traditional structures in difficult loan markets.

In relation to typical maturities, see “**Termination Date**” at Clause 1.1 (*Definitions*).

Clause 10.3: Reduction of Revolving Facility

This is a place holder for an optional provision for the reduction of the Revolving Facility over a specified period. It will often not be applicable.

Clause 10.4: Effect of cancellation and prepayment on scheduled repayments and reductions

If the Facilities are to be voluntarily prepaid or cancelled or the mandatory prepayment provisions apply (see Clauses 11 (*Illegality, Voluntary Prepayment and Cancellation*) and 12 (*Mandatory Prepayments*)), the parties must agree how the prepayment and cancellation amounts are to be applied. There are two aspects to consider:

- first, the order in which the cancellation and prepayment amounts will be applied to the Facilities; and
- second, the order in which the cancellation and prepayment amounts will be applied against subsequent repayment instalments in respect of amortising Facilities.

Clause 10.4 provides a variety of options for the application of cancellation and prepayment amounts against repayment instalments or Reduction Instalments (if the Revolving Facility is to reduce over time). This Clause will only be relevant if the Facilities include amortising debt or if the Revolving Facility is to reduce pursuant to Clause 10.3 (*Reduction of Revolving Facility*). The order in which prepayment and cancellation amounts are to be applied to the various Facilities is dealt with in Clauses 11 and 12 in relation to voluntary and mandatory cancellation/prepayments respectively.

Voluntary Prepayment and Cancellation

In relation to prepayment or cancellation as a result of illegality or the application of the increased costs or tax gross up and indemnity provisions (see Clauses 11.1 (*Illegality*) and 11.6 (*Right of cancellation and repayment in relation to a single Lender or Issuing Bank*)), Clause 10.4 provides for pro rata reduction or prepayment of subsequent repayment instalments (or Reduction Instalments) by the amount cancelled or prepaid.

In relation to voluntary prepayment or cancellation (see Clauses 11.3 (*Voluntary Cancellation*), 11.4 (*Voluntary prepayment of Term Loans*) and 11.5 (*Voluntary prepayment of Revolving Facility Utilisations*) below), Clause 10.4 provides for the reduction of subsequent repayment instalments (or Reduction Instalments) by the amount cancelled or prepaid either:

- pro rata; or
- in chronological order; or
- in inverse chronological order.

Mandatory Prepayment

Paragraph (d) of Clause 10.4 provides the same optional treatment for mandatory prepayment amounts as for voluntary prepayment amounts, that is, application pro rata, in chronological order or in inverse chronological order against repayment instalments or Reduction Instalments.

Borrower Notes

Most Borrowers will seek as much flexibility as possible in determining how prepayments and cancelled commitments should be allocated against repayment or Reduction Instalments. Where this flexibility is restricted by Lenders, Borrowers may prefer that amounts prepaid or cancelled are applied in chronological order to take the pressure off imminent repayments. The effect is to give the Group a repayment holiday during the early years of the Facilities, although the Borrowers will still need to be confident in these circumstances that they are able to meet the later repayment instalments.

The application of prepayment and cancellation amounts generally can be expected to vary, in particular depending on whether prepayment is voluntary or mandatory.

CLAUSE 11: ILLEGALITY, VOLUNTARY PREPAYMENT AND CANCELLATION

This Clause sets out the circumstances in which the Facilities may be prepaid or cancelled either as a result of illegality in relation to any Lender or, voluntarily, at the option of the Obligors.

Clause 11.1: Illegality

This provision is identical to the illegality clause in the Investment Grade Documents. If it becomes unlawful for a Lender to lend, that Lender is required to be prepaid and its Commitments cancelled with immediate effect. Note that Borrowers may, instead of prepaying, replace a Lender to which the illegality provisions apply (see Clause 41.3 (*Replacement of Lender*)).

Clause 11.2: Illegality in relation to Issuing Bank

This Clause provides for the cancellation and release of any Letter of Credit if it becomes illegal for the Issuing Bank to issue or leave outstanding any Letter of Credit.

Clause 11.3: Voluntary cancellation

This Clause provides for voluntary cancellation of an Available Facility by notice to the Agent.

Borrower Notes

The agreed notice period for voluntary cancellation is usually around 3 to 10 Business Days. Applicable minimum amounts will vary depending on the size of the Facilities.

Paragraph (b) contains optional provisions which provide either that the Company may not cancel Facilities B and C unless there is no available Commitment under Facility A or that the Company may not cancel a Commitment under a Term Facility unless at the same time it cancels a pro rata amount of the available Commitments for each other Term Facility.

The more common option selected is to provide that any cancellation of the Term Facilities must be applied against each Term Facility pro rata.

Paragraph (c) provides that if any Revolving Facility Commitments are cancelled at any time when Loans under other Facilities remain outstanding, evidence must be provided which is satisfactory to the Majority Lenders that the Group has sufficient alternative working capital facilities available.

Many Borrowers will regard paragraph (c) as unduly restrictive and will delete it.

Clause 11.4: Voluntary prepayment of Term Loans

Clause 11.4 specifies the circumstances in which voluntary prepayment of Term Loans is permissible. Applicable minimum amounts will vary depending on the size of the Facilities.

Paragraph (c) contains optional conditions which restrict the manner in which voluntary prepayments can be applied across the Facilities and contains an option for Lenders under Facility B and Facility C to elect to waive their share of any prepayment.

Borrower Notes

Voluntary prepayment is usually permitted upon between 3 and 10 Business Days' notice.

As with the optional cancellation conditions, paragraph (c) is negotiable. Strong Borrowers are often able successfully to argue that voluntary prepayments should be applied in such manner as the Parent may direct.

The first (and more Borrower-friendly) condition requires that each tranche of the Term Facilities is prepaid proportionately (subject to any election to waive prepayment, see Clause 13.8 (*Prepayment elections*) below).

The second condition requires that Facility A Loans (being (usually) the cheapest tranche of senior debt) are prepaid before the Facility B and Facility C loans may be prepaid.

Clause 11.5: Voluntary prepayment of Revolving Facility Utilisations

Clause 11.5 specifies the circumstances in which voluntary prepayment of Revolving Facility Loans is permissible.

Borrower Notes

Voluntary prepayment is usually permitted upon between 3 and 10 Business Days' notice. Applicable minimum amounts will vary depending on the size of the Facilities.

Clause 11.6: Right of cancellation and repayment in relation to a single Lender or Issuing Bank

Clause 11.6 provides for cancellation and prepayment in relation to a single Lender or Issuing Bank to whom the increased costs or tax gross up and indemnity provisions apply. Alternatively, the Obligors may elect to replace such Lenders (see Clause 41.3 (*Replacement of Lender*)).

Any prepayment pursuant to Clause 11.6 will be made either at the end of the next Interest Period or at the date specified by the Parent in its notice to the Agent. If prepayment is to take place other than at the end of the next Interest Period, Break Costs will apply (see Clause 16.4 (*Break Costs*)).

Borrower Notes

Obligors may also request a specific right to prepay Non-Consenting Lenders rather than replace them (see Clause 41.3 (*Replacement of Lender*)).

CLAUSE 12: MANDATORY PREPAYMENT

Clause 12 sets out the circumstances in which the Borrowers will be obliged to make mandatory prepayments.

The mandatory prepayment provisions applicable to a leveraged financing are likely to be significantly more comprehensive than might be expected to apply to other corporate financing. The principal aim of mandatory prepayment provisions of this sort is to reduce debt outstanding (and in turn leverage levels) as specific categories of excess cash become available within the Group. For example, if the Group disposes of a material asset the Lenders will seek to ensure that the net proceeds of that disposal are applied to reduce permanently the amount outstanding under the Facilities.

As is customary, Clause 12 also includes a requirement for mandatory prepayment in full on a change of control. This provision serves a slightly different purpose. In highly leveraged transactions, Lenders are likely to be particularly focused on the ownership and control of the Group to which they are lending. For example, it may be key to the Lenders that a particular sponsor has and retains a significant financial interest as well as control of the Group and Lenders will ensure that this remains the case by means of the requirement for mandatory prepayment of the Facilities in the event of a “**Change of Control**”.

Clause 12.1: Exit

Clause 12.1 provides for the automatic cancellation and prepayment of the Facilities upon the occurrence of a Change of Control, a Flotation or the sale of all or substantially all of the assets of the Group.

Borrower Notes

Change of Control

Leveraged transactions almost invariably provide for mandatory prepayment and cancellation of the Facilities on a change of control because (as mentioned above), the identity and track record of the owners and/or controllers of the Group is likely to be key to the Lenders in the context of a leveraged financing. However, Obligors do manage to negotiate concessions in terms of how the mandatory prepayment provisions operate. In Clause 10.1 the prepayment obligation is triggered by a “**Change of Control**”. This definition will require close attention.

The Leveraged Facilities Agreement includes a suggested definition of “**Change of Control**”. To summarise, the main requirement is that either the Investors or funds controlled by them have the power to control more than a specified percentage of the Parent (whether as a result of holding equity in the Parent or power to control the board or the shareholders of the Parent). The specified percentage is left blank but is often agreed to be 50 per cent. (at least prior to a Flotation, see further below).

Investors will sometimes plan to sell down a portion of their equity investment after the Facilities Agreement has been signed. Investors will want to ensure that the definition of Change of

Control is wide enough to permit any proposed syndication of their equity investment.

Flotation

The definition of “**Flotation**” in Clause 12.1 will require tailoring to reflect the circumstances of the transaction.

Investors may wish to limit mandatory prepayment obligations resulting from a Flotation (although this may not be a particularly important point, as Facilities are often refinanced on a Flotation). The LMA acknowledges the possibility that the Facilities may survive a Flotation in its User Guide to the Leveraged Facilities Agreement. If a Flotation occurs, the Investors may retain a strategic percentage of the Group. If that happens, Investors may argue that any proceeds of the Flotation should be retained by the Group rather than applied to mandatory prepayment as there has been no Change of Control. This may mean that the definition of Change of Control has two limbs, the first applying prior to a Flotation and the second applying after a Flotation. After a Flotation the requirement might for example be that the Investors have to own at least 30% of the issued voting share capital of the Company and that no other person or group of persons acting in concert may obtain beneficial ownership of more voting shares in the Company than the Investors taken together. An alternative that is perhaps more often accepted by Lenders, is for a certain percentage of the proceeds of the Flotation to be required to be applied to prepayment: either a specified percentage or an amount sufficient to achieve a specified reduction in leverage. In any case, Flotation is unlikely to be commercially achievable unless leverage has been reduced to a relatively low level.

Sale of all or substantially all of the Assets of the Group

The requirement to make mandatory prepayments as a result of the sale of all, or substantially all, of the assets of the Group is not always included. If excluded, the most likely reason is that the Agreement provides that such an occurrence will instead be an Event of Default. If the Group’s assets are disposed of contrary to the requirements of the covenant restricting disposals (see Clause 27.16 (*Disposals*)), subject to any applicable grace period, an Event of Default will occur.

Mandatory prepayment provisions are less likely to trigger cross-default provisions than a Default or Event of Default under the Facilities and therefore it might be preferable from a Borrower perspective to treat a sale of all or substantially all of the assets of the Group as a mandatory prepayment event rather than as an Event of Default. To achieve that result, however, specific provision would need to be made in other areas of the Agreement restricting disposals, to the effect that mandatory prepayment is the only consequence if the disposal constitutes a sale of all or substantially all the assets of the Group. Obligors should consider whether this is a real concern: in many leveraged buyouts, the Group will not have much debt other than the Facilities and any junior facilities comprised in the overall financing package, so cross-default triggers may be less likely to be a significant issue.

Clause 12.2: Disposal, Insurance and Acquisition Proceeds and Excess Cashflow

Paragraph (b) of Clause 12.2 requires mandatory prepayment out of Acquisition Proceeds, Disposal Proceeds, Insurance Proceeds and Excess Cashflow.

Other than in relation to Excess Cashflow, the Leverage Facilities Agreement assumes that the entirety of Acquisition Proceeds, Disposal Proceeds and Insurance Proceeds (net of tax and expenses and subject to specific exclusions) will be applied to prepayment.

- “**Acquisition Proceeds**” are the proceeds of claims (“**Recovery Claims**”) in relation to the Acquisition Documents, for example, under the warranties in the sale and purchase agreement, and against the provider of any due diligence report in relation to the Acquisition (a “**Report**”). In relation to the nature of the Reports and the extent to which Lenders are permitted to rely on them, see further “**Reports**” at Clause 1.1 (*Definitions*), Section 8 and Schedule 2 (*Conditions Precedent*). Acquisition Proceeds are defined as the proceeds of Recovery Claims net of Tax and expenses. The LMA drafting contemplates a category of “**Excluded Acquisition Proceeds**” which are not required to be applied to mandatory prepayment, comprising amounts payable to the Vendor under the Acquisition Agreement by way of purchase price adjustment and amounts applied to discharge a third party liability or to replace, reinstate or repair the asset which is the subject of the claim.
- “**Disposal Proceeds**” are very widely defined to encompass the proceeds of any type of “**Disposal**” net of Tax and expenses other than “**Excluded Disposal Proceeds**”. The definition of Excluded Disposal Proceeds is blank for the parties to agree.
- “**Insurance Proceeds**” are the proceeds of insurance claims received by the Group net of any expenses in relation to the claim which are incurred by a member of the Group to a third party, other than Excluded Insurance Proceeds. “**Excluded Insurance Proceeds**” comprise proceeds which are to be applied to make good the claim or loss to which the insurance proceeds relate.
- “**Excess Cashflow**” is defined in Clause 26.1 (*Financial Definitions*) and its composition is discussed in that context. In broad terms, Excess Cashflow is the Group’s cashflow which is not required for debt service. The LMA drafting requires a specified percentage of Excess Cashflow to be applied to prepayment in any Financial Year.

Borrower Notes

The detail of these provisions will need to be agreed (the LMA’s User Guide acknowledges that it is expected that these provisions will be “substantially” negotiated).

There are some general issues for Borrowers to consider which apply across these provisions:

- As a commercial matter, Borrowers may seek to reduce the amount of Acquisition Proceeds, Disposal Proceeds, Insurance Proceeds and Excess Cashflow required to be applied to mandatory prepayment to a specified percentage, perhaps reducing in steps over the life of the Facility subject to specified leverage targets. This is discussed further below in relation to “**Excess Cashflow**”.
- Tax and expenses will be deducted from Acquisition Proceeds, Disposal Proceeds and Insurance Proceeds to calculate the prepayment amount. Expenses are expressed to be deductible to the extent that they are “reasonable”: Some Borrowers may wish to resist any qualification criterion being imposed on the amount of any expenses on the basis that these expenses will be what they are and Borrowers cannot be obliged to apply net proceeds in

prepayment where they do not have such proceeds freely available for the purpose.

- The LMA drafting contemplates that Excluded Acquisition Proceeds and Excluded Insurance Proceeds (see below) will not be required to be applied to prepayment if they are applied for the permitted purpose as soon as possible, or in any event, within a specified period after receipt. Borrowers should ensure that the time period within which such amounts must be applied to their permitted purpose is realistic. A period of around twelve months is commonly agreed, subject to an extension for proceeds which are designated for application within twelve months and applied within (for example) eighteen months. Whether these typically agreed periods are appropriate will depend on the nature of the business of the Group. This issue may also arise in relation to Excluded Disposal Proceeds depending on the definition agreed. Clause 12.5 (*Excluded proceeds*) provides for certification as to the application of amounts excluded from mandatory prepayment obligations to be provided to the Agent as evidence of their application. Obligors will want to determine Lenders' expectations in terms of satisfying their obligations under this Clause.
- Many Obligors negotiate specific limitations to mandatory prepayment obligations to reflect legal restrictions on their ability to make prepayments such as those arising as a result of applicable financial assistance rules or rules restricting upstream distributions. Obligors may also seek to limit prepayment obligations if effecting the prepayment would result in the incurrance of disproportionate costs. Lenders are likely to ask that the Group seeks to mitigate the effects of applicable restrictions to the extent limitations are agreed. If limitations are agreed, the Agreement should make clear the purposes for which any funds which would have been applied to mandatory prepayment but for applicable limitations can be used.

Acquisition Proceeds

- In relation to the definition of Excluded Acquisition Proceeds, in addition to the general points outlined above, many Borrowers seek to agree a de minimis threshold and a basket such that Recovery Proceeds will not be required to be applied to prepayment unless and until they exceed a certain amount individually and a certain amount in aggregate. The agreed amounts may reflect any applicable de minimis thresholds and baskets agreed in the Acquisition Agreement.

Disposal Proceeds

"Excluded Disposal Proceeds" may be defined in a variety of ways:

- It is common to agree a de minimis threshold and a basket for Excluded Disposal Proceeds (along similar lines as outlined above in relation to Acquisition Proceeds).
- Disposals in the ordinary course of business and intra-group disposals are also commonly excluded from the prepayment obligation along with other exceptions by cross-reference to the covenant restructuring disposals.
- It may be desirable to exclude disposals of specific assets, or to impose some other criteria, perhaps by reference to leverage targets. The appropriate definition will depend on the

business plan for the Group.

- Borrowers may wish to negotiate specific exclusions for amounts retained in respect of any possible warranty or indemnity claim against them by the purchaser of the relevant asset, for Disposal Proceeds required to be applied in prepaying any Financial Indebtedness which is secured over the asset disposed of and for any related reasonable out-of-pocket, redundancy, relocation, closure or restructuring costs arising in connection with, or as a result of, or preparatory to such disposal.

Insurance Proceeds

In addition to the general points above, points Borrowers may wish to consider include the following:

- Many Borrowers agree to exclude the proceeds of business interruption insurance from Insurance Proceeds.
- Certain insurance policies contain terms directing how their proceeds should be applied, meaning that such proceeds cannot be applied to mandatory prepayment: if this is the case, an appropriate exclusion to the mandatory prepayment requirement will need to be included.
- Borrowers often negotiate a de minimis threshold and a basket for Excluded Insurance Proceeds (along similar lines as outlined above in relation to Acquisition Proceeds).

Excess Cashflow

The LMA drafting requires a specified percentage of Excess Cashflow to be applied to prepayment in any Financial Year. This is a contentious provision. The percentage of Excess Cashflow which is agreed to be applied to mandatory prepayment varies, but is often somewhere between 50 per cent. and 100 per cent. This percentage is often subject to a ratchet mechanism depending on the financial performance of the Group (often the leverage ratio) or the expiry of a certain time period.

Obligors may argue that mandatory prepayments out of Excess Cashflow should be applied at their discretion (see Clause 12.3 (*Application of mandatory prepayments*)). This is on the basis that such prepayments are more akin to voluntary prepayments.

When considering the Excess Cashflow sweep, Borrowers should remember that there is a relationship between the cash sweep and the restrictive covenants. If the Group is given very little flexibility in terms of how Excess Cashflow can be spent (for example, no Distributions are permitted and Capital Expenditure is very limited or is to be funded from the proceeds of a dedicated Capital Expenditure facility), Borrowers may be less concerned about the extent to which such amounts are applied to prepayment.

Clause 12.3: Application of mandatory prepayments

Order of prepayment

This Clause sets out the order in which mandatory prepayments under Clause 12.2 (*Disposal, Insurance and Acquisition Proceeds and Excess Cashflow*) are to be applied to the Facilities. The LMA drafting contemplates that such amounts will be applied:

- first, in prepayment of the Term Loans;
- second, in cancellation of available Revolving Facility Commitments;
- third, in prepayment and cancellation of Revolving Facility Utilisations; and
- finally, in repayment and cancellation of the Ancillary Facilities.

Borrower Notes

The manner of application of mandatory prepayment proceeds set out in Clause 12.3 generally reflects market practice. Negotiations usually centre upon how prepayment amounts are allocated amongst the Term Loans. As mentioned above, Obligors often seek to treat mandatory prepayments out of Excess Cashflow as voluntary prepayments to be applied at their discretion.

Timing of prepayment

Paragraph (b) of Clause 12.3 provides that Acquisition Proceeds, Insurance Proceeds and Disposal Proceeds shall be applied to prepayment promptly upon receipt. Payments out of Excess Cashflow are required to be made within a specified period of delivery to the Lenders of the annual financial statements.

Paragraph (d) gives the Parent the right to elect to apply prepayment amounts at the end of the next Interest Period (to avoid Break Costs). If the Parent so elects, such amounts are required to be paid into a blocked account pending payment (see Clause 12.4 (*Mandatory Prepayment Accounts and Holding Accounts*)). Paragraph (e), however, permits Lenders to require immediate application of prepayment amounts if a Default is continuing (so the Parent loses its right to elect to make payment at the end of the next Interest Period).

Borrower Notes

Borrowers may wish to soften the obligation to make payment promptly upon receipt of proceeds: for example, an obligation to apply proceeds as soon as reasonably practicable following receipt or within a set period of receipt.

Many Borrowers will resist paragraph (e) on the basis that its effect is to entitle the Lenders to accelerate payment based on a Default rather than upon an Event of Default.

Clause 12.4: Mandatory Prepayment Accounts and Holding Accounts

Clause 12.4 requires that Acquisition Proceeds, Disposal Proceeds and Insurance Proceeds be paid into blocked accounts to be released only for application to prepayment or to reinstatement etc. (in the case of Excluded Proceeds). This requirement also applies to Excess Cashflow which is to be applied at the end of the next Interest Period.

The Agreement will need to specify who is entitled to interest on credit balances on these accounts (see paragraph (c)) which entitles the Obligor account-holder to receive the interest).

Borrower Notes

Many Obligors successfully resist the requirement to pay prepayment amounts into blocked accounts. This may be on the basis that amounts are to be prepaid or applied within a short period of receipt or sometimes simply on the basis that administration of such accounts is burdensome.

If it is agreed that prepayment amounts will be paid into holding accounts, Obligors should ensure that the release mechanism operates as prepayment is required under Clause 12.

Lenders often seek rights to appropriate the contents of holding or mandatory prepayment accounts upon the occurrence of a Default (see, for example, paragraph (b) of Clause 12.4). This will often be resisted for the same reasons as paragraph (e) of Clause 12.3. The effect of this provision as drafted is similar to an enforcement right based on a Default rather than an Event of Default which negates the advantages conferred by the agreed grace periods in the relevant Event of Default.

CLAUSE 13: RESTRICTIONS

Clause 13 sets out restrictions on prepayment: for example, notices of prepayment are irrevocable, prepayments are subject to Break Costs and Term Facilities may not be re-borrowed once prepaid. Most of these provisions are customary.

Clause 13.2: Interest and other amounts

This Clause provides that any prepayments shall be made together with accrued interest and Break Costs (as to which see Clause 16.4 (*Break Costs*)), with optional drafting in square brackets.

Borrower Notes

It is not usual for any prepayment premium or “call protection” to apply to prepayments under senior Facilities. The only exception applies to prepayment of second lien debt (if relevant) which often carries a limited prepayment premium in the first year of the Facilities.

It is worth noting, however, that call protection, Original Issue Discounts and other yield protection mechanics have become more common in the European leveraged market more recently. Once the impact of the US sub-prime mortgage crisis became apparent, some

Arrangers began to offer Original Issue Discounts or “OIDs” on leveraged loans for example in order to sell participations.

It should be noted that these matters are usually documented in the commitment papers relating to the Facilities and/or in a syndication side letter (see further Clause 27.37 (*Syndication*)).

Clause 13.8: Prepayment elections

Clause 13.8 is an optional right for Facility B and C Lenders to decline prepayment and instead elect for prepayment amounts (other than prepayment amounts resulting from the illegality, increased costs or tax provisions) to be applied to Facility A.

Borrower Notes

It is reasonably common for Facility B and C Lenders to get the right to decline prepayment, albeit in a more limited form than Clause 13.8. For example, Obligor may request that declined amounts are offered to non-declining Facility B and C Lenders before being applied to Facility A or seek to impose a time limit on the exercise of the B and C Lenders’ right to decline prepayment (e.g. the right to decline subsists in the first two years of the Facilities only).

Clause 13.9: Effect of Repayment and Prepayment on Commitments

This Clause was added to the Leveraged Facilities Agreement in September 2008 and makes clear that where loans are repaid or prepaid and are no longer available for redrawing, Commitments will be cancelled.

Borrower Notes

Borrowers should be aware that the exception to cancellation “(other than by operation of Clause 4.2 (*Further conditions precedent*))” is important and must not be deleted. Without it, repayments or prepayments of the Revolving Facility which might be unavailable for drawing as a result of e.g. a Default would be automatically cancelled pursuant to this Clause.

SECTION 5: COSTS OF UTILISATION

CLAUSE 14: INTEREST

Clause 14 sets out the manner in which interest on the Facilities is to be calculated. For an explanation of the operation of these provisions, please refer to the ACT Borrower's Guide to the Investment Grade Documents (Part II, Clause 9).

This Clause provides for the calculation of cash pay interest (which usually applies to senior facilities). It does not contemplate payment in kind ("PIK") interest or "PIK toggle" interest (which switches between PIK and cash pay). It is not uncommon for PIK interest to apply to certain subordinated leveraged debt: for example, mezzanine debt often has a PIK interest element.

Clause 14.2: Payment of interest

Clause 14.2(a) provides for the payment of interest on the last day of each Interest Period (or at six monthly intervals in relation to Interest Periods of longer than six months).

Clause 14.2(b) provides that if the annual audited accounts (when delivered) show that a higher Margin should have applied during a period than has been applied based on the unaudited accounts, the Obligors will pay the difference between the Margin paid and the higher Margin to the Agent.

Borrower Notes

Paragraph (b) is presented as an optional provision but is usually included.

It has become quite common for Borrowers to raise the point that the adjustment provision contained in Clause 14.2(b) should work both ways and to seek reimbursement if the audited accounts confirm that a lower Margin should have applied during the period. Lenders may be unwilling to agree to make a cash reimbursement, so any adjustment agreed is usually dealt with by means of a reduction in future interest payments. An alternative approach (although with a different effect) would be for Obligors to take reimbursement amounts out of Excess Cashflow.

This provision is discussed further at Clause 1.1 (*Definitions*) in relation to the definition of "**Margin**".

Clause 14.3: Default interest

This Clause provides, as is customary, for the payment of default interest on overdue amounts. It entitles the Agent to select Interest Periods for overdue amounts. Lenders are likely to want this not least because they may have to continue funding the overdue amounts in the market. Compounding at the end of each Interest Period reflects market practice.

Borrower Notes

Default interest is usually set at around 1 per cent. above the applicable Margin. Borrowers should note that in the context of an Agreement comprising more than one Facility with differing Margins, there is a question (according to this Clause as drafted) as to which Margin should be used as the benchmark for the operation of the default interest provision. It is advisable to clarify this provision and specify the relevant Facility for these purposes. Overdue amounts in respect of a particular Facility should carry default interest based on the Margin applicable to that Facility. In respect of other overdue amounts (for example, under the indemnities) a Margin will need to be selected.

CLAUSE 15: INTEREST PERIODS

The provisions relating to interest periods are largely identical to the equivalent provisions in the Investment Grade Documents. The operation of these provisions is explained in the ACT Borrower's Guide to the Investment Grade Documents (Part II, Clause 10).

CLAUSE 16: CHANGES TO THE CALCULATION OF INTEREST

Clause 16 (which relates to market disruption and the non-availability of interest rate quotations) is identical to the equivalent provisions in the Investment Grade Documents. The operation of these provisions is explained in the ACT Borrower's Guide to the Investment Grade Documents (Part II, Clause 11).

Clause 16.4: Break Costs

This Clause provides that any prepayment of the Facilities shall be made with accrued interest and Break Costs.

Borrower Notes

The definition of "**Break Costs**" used in the Leveraged Facilities Agreement is substantially identical to the definition used in the Investment Grade Documents: see the ACT Borrower's Guide to the Investment Grade Documents, Part II, Clause 11.4. There is one notable difference: Borrowers often argue that loss of Margin should be excluded from Break Costs on the basis that the Lenders should not benefit from the Margin on an amount prepaid or repaid from the date of payment to the end of the Interest Period. Clause 16.4 of the Leveraged Facilities Agreement includes optional wording to exclude amounts in respect of Margin from Break Costs (which is not contemplated in the Investment Grade Documents). It is quite common for Borrowers to achieve this exclusion in leveraged transactions.

CLAUSE 17: FEES

Clause 17 sets out the various fees payable by the Obligors to the Finance Parties in relation to the Facilities. These provisions often cross-refer to the provisions of separate Fee Letters.

Borrower Notes

In relation to fees generally, a helpful commentary is included in the Introduction to Loan Finance section of the Handbook.

Obligors have often agreed with Lenders that the financing is provided on a “no deal no fee” basis. This is not reflected in this Clause. “No deal no fee” means that no fees are payable unless Completion occurs. This concession may be particularly important in competitive auction situations where committed funds are required to give the bidder a competitive advantage but where there is no guarantee that the bidder will ever utilise the Facilities.

Clause 17.1: Commitment fee

This Clause contains the framework for insertion of the applicable commitment fees. It contemplates that commitment fees will be payable across the Facilities from the start of the relevant Availability Period.

Borrower Notes

Commitment fees are traditionally payable from the start of the Availability Period for the relevant Facility. It has become quite common, however, to see commitment fees being payable from the earlier of the Closing Date or a fixed period following the date of the Agreement (sometimes around 1 to 2 months). If it is agreed that commitment fees should only apply from the Closing Date, commitment fees are unlikely to be incurred on the Term Facilities as these should be fully drawn on the Closing Date.

“Ticking” fees may also apply to some types of Facility. These are fees set at a lower level than Commitment Fees which accrue whilst the relevant Facility remains unutilised (e.g. during the period from the date of the Agreement to the Closing Date).

Clause 17.2: Arrangement fee, Clause 17.3: Agency fee and Clause 17.4 Security Agent fee

These provisions cross-refer to the fee payment arrangements in separate Fee Letters.

Borrower Notes

Arrangement fees will often be payable on first Utilisation or on the Closing Date, which in the case of the Term Facilities will usually coincide with the first Utilisation date.

Agency and Security Agency fees on a leveraged transaction are usually payable on first Utilisation or the Closing Date and then quarterly (or sometimes less frequently) thereafter.

Clause 17.5: Fees payable in respect of Letters of Credit

This Clause reflects the usual charging arrangements for Letters of Credit: a fronting fee payable to the Issuing Bank in relation to each Letter of Credit, and a fee payable to the Agent for each Lender, pro rata, on the outstanding amount of each Letter of Credit.

Paragraph (a) provides that the fronting fee (usually 0.125%) is payable to the Issuing Bank on the outstanding amount of any Letter of Credit in respect of which the Issuing Bank is counter-indemnified by the other Lenders. Paragraph (b) provides that Letter of Credit fees are payable at a rate equal to the Revolving Facility Margin (which is the rate that usually applies) on the outstanding amount of any Letter of Credit

Borrower Notes

The impact of the cash collateralisation of Letters of Credit on the amount of fees due is not entirely clear under Clause 17.5. Both fees are expressed to accrue on the outstanding amount of any Letter of Credit from the date of issue of the Letter of Credit until its Expiry Date:

- Paragraph (i) of Clause 1.2 (*Construction*) provides that an “outstanding” amount under a Letter of Credit at any time is the maximum amount that is or may be payable by the relevant Borrower in respect of that Letter of Credit at that time. This definition makes no reference as to whether cash cover should be netted off against outstanding amounts.
- “**Expiry Date**” is defined in Clause 1.1 (*Definitions*) as the last day of the “**Term**” of a Letter of Credit, meaning “each period determined under this Agreement for which the Issuing Bank is under a liability under a Letter of Credit”. Borrowers may repay or prepay Letters of Credit by posting cash cover in the manner prescribed by the Agreement (see paragraph (f) of Clause 1.2 (*Construction*) which provides that a reference to a Borrower “**repaying**” or “**prepaying**” Letters of Credit includes the provision of “**cash cover**” which is defined in paragraph (d) of Clause 1.2). The availability of “**cash cover**” results in a reduction in the contingent exposure of the Issuing Bank, hence on this basis it is arguable that the Issuing Bank is no longer under a “liability” to the extent of the cash cover. See also Clause 7.1 (*Immediately payable*) in relation to the definitions of “**repaying or prepaying**” and “**cash cover**”.

One might argue therefore, that on the basis of Clause 17.5 as drafted, neither fronting or Letter of Credit fees should accrue to the extent Letters of Credit are cash covered. The point is, however, unclear and Borrowers commonly seek clarification, by providing expressly that if and to the extent a Letter of Credit is repaid or prepaid, the fronting fee payable to the Issuing Bank and the letter of credit fee payable for the account of each Lender in respect of that Letter of Credit shall cease to be payable.

Borrowers will expect that the fronting fee will not accrue to the extent of the Issuing Bank's/its Affiliates' own participation in the Letter of Credit facility i.e. on amounts counter-indemnified by the Issuing Bank or its Affiliates in its/their capacity as Lenders, on the basis that the Issuing Bank is not “fronting” the Letter of credit to extent of its own/its Affiliates' participation.

Borrowers may prefer that these fees are payable in arrears on the last day of each quarter

(paragraph (c) provides payment options on the first or last quarter days).

Paragraph (d) contemplates some other administration or issuance fee on top of the fronting fee being paid to the Issuing Bank. This provision is commonly deleted.

Clause 17.6: Interest, commission and fees on Ancillary Facilities

This Clause provides that interest, commission and fees on Ancillary Facilities shall be determined bilaterally between the relevant parties. See further Clause 9 (*Ancillary Facilities*).

SECTION 6: ADDITIONAL PAYMENT OBLIGATIONS

CLAUSE 18: TAX GROSS-UP AND INDEMNITIES

Clause 18 is largely similar to the equivalent provisions in the Investment Grade Documents, subject to a couple of important commercial points, discussed below. It operates on the assumption that the Borrower will pay the Lenders gross (i.e. without withholding tax). Borrowers will therefore need to satisfy themselves at the outset as to the extent of any applicable gross-up obligations and consider the tax implications of potential changes in law and post-Closing changes to the syndicate.

In the event that the tax gross-up and indemnity provisions apply, under the Leveraged Facilities Agreement Borrowers can elect to exercise their rights to prepay or to replace the affected Lender pursuant to Clause 11.6 (*Right of cancellation and repayment in relation to a single Lender or Issuing Bank*) and Clause 41.3 (*Replacement of Lender*).

In September 2008, the LMA made a number of changes to the tax provisions in the Leveraged Facilities Agreement, some of the more significant substantive changes being as follows:

- in Clause 18.1 (*Definitions*):
 - the reference to Treaty Lenders was taken out of square brackets in the definition of “**Qualifying Lenders**”, recognising that Treaty Lenders are now very commonly included in lending syndicates; and
 - in the definition of “**Treaty Lender**”: the blank in square brackets which used to appear as paragraph (c) in the definition was deleted;
- a new Clause 18.5 (*Lender Status Confirmation*) was added which requires all Lenders who become Lenders after the date of the Agreement to confirm their tax status (i.e. whether or not they are a Qualifying Lender, and/or a Treaty Lender). Failure to give such a confirmation will not invalidate the transfer/assignment documentation but the Lender will not be entitled to be treated as a Qualifying Lender if it does not give the confirmation. The confirmation is expressly given for the benefit of the Agent “without liability to the Obligors”; and
- the old Clause 18.7 (*PTR Scheme*) was deleted (on the basis that the provisional treaty relief scheme was not sufficiently widely used to be contained in a model form document).

Borrower Notes

The tax provisions are considered in detail in the ACT Borrower’s Guide to the Investment Grade Documents (Part II, Clause 13). Borrowers may also find the commentary included under “Gross-up provision” and “increased costs” in the Introduction to Loan Finance section of the Handbook helpful by way of background.

A key point to note from the Borrower perspective is that the tax provisions of the Agreement are

designed for UK corporate borrowers, despite requests from the ACT that they should, at least in outline, cater for international groups. Adaptation will therefore be needed where the Borrower group includes overseas obligors. Tax advice in all relevant jurisdictions will be needed on these provisions at an early stage.

Broadly, leveraged financings generally involve (or have so far involved) much more diverse categories of Lender. The greater the diversity in terms of the types of Lenders involved in the transaction, the more complicated the tax analysis is likely to be.

Some of the September 2008 changes to the tax provisions require comment from a Borrower perspective.

- The removal of the blank in square brackets in the definition of “**Treaty Lender**” is potentially significant. The blank was intended as a marker for the parties to set out conditions (by reference to the relevant Treaty or Treaties) which a Treaty Lender must satisfy in order to qualify as a Treaty Lender and get the benefit of the gross-up.

The intention was that Borrowers would seek to include as part of the definition of Treaty Lenders, a confirmation that the relevant Lender satisfies all of the conditions a Lender is required to satisfy under the relevant Treaty, subject to completion of any procedural formalities.

If the blank was not appropriately filled in, the risk for Borrowers was that Lenders would become entitled to the gross-up on the basis that they fulfil conditions (i) and (ii) of the definition even if relief is not likely to be forthcoming.

Whilst a marker, as opposed to a suggestion as to how parties may fairly allocate risk in this area is a less than perfect solution, the deletion of the blank is a commercial point – the Leveraged Facilities Agreement no longer contemplates that Borrowers should require Lenders to satisfy Treaty conditions in order to qualify as Treaty Lenders and get the benefit of the tax gross-up provisions.

In relation to Treaty Lenders generally, Borrowers are reminded that Treaty relief from UK withholding tax can take several months to obtain. Even if “**Treaty Lender**” is defined appropriately therefore, the risk for the Borrower is that Treaty relief is not forthcoming by the first Interest Payment Date. The Leveraged Facilities Agreement (in the same way as the Investment Grade Documents) provides only a weak obligation on Treaty Lenders to assist Borrowers in this regard: Clause 18.2(g) provides that Treaty Lenders will co-operate with the Borrower in order to complete the procedural formalities for relief. Borrowers might try to frame more clearly the steps each Treaty Lender is obliged to take in terms of seeking clearance, for example, by requiring the relevant applications to be made within a particular period of time (e.g. 15 days), by requesting that copies of communications with the tax authorities are provided to the Parent and by including an undertaking from the Lender to use its reasonable endeavours to complete the process promptly.

Borrowers should also seek to provide that if an Obligor has to make a Tax Deduction and gross up a Treaty Lender, a rebate will apply if and when relief under the relevant Treaty is granted. Additionally, as a practical point, if the syndicate includes Treaty Lenders, Borrowers will want to defer the first Interest Payment Date as far as possible (although that

will not address any tax risk that may arise during the life of the loan in relation to secondary trading, see further Clause 29.2 (*Conditions of assignment or transfer below*)).

Borrowers are referred to the relevant provisions of the ACT Borrower's Guide to the Investment Grade Documents for further commentary on the treatment of Treaty Lenders.

- New Clause 18.5, the requirement that Lenders provide a tax confirmation as to their status, is a welcome development. Borrowers should note, however, that the confirmation does not apply to members of the original syndicate, only to Lenders who become Lenders after the date of the Agreement, so Borrowers will still need to undertake due diligence on the tax status of the Original Lenders. Additionally, the drafting of Clause 18.5 might be improved: it refers to the New Lender who fails to confirm its tax status being treated for the purposes of the Agreement "as if it is not a Qualifying Lender". This, combined with the confirmation being given expressly for the benefit of the Agent might conceivably cast doubt on the Obligors' ability to rely on the provision. Borrowers may wish to clarify this point, for example, by the insertion of the words "(including by each Obligor)" after "for the purposes of this Agreement".
- Another important tax-related change was made to the Leveraged Facilities Agreement in September 2008, which concerns the manner in which tax risk is allocated on the assignment or transfer of participations in the Facilities, namely the removal of the Borrower's protection, previously included in the Leveraged Facilities Agreement, against transfers or assignments resulting in an increased tax burden. This issue is discussed at Clause 29.2 (*Conditions of assignment and transfer*).

CLAUSE 19: INCREASED COSTS

Clause 19 is identical to the equivalent provisions in the Investment Grade Documents. The provisions are explained in the ACT Borrower's Guide to the Investment Grade Documents (Part II, Clause 14). See also "Gross-up provision and increased costs" in the Introduction to Loan Finance section of the Handbook.

Note that in the event that the increased costs provisions apply, under the Leveraged Facilities Agreement Obligors have the option of prepayment or replacement of the affected Lender (see Clause 11.6 (*Right of cancellation and repayment in relation to a single Lender or Issuing Bank*) and Clause 41.3 (*Replacement of Lenders*)).

Borrower Notes

As in the Investment Grade Documents, the increased costs indemnity in this Clause does not contain any exception for costs related to the implementation of Basel II (the background to this issue is explained in detail in the ACT Borrower's Guide to the Investment Grade Documents, see Part II, Clause 14). It used to be the case that investment grade Borrowers were usually able to negotiate a carve out from the increased cost indemnity for Basel II costs, but that sub-investment grade Borrowers were not. It is now fairly common for the Basel II carve out to be included in leveraged facility agreements. The arguments for including the carve out (discussed at length in the ACT Borrower's Guide to the Investment Grade Documents) remain valid

regardless of the Borrower's credit rating so this is a welcome development.

CLAUSE 20: OTHER INDEMNITIES

Clause 20 is largely identical to the equivalent provisions in the Investment Grade Documents.

Clause 20.1: 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 20.2: Other indemnities

The indemnities in paragraph (a) of this Clause are intended to cover costs and losses incurred, broadly speaking, as a result of some fault on the part of the Obligors. Paragraph (b) of this Clause contains a wide indemnity in relation to liabilities in connection with the Acquisition.

Borrower Notes

Given that paragraph (a) is aimed at situations where the Obligors are at fault, it may be difficult to justify limiting costs and losses to those reasonably incurred. The Obligors may, however seek to restrict the costs indemnified to those incurred as a direct result of the events specified.

The inclusion of an indemnity along the lines of paragraph (b) is customary, but some Borrowers may seek to agree some level of control over claims which are covered by the indemnity. The Finance Parties should be required to notify the Parent of receipt of any such claims and keep the Parent informed of progress. The Finance Parties might also for example be required to take into account the views of the Parent in relation to the conduct of the claim and to pursue the claim in both their own interests and in the interests of the Group.

Clause 20.3: 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) relates to the costs of currency-switching.
- Paragraph (c) relates to the Agent's liabilities incurred as a result of acting on any notice, request or instructions which it believes to be genuine, correct and appropriately authorised.

Borrower Notes

In relation to this provision generally, the Borrowers may want to ensure that the causal link

between the cost and the event is direct, not just indirect.

In the multi-currency Investment Grade Documents, paragraph (b) enables the Agent to recover any costs incurred in managing currency switching in relation to Term Loans. As noted above, the Leveraged Facilities Agreement assumes that the Term Facilities will be available and remain outstanding in the Base Currency. As a result, it does not contain currency switching mechanics and this provision is not relevant unless such mechanics are inserted.

Obligors might argue that paragraph (c) should only apply to the extent that the notice, request or instruction turns out not to be genuine, correct or appropriately authorised (on the basis that if it is, the action should be covered by the Agency Fee).

Clause 20.4: Indemnity to the Security Agent

The inclusion of an indemnity to the Security Agent in relation to the performance of its functions is customary in some form, but is often included in the Intercreditor Agreement rather than the Facility Agreement (together with the rest of the provisions relating to the appointment and administration of the Security Agent function).

Borrower Notes

The terms of this indemnity are wide-ranging and Borrowers are likely to want to narrow them down, for example, by inserting appropriate qualifications in terms of the reasonableness of costs incurred (at least in relation to costs other than enforcement costs).

CLAUSE 21: MITIGATION BY THE LENDERS

In this Clause, each Finance Party undertakes that, if an Obligor has to make certain payments to a Finance Party, or a Lender's Commitment is cancelled (for example, as a result of the operation of the tax or increased costs or illegality provisions), the relevant Finance Party will take all reasonable steps to mitigate the circumstances causing this. Mitigation is most 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 the Parent if any of these circumstances arise.

Clause 21.2(b) protects a Finance Party by excusing it from taking mitigating action which would, in its opinion (acting reasonably), be prejudicial to it. The Finance Parties are given substantial and similar protection in this regard by Clause 32 (*Conduct of business by the Finance Parties*). Some Borrowers may therefore argue that the Finance Parties do not need both Clauses. Clause 32 is regarded as an important provision for Lenders, but is sometimes amended. For example, Clause 32 does not require the Finance Parties to act reasonably.

CLAUSE 22: COSTS AND EXPENSES

This Clause contains the customary costs indemnities. These provisions replicate the equivalent provisions in the Investment Grade Documents save for those aspects which relate to the Security Agent.

Borrower Notes

As a general point, Borrowers should take care to ensure that the agreed scope of these provisions is not undermined by conflicting provisions in other Finance Documents (for example, the Transaction Security Documents).

Clause 22.1 and 22.2: Transaction expenses and Amendment costs

These provisions deal with the reimbursement of the transaction expenses of the Agent, the Arrangers, the Issuing Banks and the Security Agent and the Agent, and the Security Agent's expenses in relation to any requested amendment, waiver or consent. They apply equally to expenses incurred by any Receiver or Delegate of the Security Agent.

Borrower Notes

Clause 22.1, dealing with transaction expenses, is fairly standard, though some Borrowers are able to replace the obligation to pay promptly on demand with an obligation to pay within a fixed period, such as a certain number of Business Days. Also, some Borrowers take the view that they should not reimburse syndication expenses in addition to paying an arrangement fee and therefore amend this provision to exclude syndication costs.

Leveraged transactions are extremely document intensive. As a result, fees payable to the Lenders' professional advisers are often capped for the purposes of the indemnity. The fee arrangement will usually be documented outside the Facilities Agreement.

Clause 22.2, dealing with amendment costs, is also fairly standard, although the Borrower may take the view that the costs of "responding to" and "evaluating" requests for a waiver or amendment are really overheads for the Agent. Borrowers may also feel that three Business Days is too short a time frame.

Borrowers sometimes seek to require that claims under these provisions are accompanied by reasonable supporting evidence illustrating how the costs have been incurred.

Clause 22.3: Security Agent's ongoing costs

This Clause provides for additional remuneration to be paid to the Security Agent in the event of a Default, if the Security Agent thinks it expedient or if it is asked to undertake duties outside its normal function. The level of such remuneration is as agreed between the Parent and the Security Agent (subject to a dispute resolution process if they fail to agree).

Borrower Notes

This provision is quite often deleted. Borrowers might argue that the scope of a Security Agent's functions should be perfectly apparent to an experienced Security Agent and as such, reflected in its Security Agent fee. Should any unforeseen and exceptional circumstances arise that might warrant additional remuneration, the extent of any such additional fees can be discussed when the situation arises.

Clause 22.4: Enforcement and preservation costs

This Clause provides for reimbursement of costs and expenses in relation to the enforcement or preservation of rights under the Finance Documents and is fairly standard.

SECTION 7: GUARANTEE

CLAUSE 23: GUARANTEE AND INDEMNITY

Most leveraged facilities will be guaranteed by the Parent and by members of the Group. See Clause 27.35 (*Guarantors*) in relation to the scope of applicable guarantee requirements.

The guarantee and indemnity provisions are not particularly unusual and subject to the two issues discussed below, substantially identical to those in the Investment Grade Documents.

Borrower Notes

The guarantee provisions in both the Investment Grade Documents and the Leveraged Facilities Agreement were amended as a result of a 2005 decision, Triodos Bank NV vs Ashley Dobbs. The court held in that case that a guarantee will only extend to an amended or varied loan agreement if the relevant amendment or variation was contemplated by the parties at the time the guarantee was entered into. Paragraph (e) of Clause 23.4 (*Waiver of defences*) is intended to make clear that the guarantee will survive changes to the Finance Documents. The Investment Grade Documents contain a similar provision. The Leveraged Facilities Agreement, however, goes on further to reinforce this issue, in the form of optional Clause 23.5 (*Guarantor Intent*). This Clause lists practically every conceivable action that could be taken in relation to the Finance Documents and confirms that the same will not affect the validity of the guarantee. It is not always used (and some Guarantors may object to such a widely drafted provision).

Clause 23.11 (*Guarantee Limitations*) will be relevant if it is necessary to limit the liability of any Guarantor as a result of applicable laws (for example, relating to financial assistance). Legal advice will be required in each relevant jurisdiction to determine the scope of any applicable limitations.

SECTION 8: REPRESENTATIONS, UNDERTAKINGS AND EVENTS OF DEFAULT

Introduction

This section of the Leveraged Facilities Agreement contains the provisions which are most often negotiated, the representations, the information, financial and general covenants and the Events of Default.

There are points of principle that Borrowers will raise in relation to these provisions of the Leveraged Facilities Agreement on every transaction. Most issues arising, however, are likely to be transaction specific.

The Reports and the Acquisition Agreement

The Investors will almost always have conducted some level of due diligence on the Target Group. Even on a hostile public takeover, public sources of information are likely to be examined. Legal, accounting, tax, pensions, insurance, marketing and, where appropriate, environmental advisers are commonly engaged to review various areas of the Target Group's business. Each adviser will provide a due diligence report to the Investors/the Parent (collectively termed the "**Reports**" for the purposes of the Leveraged Facilities Agreement).

To the extent that the results of the due diligence (or the Disclosure Letter – see below) reveal the existence of any material risk or liability in relation to the Target Group, on a private acquisition, the Vendor and the Company may seek to allocate that risk or liability in the Acquisition Agreement. Some identified risks or liabilities may be reflected in the purchase price. Others may be allocated contractually, for example the Vendor may agree to provide warranty protection, or to indemnify the Company against particular risks should they materialise.

The Acquisition Agreement for a private company acquisition will usually contain a raft of warranties and indemnities given by the Vendor to the Company in relation to the Target Group. The warranties in the Acquisition Agreement are likely to be qualified by reference to a Disclosure Letter. The contents of the Disclosure Letter will be carefully reviewed by the Company to ensure that it accords with the results of its due diligence. The purpose of the Disclosure Letter is to limit the Vendor's liability under the warranties.

Allocation of risk in the Facilities Agreement

Lenders will review the Reports (they are often heavily involved in the due diligence) and will expect to be granted a right to rely on the Reports, and thus have direct rights (typically subject to agreed limits including a financial cap) against the Report providers, as a condition precedent to funding (see definition of "**Reports**" at Clause 1.1 (*Definitions*) above in relation to the scope of such reliance). Lenders are also likely to review the Acquisition Agreement and the Disclosure Letter to determine how risks highlighted in the Reports have been allocated and will seek to take security over the Company's rights against the Vendor pursuant to the Acquisition Documents and the Report providers in relation to the Reports. The proceeds of any such claims ("**Recovery Claims**") are usually required to be applied to mandatory prepayment (see Clause 12.2 (*Disposal, Insurance and Acquisition Proceeds and Excess Cashflow*)).

Borrower Notes

Lenders will want to ensure that any matters revealed by the Reports or otherwise as a result of the due diligence exercise are specifically dealt with in the Facilities Agreement. Significant risks may result in adjustments to the amount of the Facilities or leverage adjustments. Other risks may be dealt with in the Facilities Agreement, by means of representations, positive or negative covenants or conditions precedent or subsequent. Borrowers should be mindful that the representations are given subject to any matters disclosed in the Reports (or otherwise specifically disclosed to the Lenders) and that appropriate carve outs for matters arising out of the due diligence are included in the restrictive and/or financial covenants.

Some Borrowers might argue that to the extent a particular risk is the subject of a claim under the Acquisition Documents or against a Report provider (of which Lenders will have the benefit), it should not need to be dealt with specifically in the Facilities Agreement (or via financial adjustments). Lenders are likely to resist this argument for three reasons. First, they will want the right to call an Event of Default if the issue in question materialises (rather than simply to pursue a damages claim against a third party). Secondly, third party claims are often limited contractually which would impact their ability to recover any losses and thirdly, Lenders do not want to take on the credit risk of the relevant third party. There may, however, be limited circumstances where Borrowers can avoid a Default under the Facilities arising out of a risk covered by a third party claim. An example might be where a particular liability under the Acquisition Agreement is the subject of a cash retention against the purchase price or is guaranteed by a bank guarantee or standby letter of credit. See also comments at Clause 1.1 (*Definitions*) above in relation to the impact of the availability of a third party claim on the definition of “**Material Adverse Effect**”.

CLAUSE 24: REPRESENTATIONS

Introduction

An extensive list of representations is included in Clause 24, each to be given by each Obligor. They cover a variety of legal and factual issues. If any of these representations is untrue on the date upon which it is expressed to be given, then subject to any agreed grace period, the misrepresentation will be an Event of Default (see Clause 28.4 (*Misrepresentation*)).

Lenders seek representations in order to address particular risks in relation to the transaction. Not all of the representations presented in the Leveraged Facilities Agreement will be relevant for every transaction and further representations (or carve-outs or additions to representations) specific to the transaction in question may be required. Materiality qualifications and other limitations are commonly agreed, for example in terms of which entities the representations apply to and by reference to the knowledge of the representor. The LMA emphasises in its User Guide to the Leveraged Facilities Agreement that Clause 24 is just a starting point for negotiation.

Borrower Notes

Scope of Representations

The representations in Clause 24 vary in terms of whether the Obligor is expressed to give the representation in relation to just itself, or in relation to itself and each of its Subsidiaries or in relation to itself and all other members of the Group. The scope of each representation is considered in the commentary on individual provisions below.

Borrowers will need to agree with the Lenders the extent to which particular Obligors can give representations with application beyond themselves and, in some circumstances, their Subsidiaries. Whilst 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 are required to give representations in relation to the activities of each member of the 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 (see Clause 1.1 (*Definitions*)). The extent to which this is appropriate and reasonable will depend on the circumstances including the extent of due diligence, the applicability of qualifications by reference to knowledge and the size of the Group. In relation to warranties given by the Parent and the Company concerning the Target Group, see further “*Application of Representations to Target Group*” below.

Parties should bear in mind the scope of the cross-guarantees being given by Obligors when considering the extent to which representations should be given in relation to parties other than the representor. Pursuant to the Leveraged Facilities Agreement as drafted, each Guarantor guarantees the obligations of each other Obligor (see Clause 23 (*Guarantee and Indemnity*)). This means that even if a particular Obligor does not give a representation in relation to certain members of the Group, if another Obligor does so, the Guarantor will be standing behind the representation of that other Obligor in the event that the Lenders become entitled to enforce the Facilities. This is a further reason for an Obligor which is a Guarantor to argue that it should not be required to give representations concerning members of the Group of which it has no knowledge and might not reasonably be expected to have or to obtain knowledge.

Application of Representations to Target Group

As noted at Clause 1.1 (*Definitions*) in relation to the definitions of “**Group**” and “**Subsidiary**”, Borrowers will usually seek to amend the Leveraged Facilities Agreement to provide expressly that where representations are given prior to the Closing Date (or sometimes, the first Utilisation Date), the Target Group shall not be considered to be part of the Group or to be a Subsidiary of the Company. The Leveraged Facilities Agreement does not reflect market practice in this respect. See further comments on paragraph (b) of Clause 24.1 (*General*) below.

From the Obligors’ perspective, one might argue (in particular in a public bid situation where due diligence is limited), that it is equally difficult for the Parent and the Company to give representations relating to the Target Group on the Closing Date or first Utilisation Date, on the basis that it will take some time for them to get to know their new Subsidiaries. Market practice, however, is generally to require that the representations are given on such date on the

assumption that Completion has occurred, and the Obligors' concern is instead usually addressed in two ways:

- First, by paying close attention to those representations which are given by an Obligor in relation to parties other than itself, discussed above in general terms and below in the context of individual representations.
- Secondly, by providing for a "**Clean-Up Period**", a grace period post-Completion to deal with certain misrepresentations and Defaults relating to the Target Group (which is reflected in the Leveraged Facilities Agreement, see Clause 28.21 (*Clean-Up Period*)). The existence of a Clean-Up Period is an acknowledgement of the more limited extent to which Obligors can be expected to have knowledge of the Target Group in the immediate aftermath of Completion.

If the financing is offered on a certain funds basis, the scope of any representations which can operate as a drawstop during the Certain Funds Period will be limited (see Clause 4.5 (*Utilisations during the Certain Funds Period*) above). However, the ability to have funds advanced may not be terribly helpful to the Borrower if the misrepresentation cannot be cured by the end of the Certain Funds Period, leaving the Borrower then faced (subject to the Clean-Up Period protection) with an Event of Default.

Qualifications by reference to materiality

The Leveraged Facilities Agreement contemplates that 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. Will they 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 24 of the Leveraged Facilities Agreement. In addition, in certain cases, monetary thresholds for materiality are contemplated (see e.g. paragraph (a) of Clause 24.17 (*Taxation*)). The definition of "**Material Adverse Effect**" is usually negotiated in some detail, see Clause 1.1 (*Definitions*) above. Whilst the operation of any qualification must be considered in context, Borrowers may prefer to use this term rather than a mixture of terminology as there is a view that its detail provides greater certainty in construing the qualified representations.

Where the Leveraged Facilities Agreement includes a "**Material Adverse Effect**" qualification, it is usually phrased in terms of a matter which "has or is reasonably likely to have" a Material Adverse Effect. Some lawyers believe that the fact that a matter might be said to have a reasonable likelihood of having a "**Material Adverse Effect**" should not be enough to give rise to a misrepresentation, and seek to amend such references to matters which "have or will have" or (the less certain) "have or is reasonably expected to have", a Material Adverse Effect.

Qualifications by reference to knowledge

Borrowers will usually seek to agree qualifications to the representations, or at least certain of them, by reference to the knowledge or awareness of the Parent, the Company and/or the relevant Obligor. The Leveraged Facilities Agreement contemplates that a very limited number

of representations might be qualified by reference to knowledge to some extent.

Where a representation is qualified by reference to the knowledge or awareness of a corporate entity, the obvious question is with whose knowledge the company will be fixed for such purposes (and, in practical terms, who must be involved in determining whether particular representations can be given). In very broad terms, a court in this context is likely to consider who is authorised to represent the company and/or whose “mind and will” directs the company. It should be assumed that the knowledge of the directors of the Obligor giving any representation is relevant for these purposes. However, in relation to particular issues, it may be prudent for other key senior personnel to be involved, for example, the Obligor’s in-house lawyers in relation to litigation issues or its asset management team in relation to property issues if those persons have responsibility for the management of and/or control the company’s actions in relation to particular areas of its operations. Additionally, matters within the knowledge of the company’s advisers, for example, its lawyers and accountants may well be considered to be relevant by a court.

However, even in the absence of any positive obligation to make enquiries, it may be the case that a court will construe a reference to a corporation’s knowledge by reference to an objective standard. Again, very broadly speaking, there is case law to the effect that references to the awareness of a company might result in that company being imputed with knowledge of the contents of relevant documentation in its possession. The precise limits of any such qualification cannot easily be defined (although clearly the inclusion of an awareness qualification is better than an unqualified representation).

Obligors may prefer, therefore, that references to an Obligor’s awareness or knowledge are expressed to be limited to matters within its “actual” knowledge or awareness. There is some judicial authority to the effect that a reference to “actual knowledge” is a more limited concept, and might not, for example, include matters within the knowledge of a company’s advisers that might otherwise be imputed to the company. Even better from the Obligor’s point of view, is to define references to an Obligor’s awareness or knowledge as matters within the actual knowledge of specified named individuals. This technique is commonly used in relation to representations given in share or business purchase agreements and might be considered by strong Borrowers.

Lenders may be unwilling to accept that ignorance of particular facts in respect of which an Obligor could have educated itself should operate to avoid a misrepresentation. Hence, they may seek to make clear that an objective standard applies, for example, a knowledge qualification expressed along the lines of “so far as [the relevant Obligor] is aware having made due and careful enquiry”. What constitutes “due and careful enquiry” may depend on the circumstances and what information might be available to the relevant Obligor at the relevant time. For example, in the context of a private acquisition, the Investors, the Parent and Company will conduct as extensive a due diligence exercise as is possible, but there may be practical limitations on the amount of information they are able to obtain and/or digest in the available time frame.

Qualifications by reference to matters disclosed

In addition to operating as a mechanism for defaulting the Facilities, the representations function as a checklist to flush out matters of concern to the Lenders which, in the context of an

acquisition financing, requires the Obligors to focus on the results of the due diligence. As discussed above in the introductory commentary to Section 8 (see “*The Reports and the Acquisition Agreement*” and “*Allocation of risk in the Facilities Agreement*”), the Lenders will usually be closely involved in the due diligence and any material risks arising will be specifically addressed.

Accordingly, the Parent and the Company will usually try to argue that the representations should be given expressly subject to any matters disclosed in the Reports (or otherwise specifically disclosed to the Lenders) and qualifications based on specific matters disclosed are commonly included in Clause 24 by reference to the affected representation. Some Borrowers may seek to qualify the representations generally by reference to matters disclosed to the Lenders in the Reports or otherwise, but a clause by clause approach to exceptions is probably more common. Borrowers may also achieve the right to make further written disclosures to the Agent which will operate to qualify the representations when they are repeated after the date of the Agreement.

When are the representations given?

The times at which the representations are made are set out in Clause 24.32 (*Times when representations made*). Subject to certain exceptions which are discussed at Clause 24.32 below, the Leveraged Facilities Agreement contemplates that the representations will be given by the Obligors on the signing date and the Closing Date which reflects usual market practice.

Certain representations, “**Repeating Representations**”, are expressed to be repeated on the date of each Utilisation Request, on each Utilisation Date and on the first day of each Interest Period by reference to the facts and circumstances existing on that date. The scope of the “**Repeating Representations**” will require attention as the requirements of the Leveraged Facilities Agreement are wider than the position many Borrowers achieve. It is not appropriate that all of the representations are repeated, in particular where the Group’s ongoing obligations in relation to a particular issue are the subject of a covenant or an Event of Default or where the representation relates to circumstances existing at Closing. An indication is given in relation to each representation below as to whether it is usually or should properly be a Repeating Representation. See also Clause 24.32 (*Times when representations made*).

Note that most of the representations (not just the Repeating Representations) are deemed to be made by each Additional Obligor on the date upon which it becomes an Obligor (see Clause 24.32 (*Times when representations made*)). As mentioned above (see “*Qualifications by reference to knowledge*”), when negotiating the Facility Agreement, the Parent and the Company will have to bear in mind the likely concerns and the extent of the knowledge of those members of the Target Group which are intended to accede to the Facility Agreement as Obligors and ensure that those representations which they will be deemed to give are appropriately tailored. The Leveraged Facilities Agreement contains more onerous requirements in this regard than are commonly negotiated in practice, see further comments in relation to paragraph (e) of Clause 24.32 (*Times when representations made*) below.

Duplicative requirements

A number of representations included in the Leveraged Facilities Agreement duplicate matters covered by other parts of the document, in particular the undertakings and Events of Default. In

some areas, the representations also overlap.

In theory, Borrowers should be able successfully to delete duplicative requirements as they make the Agreement unnecessarily complex. However, Lenders may resist, often arguing that the absence of representations in relation to a particular issue which are expected by the market may prejudice syndication. Additionally, as mentioned above, representations may be included to elicit information and to provide specific comfort on key risk factors for Lenders.

Whilst it is in neither party's interest to waste too much time debating whether a requirement is duplicative, there is a conceptual point that both parties should bear in mind. A representation is given at a particular point in time. A misrepresentation will be an Event of Default. A grace period is usually agreed to enable the Borrower to cure any Default resulting from a misrepresentation before it becomes an Event of Default. If a Repeating Representation covers the same ground as a covenant or an Event of Default, a separate Default will be triggered resulting from the same circumstances which, subject to any agreed grace period for cure, will be an Event of Default. It is conceptually easier to remedy a breach of covenant or the existence of a specific set of circumstances than it is a misrepresentation (the representation has been made and was incorrect).

Clause 24.1: General

Clause 24.1(a) provides that the representations in Clause 24 are to be given by each Obligor.

Clause 24.1(b) provides that where representations are made at any time prior to the Closing Date, it is assumed (optionally) that Completion has occurred and that the Parent has the knowledge of Senior Management (to be defined). The effect of Clause 24.1(b) is that for the purposes of the representations which are expressed to apply to members of the Group or Subsidiaries, members of the Target Group will be caught even prior to the date upon which they become members of the Group.

Borrower Notes

It is usual for all original Obligors to give the representations, although as noted above (see "*Scope of Representations*"), Additional Obligors should not be required to make all of the representations. This issue is usually addressed via the repetition mechanism, see Clause 24.32 (*Times when representations made*) below. The extent to which an Obligor gives representations in relation to parties other than itself will need to be considered in relation to each representation.

Clause 24.1(b) is a controversial provision. It is commonly omitted and replaced with a provision to the effect that the Target will not be considered as part of the Group prior to the Closing Date. Some Borrowers go further and seek to provide expressly that the Parent and the Company will not be imputed with the knowledge and belief of Target Group management prior to the Closing Date. Weaker Borrowers might achieve the less satisfactory position that prior to Closing, the Target Group shall be treated as the Group, but the representations are deemed to be qualified by reference to the actual knowledge of the relevant Obligor at the relevant time.

See further "*Application of Representations to Target Group*" and "*Qualifications by reference to*

knowledge” above.

Clause 24.2: 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 a Repeating Representation (which is usually the agreed position).

Borrower Notes

Some stronger Borrowers might seek to limit this representation to Material Companies or (in relation to paragraph (b)), by reference to their ability to own their assets and carry on business in all material respects.

If the Group includes entities other than limited liability companies, for example, limited partnerships, this representation will require appropriate amendment to reflect their legal status.

Clause 24.3: Binding obligations

Clause 24.3 confirms that each Obligor’s obligations under the Transaction Documents are legal, valid, binding and enforceable and that the Transaction Security is valid and creates the intended security. It is given by each Obligor in relation to its own obligations. It is a Repeating Representation (as is usually the case).

Borrower Notes

The legal opinions to be delivered as conditions precedent to the transaction (see Schedule 2 (*Conditions Precedent*)) will confirm that the Transaction Documents are valid, binding and enforceable. The subject of this representation therefore overlaps with that of the legal opinions. Legal opinions, however, will contain a number of reservations which operate to qualify the opinion as to the validity and enforceability of the Transaction Documents, which (Borrowers will argue) should likewise apply to this representation.

The LMA drafting acknowledges this issue and qualifies this representation by reference to the “**Legal Reservations**”. The definition of “**Legal Reservations**” reflects certain insolvency related and other matters in respect of which reservations are customarily included in legal opinions. It provides optional wording which extends the definition to any other reservations included in the legal opinions (at paragraph (d)), which Borrowers should seek to include.

Note that in the context of the Transaction Security Documents, English law legal opinions very often contain a reservation to the effect that no opinion is expressed on the priority of the security or its status as fixed or floating. It is therefore important that a qualification by reference to these types of reservation applies to paragraph (b) of this representation. The status of Transaction Security as fixed or floating is discussed further at Clause 27.15 (*Negative Pledge*).

Sometimes Lenders resist representations being qualified by all of the reservations contained in

the legal opinions. They may argue that legal opinions are given at a fixed point in time and are not usually refreshed (in contrast to representations). They may be concerned that the effect of a qualification by reference to risks not assumed by the providers of the legal opinions may transfer risks to the Lenders which should properly be Borrower risks. In addition, legal opinions are usually delivered to the Lenders by their legal advisers and may not be delivered until the Closing Date. Therefore Lenders might argue that compliance with representations cannot be monitored by reference to qualifications that (a) might not yet exist (if representations are given prior to the Closing Date) and (b) which the Borrower is not entitled to see.

These arguments are not often sustained. They are conceptual rather than practical issues as the scope and content of closing opinions provided to Lenders is well settled in the market.

A further qualification is usually made to this representation insofar as it applies to the Transaction Security in respect of any action (such as filings or notice requirements) to be taken to perfect the Security. This concept is commonly a defined term, the "Perfection Requirements", defined as something like "the making or procuring of the appropriate registrations, filings, stampings and/or notifications of the Transaction Security Documents and/or the security created by them".

Clause 24.4: Non-conflict with other obligations

This representation confirms that the entry into and performance of the transaction does not conflict with other legal or contractual obligations.

The representation is widely drafted to cover non-conflict with:

- any law or regulation applicable to the relevant Obligor;
- the constitutional documents of any member of the Group; and
- any agreement or instrument binding upon any member of the Group or the assets of any member of the Group.

It also covers the absence of any default or termination event under any agreement or instrument binding upon any member of the Group or the assets of any member of the Group.

It is a Repeating Representation, which is usually the case.

Borrower Notes

This representation is wide-ranging in that it requires each Obligor to have regard to whether its entry into and performance of the transactions contemplated by the Transaction Documents and the Transaction Security conflicts with not only its own constitutional documents and contractual obligations, but those of any other member of the Group.

The Parent, the Company and the Target are usually expected to give this representation at least in relation to themselves and their Subsidiaries (or Material Companies).

Additional Obligors will quite often point out that their entry into and performance of their obligations in relation to the transaction should only be considered by reference to their own constitutional documents and contractual obligations etc. (or, at least, only those of themselves and their Subsidiaries).

This representation is also often qualified by a reference to Material Adverse Effect, as to which (see Clause 1.1 (*Definitions*)). Borrowers might also properly qualify paragraph (a), which relates to non-conflict with applicable law, by reference to the Legal Reservations.

Borrowers commonly seek to delete the reference in paragraph (c) to the absence of any default or termination event under any agreement or instrument binding upon any member of the Group or the assets of any member of the Group, on the basis that it is duplicative of paragraph (b) of Clause 24.11 (*No default*), but has a wider scope.

Clause 24.5: Power and authority

Paragraph (a) is a standard representation relating to the Obligors' power to enter into the transaction and having taken all necessary action to authorise their entry into, performance and delivery of the Transaction Documents.

Paragraph (b) confirms that no applicable limits on borrowing, security or guarantees will be exceeded by the Obligor's entry into the transaction.

This representation is given by each Obligor in relation to itself and is a Repeating Representation (as is usually the case).

Borrower Notes

Depending on the point at which the Agreement is signed, Obligors might consider whether the reference to their having taken all necessary action should be amended to something like "will, by the required date, have taken all necessary action".

Paragraph (b) is in square brackets and some Borrowers may feel it should be deleted on the basis that it is duplicative. Borrowing limits and the like are likely to be contained in a company's constitutional documents and this matter would therefore be covered by the "no-conflict" representation. Additionally this issue is dealt with in the legal opinions and certificates from officers of each Obligor provided as conditions precedent, see Schedule 2 (*Conditions Precedent*).

Clause 24.6: Validity and admissibility in evidence

Paragraph (a) of Clause 24.6 requires each Obligor to confirm that all Authorisations "required or desirable" have been obtained in relation to the Transaction Documents to which it is a party including to make those Transaction Documents admissible in evidence in "**Relevant Jurisdictions**". Paragraph (b) relates to those Authorisations having been obtained and being in full force and effect which are necessary for the conduct of the Group's business.

This representation is a Repeating Representation (as is usually the case).

Borrower Notes

As a general point, this is another representation which overlaps to some extent with the legal opinions and, as such, might properly be made subject to the Legal Reservations, and insofar as it relates to the Transaction Security Documents, any perfection requirements (see Clause 24.3 (*Binding Obligations*) above).

Paragraph (a)(ii) is a representation that all Authorisations required or desirable to make the Transaction Documents admissible in evidence in court in all “**Relevant Jurisdictions**” have been obtained. The LMA User Guide to the Investment Grade Documents acknowledges that this is not required in relation to Obligor incorporated in England and Wales. The same point applies to the Leveraged Facilities Agreement, where the Group comprises English companies.

If this representation is included, there are a number of issues which Borrowers might seek to amend, for example:

- Borrowers might argue that paragraph (a) should be limited to all Authorisations “required” as opposed to all Authorisations “desirable” which is less certain.
- The LMA definition of “**Relevant Jurisdictions**” is very wide, including any jurisdiction where any asset subject to or intended to be subject to the Transaction Security is situated and any jurisdiction where the Obligor carries on business. In relation to Obligor whose business has a wide geographical reach or who are to grant security (for example by way of an English law floating charge) over all or substantially all of their assets, it is not likely to be possible for them to confirm with any certainty that the laws of all “**Relevant Jurisdictions**” have been considered in the context of the transaction. It is common therefore for this definition to be limited, for example, by reference to the Obligor’s jurisdiction of incorporation and any jurisdiction whose laws govern the perfection of any Transaction Security granted by it.
- A carve-out from paragraph (a) is likely to be required in respect of requirements which are to be satisfied, but may not have been satisfied at the date of the Agreement (e.g. stamping or filing requirements, if applicable).
- Some Obligor may object to giving the representation in paragraph (b) on the basis that they do not have knowledge as to whether all members of the Group have obtained necessary Authorisations. For example, Obligor may be able to speak only in relation to themselves and their Subsidiaries. Many Borrowers successfully delete this paragraph altogether (it overlaps to a large extent with Clause 24.15 (*No breach of laws*)).
- Paragraph (b) contains an optional qualification by reference to Material Adverse Effect which Borrowers commonly seek to extend to apply also to paragraph (a).

Clause 24.7: Governing law and enforcement

This representation is a statement as to the governing law and jurisdiction of the Finance Documents. The Obligors here are asked to represent that the choice of English law will be effective in, and that a judgment obtained in England will be enforced in, all Relevant Jurisdictions. This representation is a Repeating Representation.

Borrower Notes

In the investment grade market, this representation is often deleted. This is on the basis that it covers technical legal matters which are properly the subject of legal opinions. The LMA User Guide to the Investment Grade Documents acknowledges that it is not required from English corporate Obligors. There is no reason why this should not also be true in leveraged transactions which are concerned solely with English Obligors.

If Lenders insist on obtaining this representation in addition to a legal opinion, Obligors should ensure that it is qualified by reference to the reservations in the legal opinion, which should set out any necessary qualifications (the “**Legal Reservations**”: see Clause 24.3 (*Binding obligations*) above).

Borrowers should also pay attention to the definition of “**Relevant Jurisdictions**”: see comments above at Clause 24.6 (*Validity and admissibility in evidence*). Obligors might also seek to limit these representations to apply only to those Finance Documents to which they are a party (rather than all of them).

Clause 24.8: Insolvency

This representation confirms that none of the events described in Clause 28.6 (*Insolvency*), Clause 28.7 (*Insolvency proceedings*) and Clause 28.8 (*Creditors’ process*) have occurred or apply to any member of the Group. This is not and should not be a Repeating Representation (as the insolvency Events of Default will apply).

Borrower Notes

Borrowers may seek to resist this representation on the basis that it is duplicative of the insolvency Events of Default (see “*Duplicative Requirements*” above). Lenders may respond that this representation serves to focus attention on a key issue of concern to Lenders. It is commonly included, albeit in a more limited form. Some points commonly raised by Borrowers include the following:

- Each Obligor is required to make this representation in relation to itself and each other member of the Group. Obligors may seek to limit its application to the relevant Obligor and its Subsidiaries, to Material Companies or, if the representation is given to each member of the Group, by reference to the knowledge of the relevant Obligor (as to which see “*Scope of Representations*” and “*Qualifications by reference to knowledge*” in the introduction to this Clause 24 above).

- If this representation is included, care should be taken to ensure that it reflects the agreed scope of the corresponding Events of Default. For example, the representation refers to the circumstances covered by Clause 28.6 (*Insolvency*) insofar as they apply to any member of the Group. If Clause 28.6 is limited to apply only to Material Companies, for example, this should be reflected in Clause 24.8.

Clause 24.9: No filing or stamp taxes and Clause 24.10: Deduction of Tax

These representations relate to filing requirements and applicable stamp taxes on the Finance Documents in all Relevant Jurisdictions and the existence of tax deduction requirements on payments under the Finance Documents. These representations are not Repeating Representations.

Borrower Notes

The LMA acknowledges in relation to the Investment Grade Documents that these representations should not be needed from English corporate Obligors. Again, there is no particular reason why the situation should be any different in the Leveraged Facilities Agreement where the Target Group comprises English companies. It is very common for these representations to be deleted, in particular Clause 24.10.

Clause 24.9 contemplates that any filings or stamp taxes that are required on the Finance Documents are listed as exceptions to the representation. Legal and tax advice will be required to ensure the appropriate carve-outs are included, for example, any relevant filings in relation to the Transaction Security being made at Companies House. Note that the representation is drafted by reference to the requirements of all "**Relevant Jurisdictions**": see comments at Clause 24.7 (*Governing law and enforcement*) in relation to this definition.

If included, these representations should not be Repeating Representations (and are not included in the suggested definition of Repeating Representations included in the Leveraged Facilities Agreement). Clause 24.9, if repeated would amount to an additional tax gross up provision.

Clause 24.11: No default

Paragraph (a) of this representation relates to the existence of any Default or Event of Default and the likelihood of the same occurring as a result of any Utilisation or the entry into and performance of the transaction.

Paragraph (b) states that no default exists under any other agreement to which an Obligor or any of its Subsidiaries are party or to which their respective assets are subject.

This representation is a Repeating Representation.

Borrower Notes

Clause 24.11 (paragraph (a)) differs from the equivalent representation in the Investment Grade

Documents in that it states that on the signing date and on the Closing Date, no Default (rather than Event of Default) is continuing or is reasonably likely to result from the Utilisation or entry into the transactions contemplated by the Finance Documents. If this is untrue on either of those dates, a misrepresentation Event of Default will occur (subject to any agreed grace period). Therefore the effect of this representation as drafted is to enable Lenders to accelerate based on a Default rather than an Event of Default. If included, it should relate to Events of Default, not Defaults, and Borrowers quite commonly make this change.

Paragraph (b) confirms that no default exists under any other agreement to which a member of the Group is a party to the extent such default would have a Material Adverse Effect. Borrowers may argue that this is duplicative (covered by the representations at Clause 24.4 (*Non-conflict with other obligations*), Clause 24.14 (*No proceedings pending or threatened*) and the cross-default Event of Default (Clause 28.5)). Borrowers may become comfortable with inclusion subject to a satisfactory definition of “**Material Adverse Effect**” being agreed (see Clause 1.1 (*Definitions*) above).

Practice varies as to whether this representation constitutes a Repeating Representation. Additional Obligors may object to giving this representation, and it being repeated on the basis that paragraph (a) applies to the Transaction Documents (not just the Finance Documents). Consideration might be given to limiting paragraph (a) to those Transaction Documents to which the relevant Obligor is a party.

Clause 24.12: No misleading information

In order to arrange and syndicate the Facilities, the Agent and the Arrangers will rely on an array of information relating to the Parent and other members of the Group. This information may come from public sources or from members of the Group and their advisers. A key source of information will be the due diligence reports prepared for the purposes of the Acquisition (the “**Reports**”, see “*The Reports and the Acquisition Agreement*” above).

Based on the available information, the Investors will prepare financial models projecting the performance of the enlarged Group during the life of the Facilities based on a set of assumptions. From the Lenders’ perspective, the model will need to project sufficient cashflow within the business to service their debt in order for the transaction to proceed. The accuracy of the assumptions upon which their financial model (which, once agreed is usually referred to as the “**Base Case Model**”), is based is therefore of great importance. It will be the basis upon which the Lenders obtain credit approval to enter into the transaction. The financial covenant provisions will be set against the Base Case Model, in order that Lenders have a mechanism for being warned of any deterioration in the financial performance of the Group.

The Arrangers will also use the Reports and the Base Case Model to prepare an “**Information Memorandum**”, which will be distributed to potential Lenders as part of the syndication process. In the Leveraged Facilities Agreement, the Reports and the Base Case Model are together referred to as the “**Information Package**” (which definition also contains a blank contemplating that the parties might include any other information to be warranted).

The Arrangers, the Agent and the other Lenders will require comfort from the Obligors that the contents of the Information Package (in particular the Base Case Model and the assumptions

upon which it has been prepared) and the Information Memorandum are true, accurate and up to date. This is the purpose of the representations in Clause 24.12.

These representations are expressed to be repeated at different times to most of the other representations. Clause 24.32 (*Times at which representations made*) provides that the representations in Clause 24.12 are each made on the Closing Date and the Syndication Date and:

- with respect to the Information Memorandum, on the date it is approved by the Parent (although note that the Parent is permitted to make disclosures in writing to the Agent to qualify its warranties in relation to the Information Memorandum at any time prior to its date);
- with respect to the Information Package (the Reports and the Base Case Model), on the signing date;
- additionally with respect to the Reports, on any date falling after the signing date upon which the Information Package (or part of it) is released to the Arranger for distribution.

The “**Syndication Date**” is intended to be the date upon which primary syndication of the Facilities is completed. The definition provides two alternatives: either a specified period post-Completion “or such earlier date specified by the Arranger” or “the day upon which the Arranger confirms that primary syndication of the Facilities has been completed”.

Only paragraph (g) of this representation (which relates to “other” written information) is a Repeating Representation.

Borrower Notes

Terms of the representations

As the LMA User Guide notes, this is a particularly important representation in leveraged transactions and should be expected to be the subject of negotiation. Clause 24.12 is extremely wide and it is fairly unusual for it to be agreed as drafted. Borrowers should ensure that the scope of the information covered is described specifically to enable verification of its content. To this end, Borrowers might seek to limit these representations generally to written information (or material written information) and should seek to keep records of information provided to Lenders during the process leading up to signature of the Facilities and syndication.

The agreed permutations of this clause are many. Some issues commonly raised by Borrowers include the following:

- It is quite common for this representation to be made by the Parent alone (rather than by all of the Obligors), and for it to be qualified by reference to the Parent’s knowledge. A knowledge qualification is included in the LMA drafting in square brackets, but it applies only to the representations as to the Reports.
- Borrowers might argue that the representations which relate to accuracy of factual information, should be limited to written factual information (e.g. paragraph (a)) and should

refer to the material to which they relate (e.g. the Information Memorandum, or the Information Package) taken as a whole.

- The LMA language refers to financial projections and forecasts in the Information Package and the Information Memorandum. Borrowers may wish to limit representations on projections and forecasts to those contained in the Base Case Model, as the primary source of such information.
- In relation to the Base Case Model, Borrowers may seek to limit the representation concerning the projections to the effect that were based on recent (and possibly, in the case of a public bid, publicly available) historical financial information and on assumptions which in the opinion of the Parent were fair and reasonable at the relevant time. The extent to which a representation can be given that the Base Case Model has been prepared in accordance with Accounting Principles as applied to the Original Financial Statements is a matter of fact to be considered on a case by case basis.
- Any representations given as to expressions of opinion or intention (for example, paragraph (d)) may be limited to those contained in the Information Memorandum and provided by the Parent and their reasonableness and fairness judged in the Parent's opinion at the date upon which the Information Memorandum was approved.
- The use of the term "**Information Package**" to refer to the Base Case Model and the Reports in this provision requires close attention. Its use means that some of the provisions overlap (e.g. paragraphs (b) and (c) both relate to the financial projections in the Base Case Model). Borrowers may prefer to address representations as to the Reports and as to the Base Case Model separately.
- Borrowers will not wish to give the same levels of comfort to Lenders on the Information Memorandum and the Reports (which are provided by external advisers). Rights against the Report providers in respect of the contents of the Reports will be defined in the terms of engagement agreed with each Report provider. The Report providers, however, in preparing the reports, will not usually take responsibility for the accuracy of information provided by the Group for the purposes of preparing the relevant Report. Thus there is a gap in the Lenders' protection, which they are likely to perceive is appropriately a risk for the Borrower. In relation to the contents of the Reports, it is particularly important for any representations to be limited to the extent of the Parent's knowledge (and preferably, "actual" knowledge) and most Borrowers will resist giving representations in relation to information provided to Report providers (see e.g. paragraph (g)).
- Borrowers often successfully negotiate the deletion of paragraphs (f) and (g) on the basis that they are simply too wide and that the key information for the Finance Parties' purposes is contained in the Base Case Model, the Reports and the Information Memorandum. Paragraph (f) relates to any information relating to the Acquisition provided to a Finance Party by or on behalf of the Parent, the Company or the Investors. Paragraph (g) relates to all other written information provided by any member of the Group (including its advisers) to a Finance Party. If Lenders insist on paragraph (g) (which is intended by the LMA to be a Repeating Representation), Borrowers should negotiate to cut down its scope to something they can monitor, for example, all material factual information provided by the Parent to the Arrangers, the Agent or the Security Agent, or the conditions precedent documents provided

pursuant to the Agreement, by reference to appropriate materiality qualifications.

Times at which representations are given

The times at which these representations are given needs to be considered carefully. As mentioned above, Clause 24.12 is treated separately from the other representations in terms of repetition in the Leveraged Facilities Agreement (see Clause 24.32 (*Times when representations made*)). The representation in relation to the Information Memorandum, for example, cannot be made at signing unless the Information Memorandum has been finalised. The Lenders will instead want it to be made at the date the Information Memorandum is approved and/or issued. Lenders will want to know that the information they are using for syndication purposes is accurate at the date such information is released to potential Lenders.

The Obligors making the representations, however, are likely to be uncomfortable with giving representations on dates which are not fixed, in particular, on the “**Syndication Date**” as defined. The “**Syndication Date**” is intended to be the date upon which primary syndication of the Facilities is completed. The definition provides two alternatives: either a specified period post-Completion “or such earlier date specified by the Arranger” or “the day upon which the Arranger confirms that primary syndication of the Facilities have been completed”. The Obligors may prefer the option of a specified date (or at least prior notice of the date) to enable the accuracy of the representations to be reviewed.

Borrowers should note that the representations are expressed to be subject to matters disclosed in writing to the Agent or the Arranger prior to the signing date or the date of the Information Memorandum (in relation to the Information Memorandum). Borrowers may seek to extend their right to make disclosures to the “**Syndication Date**” if the representations are to be repeated on that date.

Clause 24.13: Original Financial Statements

This provision contains representations with regard to the accuracy of the Group’s financial statements (despite its title, it relates to both the “**Original Financial Statements**” and the financial statements most recently delivered to the Lenders pursuant to Clause 25.1 (*Financial statements*)).

Paragraph (a) is a standard representation that the Original Financial Statements have been prepared in accordance with Accounting Principles. The definition of “**Accounting Principles**” is “generally accepted accounting principles in []”, with an option to continue “including IFRS”, if the Original Financial Statements are IFRS-compliant. 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. If the Accounting Principles are “**IFRS**”, the option to define Accounting Principles simply as “**IFRS**” is provided.

The definition of “**IFRS**” is designed to reflect the fact that, for example, not all IFRS have been adopted in their entirety by the EU, and that the extent of their incorporation in the national law

of Member States differs (for example, IFRS can be used in the accounts of unlisted English companies and the individual accounts of listed English companies).

Paragraph (b) states that the unaudited Original Financial Statements “fairly represent” the Obligor’s financial condition and operations during the relevant financial year. Paragraph (c) provides that the audited Original Financial Statements “give a true and fair view” of the Obligor’s financial condition and operations during the relevant financial year. In each case, optional language is included to enable disclosure to the contrary.

The requirement applicable to IFRS financial statements is 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 Acts 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, recently confirmed in an opinion given by Michael Moore QC to the Financial Reporting Council.

Paragraph (d) is a representation that no material adverse change has occurred since the date of the Original Financial Statements.

Paragraphs (f) and (h) apply the same representations given in relation to the Original Financial Statements in paragraphs (a) to (d) to the most recently delivered financial statements.

Paragraph (g) is a representation in relation to budgets and forecasts, to the effect that they have been arrived at after careful consideration and have been prepared in good faith on the basis of recent information and reasonable assumptions.

Borrower Notes

The first issue for Borrowers to focus on is the identification of those financial statements which will comprise the “**Original Financial Statements**”. This is likely to depend on what is most recently available at the time the Agreement is signed and will need to be agreed.

In terms of the scope of this provision, issues for Borrowers include the following:

- The drafting of paragraphs (a) to (c) contemplates that these representations will be qualified by reference to matters disclosed to the Agent. Borrowers will need to ensure that appropriate disclosure is made in writing to limit their liability. Borrowers quite commonly succeed in qualifying the representations relating to the Original Financial Statements by reference to knowledge (see “*Qualifications by reference to knowledge*” above).
- Some Borrowers successfully resist the “no material adverse change” representation in this Clause in the leveraged market. This may be on the basis that Lenders do not need it where they have financial covenants against which to measure the Group’s financial condition and additionally, because a Material Adverse Change Event of Default often applies to leveraged transactions. If this representation is included, focus is required on what will constitute a material adverse change for these purposes, which is likely to include

a consideration of the definition of “**Material Adverse Effect**”. See further “**Material Adverse Effect**” at Clause 1.1 (*Definitions*) and Clause 28.19 (*Material adverse change*).

- The considerations outlined above also apply to paragraphs (f) and (h) which apply the same representations given in relation to the Original Financial Statements to the most recently delivered financial statements.
- Paragraph (e) is, in our view, quite rarely required by Lenders (it relates to consolidation of non Group entities).
- Paragraph (g) is often resisted by Borrowers. The Agreement is likely to require that periodic “**Budgets**” are delivered to Lenders during the life of the Facilities but Lenders have a significant level of control over these budgets via the financial covenants and the general undertakings and therefore Borrowers might argue that this representation is unnecessary. Initial budgets and forecasts are also the subject of the “no misleading information” representation (see Clause 24.12).

This representation is included as a Repeating Representation in the Leveraged Facilities Agreement to the extent that it applies to the most recently delivered financial statements. It is reasonably common for Borrowers to argue that rather than being treated as a periodically repeating representation, the elements of this provision which apply to financial statements to be delivered after the Closing Date pursuant to Clause 25.1 (*Financial statements*), should be repeated only on the date upon which such financial statements are delivered to the Agent.

Clause 24.14: No proceedings pending or threatened

This representation, in relation to the existence of any current or threatened litigation, is fairly standard. It is limited to litigation, arbitration or administrative proceedings or investigations which, if adversely determined, are reasonably likely to having a Material Adverse Effect. It is qualified by reference to the knowledge and belief (having made due and careful enquiry) of the relevant Obligor.

Borrower Notes

Clearly the Material Adverse Effect qualification is helpful from the Borrower’s perspective subject to agreement on a satisfactory definition. Some argue that a financial limit is more appropriate in this context, but the difficulties in determining an appropriate threshold mean that a Material Adverse Effect qualification is probably the more commonly agreed qualification.

Many Borrowers delete the reference to “if adversely determined”, on the basis that the commencement of litigation proceedings which, if adversely determined, would have a Material Adverse Effect should not result in this representation being breached if they are not likely to be adversely determined.

This representation is not and should not be a Repeating Representation as the existence of litigation is also covered by the information covenants and the Events of Default (see paragraph (b) of Clause 25.8 (*Information: miscellaneous*) and Clause 28.17 (*Litigation*)).

Clause 24.15: No breach of laws

Paragraph (a) is a customary representation confirming compliance with laws, subject to non-compliance having a Material Adverse Effect. It relates to compliance by the relevant Obligor and (optionally) its Subsidiaries. Paragraph (b) relates to the existence of labour disputes against any member of the Group.

Borrower Notes

Paragraph (b), relating to labour disputes, should be deleted unless there are specific concerns. It overlaps with the general “compliance with laws” representation in paragraph (a) and Clause 24.14 (*No proceedings pending or threatened*). If included, Borrowers should consider whether to limit its scope (e.g. to the relevant Obligor and its Subsidiaries which are Material Companies).

This representation is not and should not be a Repeating Representation as compliance with laws is also the subject of a covenant (see Clause 27.2 (*Compliance with laws*)).

Clause 24.16: Environmental laws

Clause 24.16 contains specific representations relating to compliance with environmental laws and environmental claims. It relates to compliance and claims by and against all members of the Group. Paragraph (c) relates to the adequacy of provisions in relation to environmental costs made in the Base Case Model.

Borrower Notes

Paragraphs (a) and (b) of this representation overlap with the general “no litigation” and “compliance with laws” representations in Clauses 24.14 and 24.15. Separate representations may be appropriate if environmental issues are of particular concern. If included, Borrowers will wish to consider its scope (e.g. whether to limit to the relevant Obligor and its Subsidiaries), any disclosures and an appropriate knowledge qualification (in relation to which, please refer to the introductory commentary to Clause 24 above).

Paragraph (c) is more controversial, relating to the adequacy of provisions in relation to environmental liabilities. In larger transactions at least, our view is that it is not common to include this provision, on the basis that representations as to the Base Case Model are dealt with in Clause 24.12 (*No misleading information*) and as to the financial statements in Clause 24.13 (*Original Financial Statements*).

This representation is not and should not be a Repeating Representation as environmental compliance (or compliance with laws generally) is dealt with in the covenants on an ongoing basis (see Clause 27.2 (*Compliance with laws*)).

Clause 24.17: Taxation

This Clause is optional. It relates to filing of tax returns, tax claims and investigations and the tax residency of the Obligors.

Borrower Notes

The first two limbs of this provision duplicate the general “compliance with laws” and “no litigation” representations. If included, they are usually subject to an appropriate materiality qualification and are commonly the subject of disclosures.

Paragraph (c), relating to tax residency, is rarely used.

This representation (if included) is not and should not be required to be a Repeating Representation.

Clause 24.18: Security and Financial Indebtedness

In Clause 24.18, the Obligors represent that no Security, Quasi-Security or Financial Indebtedness exists other than as permitted by the Agreement. These representations apply to all members of the Group.

Borrower Notes

Borrowers might consider limiting the scope of this clause e.g. to apply only to the relevant Obligor and its Subsidiaries.

This is a standard representation and is not and should not be a Repeating Representation, as the extent of Permitted Security and Permitted Financial Indebtedness is dealt with in the restrictive covenants (see Clauses 27.15 (*Negative Pledge*) and Clause 27.23 (*Financial Indebtedness*)).

Clause 24.19: Ranking

This representation confirms the ranking of the Transaction Security.

Borrower Notes

This is a fairly standard representation. In order to be accurate, Borrowers might argue, it should be qualified by reference to the Legal Reservations and any requirements relating to perfection of the relevant security interest (see Clause 24.3 (*Binding obligations*) above) and to security interests permitted to exist under the Agreement (e.g. “**Permitted Security**”).

It is expressed to be a Repeating Representation, but Borrowers may resist on the basis that the Lenders are protected by Clause 27.15 (*Negative Pledge*).

Clause 24.20: Good title to assets

In this provision the Obligors confirm that they (and their respective Subsidiaries) have good title to the assets required to carry on their business.

Borrower Notes

This representation is very often deleted but if included is commonly agreed subject to a materiality qualification and a knowledge qualification.

It is expressed to be a Repeating Representation, but this is quite often not the agreed position if the representation is included. Borrowers may argue that it is not necessary for this representation to be repeated on the basis that title to material assets which are subject to the Transaction Security will be subject to covenants for title in the security documents (at least, to the extent governed by English law).

Clause 24.21: Legal and beneficial ownership and Clause 24.22: Shares

These representations confirm the Obligors' ownership of assets over which security is being granted and that the assets are free from encumbrances.

Borrower Notes

Contractual protection along these lines is often included in the Transaction Security Documents which should be consistent with the Facility Agreement in this regard. This is also a reason why these representations do not need to be Repeating Representations. These provisions may require amendment to reflect the transaction and the circumstances of the Obligors' title to the relevant assets (e.g. if shares are held by a nominee on an Obligor's behalf, an Obligor cannot make a representation that it has legal ownership of those shares).

Paragraph (c) contemplates that on the Closing Date, the Target Shares will be beneficially owned by the Company and registration (required to transfer legal ownership) will be completed as soon as possible after Closing. Obligors should consider the accuracy of this statement carefully. In the context of a public offer, it is likely that only beneficial ownership of the shares in respect of which acceptances have been received will be achieved on the Closing Date, and this provision will need to be amended to reflect the circumstances.

Clause 24.23: Intellectual Property

This Clause contains specific representations in relation to the Group's intellectual property rights.

Borrower Notes

Specific representations in relation to Intellectual Property may not be required if such rights are not significant in the context of the Group. Title to intellectual property is addressed by the good

title to assets/legal and beneficial ownership representations (Clauses 24.20 and 24.21 above) and infringement claims, by the “no litigation” representation (Clause 24.14 above). If included, Borrowers commonly seek to include materiality and knowledge qualifications (as to which, please refer to the introductory commentary to this Clause 24 above).

See Clause 1.1 (*Definitions*) in relation to the definition of “**Intellectual Property**” which has an impact on the scope of this representation.

This representation (if included) is not and should not be a Repeating Representation.

Clause 24.24: Group Structure Chart

An accurate Group Structure Chart is required as a condition precedent (see Schedule 2 (*Conditions Precedent*)), and paragraph (a) of this Clause is a statement confirming its accuracy.

Paragraph (b) provides that all transfers and other steps resulting in the final Group structure set out in the chart have been taken in compliance with laws and the requirements of regulatory authorities.

Borrower Notes

The information contained in the Group Structure Chart will usually be obtained from searches at the relevant company registries and from information provided in the course of the due diligence exercise, so this representation should not be controversial. Any matters which cannot be verified will need to be disclosed to the Lenders by way of qualification to this representation. A representation as to the accuracy of the chart (appropriately qualified) is customary but the level of detail specified in paragraphs (a)(i) and (ii) is not usually required.

Paragraph (b) is not always used. It overlaps with and may therefore cut through any qualifications agreed in relation to Clause 24.15 (*No breach of laws*).

The Group Structure Chart representation is not and should not be a Repeating Representation. Other aspects of the Agreement will deal with changes to the Group structure post-Completion (e.g. provisions relating to change of control, acquisitions and disposals) and repeating this representation could have the effect of undermining those provisions.

Clause 24.25: Obligors

This representation confirms that all required parties become parties to the Finance Documents as Obligors on the Closing Date.

Borrower Notes

The identities of the Obligors, the timing of their accession to the Agreement and the capacity in which they do so will depend on the circumstances. For example, it may be agreed that all Subsidiaries of the Parent will be Obligors, or that all Material Companies, or all Subsidiaries

incorporated in agreed jurisdictions, will be Obligors. Whether certain entities accede to the Agreement as Obligors will depend on whether they hold assets which are to be subject to the Transaction Security.

Not all of the Obligors will be party to the Agreement on the Closing Date. Until the Closing Date, the sole Obligors are likely to be the Parent and Company. The Target often becomes an Obligor at Completion and relevant Subsidiaries will accede to the Agreement at Completion or within a pre-agreed period following the Closing Date (see Clause 27.38 (*Conditions subsequent*)).

Paragraph (b) of Clause 24.25 confirms that members of the Group representing the agreed level of Guarantor coverage are party to the Agreement as Guarantors. Until the Closing Date, the sole Guarantors are likely to be the Parent and the Company so there is a timing issue that is not reflected in the LMA drafting: members of the Target Group will accede to the Transaction Documents as Additional Guarantors shortly after the Closing Date. Lenders will usually insist on a long-stop date by which time all guarantees must be in place (see Clause 27.38 (*Conditions subsequent*)), but it would be fairly unusual for all cross-guarantees to be in place on the Closing Date itself.

As a result of these factors, Lenders do not usually require a representation to be given in these terms. The criteria for Obligor accession, the scope of the Transaction Security and guarantees is dealt with elsewhere in the document; in particular, ongoing Guarantor coverage requirements are dealt with in Clause 27.35 (*Guarantors*), the Agreed Security Principles (see Schedule 14) set out the scope of the Transaction Security and the conditions subsequent (Clause 27.38) will address timing issues.

If included, Clause 24.25 will need to be tailored and should not be a Repeating Representation as it relates to circumstances existing at the Closing Date.

Clause 24.26: Accounting reference date

This representation confirms the Group's accounting reference date.

Borrower Notes

This representation may be deleted if the point is dealt with in Clause 25 (*Information Undertakings*) or Clause 26 (*Financial Covenants*). See in particular Clause 25.7 (*Year-end*).

If included, this representation is not and should not be a Repeating Representation as Clause 25.7 (*Year-end*) contains ongoing undertakings relating to the year end of each member of the Group.

Clause 24.27: Acquisition Documents, disclosures and other Documents

Paragraph (a) is a confirmation that the Acquisition Documents contain all the terms of the Acquisition. Paragraph (b) states (in effect) that no "disclosure" exists which could have an adverse effect on the Information Package. Paragraph (c) requires the Obligors to confirm that

the representations and warranties in the Acquisition Agreement are true and paragraph (d) states that all material terms agreed between Senior Management and the Investors and Senior Management and any member of the Group are contained in the documents specified.

Borrower Notes

Paragraph (a) is often included, but limited to refer to all material terms of the Acquisition. In many transactions, this is the sole extent of this representation.

The remainder of the representation is more controversial. Paragraph (b) is extremely wide and what is meant by a “disclosure” is vague. Borrowers should argue that the accuracy of the Information Package is dealt with in the “no misleading information” representation (Clause 24.12) and therefore this paragraph should be excluded. The same argument applies to paragraph (c), which requires the Obligors to confirm that the representations and warranties in the Acquisition Agreement are true.

The intention of paragraph (d) is to confirm that Lenders have notice of all relevant terms. Again, this is likely to be objectionable to Borrowers. The terms of senior personnel are likely to be the subject of due diligence but that does not mean that all such terms will be disclosed by the Vendor. A representation of this nature is not commonly included although Lenders sometimes seek a specific representation that the “*Investor Documents*” (i.e. those documents evidencing the equity funding arrangements) contain all material terms of those arrangements.

This Clause is not appropriate in the context of a public bid, where instead a representation along the lines of paragraph (a) might be included in relation to the offer or scheme of arrangement documents.

This representation is not and should not be a Repeating Representation as it relates only to circumstances existing at Closing.

Clause 24.28: Centre of main interests and establishments

Clause 24.28 requires each Obligor to confirm the location of its centre of main interests or “COMI” and (optionally) that it has no “**establishment**” in any other jurisdiction for the purposes of the EC Insolvency Regulation 1346/2000 (the “*Regulation*”).

The Regulation is intended to facilitate cross-border insolvencies within the EU. It provides for mutual recognition of insolvency proceedings between EU member states and determines the jurisdictions in which main and secondary insolvency proceedings can be opened.

The Regulation provides that the courts of the member state in which the Obligor’s COMI is located shall have jurisdiction to open “main insolvency proceedings” and that the law applicable to those proceedings will be the law of that member state opening those proceedings. The jurisdiction of any “secondary” or “territorial” proceedings to be opened in an EU member state will be determined by reference to whether the Obligor has an “establishment” in that member state.

The Lenders’ main concern is to avoid the risk that an Obligor’s COMI will be found to be located in a jurisdiction other than that assumed to be applicable and that insolvency

proceedings in relation to an Obligor in that jurisdiction (i.e. that member state where its COMI is located) could operate to restrict their rights.

If the Lenders have the benefit of security (as will invariably be the case in a leveraged transaction) concerns about the operation of the Regulation are mitigated to some extent by the effects of Article 5 of the Regulation. Article 5 protects rights “in rem”, a legal concept referring to rights based on an interest in an asset. This includes rights to enforce security, meaning that generally speaking, such rights can be asserted against property situate in a particular jurisdiction, unaffected by the existence of main proceedings elsewhere. To this extent Lenders’ rights in relation to security are unaffected by an Obligor’s COMI.

The Regulation is directly applicable in all EU member states except Denmark. Certain types of debtor are excluded from the Regulation, the key examples being credit institutions and insurance companies which are subject to separate regulations. The Regulation also does not apply to all types of insolvency proceedings. Lenders and Obligors will need to take legal advice to determine the extent to which the Regulation is relevant to the transaction at the outset.

A brief outline of the detailed legislative provisions is set out below, but this is a complex topic upon which specific legal advice will be required.

“COMI” and “establishment”

“COMI” is not defined in the Regulation. Instead, Article 3(1) of the Regulation contains a rebuttable presumption that a debtor’s COMI is the country in which its registered office is located. An “establishment” is defined in Article 2 of the Regulation as “any place of operations where the debtor carries out a non-transitory economic activity with human means and goods”.

These provisions make it difficult to determine a debtor’s COMI and the existence of any “establishment” with any certainty. The provisions fall to be interpreted by the courts, and differing interpretations may apply under the national law of each EU member state. Interpretation of the terms will depend on the state of the law at the time at which the question is asked. The question may be especially difficult where the debtor is controlled by another member of the same corporate group with its registered office in a different jurisdiction (the Regulation does not recognise the concept of group companies but treats each company as a separate entity).

There have been a number of cases in which these provisions have been considered by the courts. In the Eurofood case (Case C – 341/04), the ECJ held that the presumption as to a debtor’s COMI can be rebutted only if factors to the contrary exist which are both “objective and ascertainable by third parties”. In the Eurofood case and others, considerable importance has been attached to Recital 13 to the Regulation, which states that a debtor’s COMI “should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties”. Since the Eurofood decision, it is likely to be more difficult to rebut the presumption that a debtor’s COMI is its registered office than had previously appeared to be the case. Judicial guidance is still insufficient, however, to determine COMI in all cases with absolute certainty.

Borrower Notes

The language of the representation is problematic because of legal uncertainties referred to

above in relation determining an Obligor's "COMI" or "establishment". Borrowers may be concerned that their business interests could shift, resulting in a change in COMI that was not necessarily intended. This uncertainty results in many Borrowers arguing that the representation should be deleted. Borrowers might also base this argument on the mitigating effects of the existence of security on the impact of the Regulation, outlined above.

If Lenders insist on a representation on this topic, Borrowers should ensure that the text of the representation deals with matters of fact rather than law, and that its meaning is certain. The most important single factor in determining COMI is likely to be the location of the Obligor's registered office, because of the rebuttable presumption in the Regulation that a corporate debtor's COMI is its registered office. Therefore, for example, each Obligor should be able to represent the location in which its registered office is situated (and repeat that representation).

Although a representation as to the location of its registered office may be the most satisfactory solution for an Obligor, Lenders may wish for greater comfort, as the COMI presumption is rebuttable. In the light of the Eurofood decision, Lenders might request a representation as to the location of the Obligor's registered office coupled with a representation that on the basis of factors which are both objective and ascertainable by a third party, a third party would conclude that its COMI is in the same jurisdiction as its registered office, if that is the case. From a Borrower's point of view, this may be insufficiently certain to be acceptable. Borrowers might, however, be able to offer further comfort in terms of specific factual issues that might be considered relevant to satisfy the Eurofood test. Relevant facts could be the usual location for board meetings, for example.

As explained above, a key concern for Lenders is becoming subject to the insolvency laws of jurisdictions in relation to which they have not taken legal advice in structuring transactions. Lenders will have taken legal advice in each jurisdiction in which an Obligor is incorporated (and most likely, in each jurisdiction in which security assets are situated), each a "**Relevant Jurisdiction**". Therefore, Borrowers might argue that the operation of any representation in relation to the Regulation should be limited to situations where a law other than that of a Relevant Jurisdiction will come into play. For example, if a transaction involves both French and English Obligors, Lenders will have taken advice in both jurisdictions before entering into the transaction.

Borrowers should note that even if the Regulation is not relevant at the signing date (as there are no Obligors with a COMI in the EU), the Regulation might still be a topic for discussion. Lenders may feel that they could be disadvantaged if, for example, a non-EU subsidiary moved its COMI to an EU member state or set up an establishment in the EU, as the transaction will not have been structured to cater for this eventuality.

As mentioned above, any representation on this topic is usually a Repeating Representation. However, in some transactions, Obligors undertake to Lenders that they will take no action knowingly to alter their COMI. Any such undertaking should take the place of a Repeating Representation.

Clause 24.29: Pensions

This is one of a series of provisions inserted into the Leveraged Facilities Agreement as a result of the Pensions Act.

This representation confirms that (save as disclosed to the Lenders), no member of the Group is or at any time has been an employer or “connected” or “associated” with the employer of a pension scheme which is not a money purchase scheme. The reference to “connected” and “associated” members of the Group is necessary as the Pensions Act empowers the Pensions Regulator, in certain circumstances, to impose liability for an underfunded scheme on such persons. See “**Pensions Regulator**” at Clause 1.1 (*Definitions*) for an outline of the statutory regime.

Borrower Notes

This representation will only be relevant if the Group has not and never has operated a defined benefit pension scheme. It confirms to the Lenders that no liabilities exist because no relevant pension schemes exist. If due diligence confirms that this is the case (or appropriate disclosure is made to qualify the representation), this should not be controversial. Note that the statutory definitions of “connected” and “associated” which apply in this context are very wide and would include, for example, the situation where a director of a Group company is also a director of a company outside the Group which operates a defined benefit pension scheme. See further commentary under “**Pensions Regulator**” at Clause 1.1 (*Definitions*) above.

In some transactions, Lenders have sought specific representations regarding compliance with legal and regulatory requirements in relation to the funding of relevant pension schemes. Such provisions may be resisted on the basis that the general “compliance with laws” representation applies, or that their wording implies that the scheme is “fully funded” in circumstances where it is perfectly acceptable for the scheme to be in default on a certain basis. If a separate representation along these lines is included, Borrowers should ensure that appropriate limitations are negotiated on a consistent basis with the “compliance with laws” representation (often, a qualification by reference to Material Adverse Effect).

This representation should not be a Repeating Representation (especially if the Agreement contains ongoing covenant requirements in relation to pensions).

Clause 24.30: No adverse consequences

This representation is aimed at giving Lenders comfort that there will be no adverse consequences to them of lending to the Group in terms of legal or regulatory issues (for example, if any kind of licence or authorisation is required).

Borrower Notes

This representation is likely to be strongly resisted by Borrowers. The Lenders’ regulatory, legal and tax affairs are for each Lender to determine in conjunction with its advisers.

Clause 24.31: Holding and Dormant Companies

This representation confirms the status of holding companies and dormant companies within the Group. The Leveraged Facilities Agreement assumes that the Parent and the Company are both holding companies (as is usually the case) and, before the Closing Date, that they have no

liabilities save as arising under the Transaction Documents and in respect of the Acquisition Costs.

Borrower Notes

This representation will need to be tailored to reflect accurately the circumstances. For example, if market purchase facilities have been entered into on a public bid financing or if the Facilities refinance bridge debt incurred by the Company, this will need to be reflected in the wording of this representation. In the interests of greater certainty, in some transactions, liabilities relating to holding company activity are specified to include, for example, administrative costs, liabilities for tax and other customary liabilities of holding companies.

It may be more accurate to change the reference to the Parent and the Company having no liabilities prior to the Closing Date to their having no liabilities prior to the first Utilisation Date.

Borrowers often resist giving representations in relation to Dormant Companies.

This representation is not and should not be a Repeating Representation (as the circumstances of the Parent and the Company will obviously change after the Closing Date and are likely to be the subject of a covenant: see Clause 27.10 (*Holding Companies*)).

Clause 24.32: Times when representations made

This Clause sets out the times at which the representations are made. In general, the Leveraged Facilities Agreement contemplates that the representations will be given by the Obligors on the signing date and the Closing Date which reflects usual market practice. This is subject to modification in relation to Clause 24.12 (*No misleading information*).

The “**Repeating Representations**” are expressed to be repeated on the date of each Utilisation Request, on each Utilisation Date and on the first day of each Interest Period by reference to the facts and circumstances existing on that date.

All of the representations except Clause 24.12 (*No misleading information*), Clause 24.24 (*Group Structure Chart*), Clause 24.27 (*Acquisition Documents, disclosures and other Documents*) and Clause 24.31 (*Holding and Dormant Companies*) are deemed to be made by each Additional Obligor on the date upon which it becomes or it is proposed that it becomes an Obligor.

Each representation made after the date of the Agreement is deemed to be made by reference to the facts and circumstances existing on the date upon which the representation is deemed to be made.

Borrower Notes

Clause 24.12 (No misleading information)

Borrowers may have concerns as to the times at which these representations are repeated.

Certain of these are considered above at Clause 24.12.

Repeating Representations

Stronger Borrowers often resist repetition of the Repeating Representations on each Utilisation Date (on the basis that the time period between a Utilisation Request and a Utilisation Date is very short).

An indication is given in relation to each representation above as to whether it is usually or should properly be a Repeating Representation. To summarise, Borrowers generally seek to limit the scope of the Repeating Representations to those relating to the Obligors' validity, enforceability and capacity to enter into the transaction documents, that is, Clauses 24.2 (*Status*) to 24.7 (*Governing law and enforcement*). Others may be appropriate depending on the circumstances. Additionally, it is reasonably common for the representations in relation to the financial statements provided after Closing to be repeated but in relation only to the most recently delivered financial statements and on the date on which those statements are delivered: see Clause 24.13 (*Original Financial Statements*) above.

Additional Obligors

As mentioned above (see "*Qualifications by reference to knowledge*"), when negotiating the Facility Agreement, the Parent and the Company will have to bear in mind the likely concerns and the extent of the knowledge of those members of the Target Group which are intended to accede to the Facility Agreement as Obligors and ensure that the representations which they will be deemed to give are appropriately tailored.

The Leveraged Facilities Agreement contains more onerous requirements in this regard than are commonly negotiated in practice. The representations that are required to be given by acceding Obligors are quite commonly limited to those mentioned as appropriate Repeating Representations above, that is, Clauses 24.2 (*Status*) to 24.7 (*Governing law and enforcement*), and in each case, applicable only to either the acceding Obligor itself or, for example, the acceding Obligor and its Subsidiaries.

Note that according to paragraph (e) as drafted, representations by acceding Obligors are given both on the date that they become Obligors or "the date upon which it is proposed that they become Obligors". The latter should be resisted on the basis of being insufficiently certain.

CLAUSE 25: INFORMATION UNDERTAKINGS

Introduction

These undertakings relate to the information required to be delivered by the Obligors to the Lenders during the life of the Facilities.

Borrower Notes

The key issue from the Borrower's point of view in relation to information undertakings is to

ensure that the Lenders' requirements accord with what the Company and the Target Group are able to produce and that the time frames for delivery are achievable. The scope of the information undertakings in the Leveraged Facilities Agreement very broadly reflects the approach often seen in the market. However, the scope of information undertakings has been the subject of increased focus in recent times as a result of certain developments relating to the types of investor now participating in the loan market.

Concerns have been voiced about market abuse by non-bank institutions such as hedge funds who participate in syndicated loans and also deal in regulated investments (such as equities). The LMA has issued two statements which relate to the inclusion in syndicates of public-side Lenders, the second of which contains guidance for loan market participants on potential areas of concern and how information flows might be managed in such circumstances.

In September 2008, the LMA made a number of amendments to the Leveraged Facilities Agreement which were intended to address the concerns of public-side Lenders, for example, a new paragraph (d) was added to Clause 32.13 (*Relationship with the Lenders*) to enable Lenders to appoint a person to receive communications on their behalf and new paragraph (c) of Clause 32.8 (*Responsibility for documentation*) was added to make clear that none of the Arranger, the Issuing Bank or any Ancillary Lenders is responsible for any determination as to whether information provided to any Finance Party is non-public information.

These changes are a useful response to requests from certain participants in the loan market who have asked for sanitised information packages, "scrubbed" of private-side information. From a Borrower perspective it is hard to see how such requests could be dealt with in practical terms, save by not providing any documentation at all to such participants who opt out. The internal requirements of a Lender in relation to the provision of confidential 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 raised, Borrowers are likely to resist any suggestion that they might police the information flow on behalf of such Lenders.

Clause 25.1: Financial statements

Clause 25.1 contemplates the delivery of annual, quarterly and monthly financial statements to the Lenders.

Borrower Notes

Financial covenants (see Clause 26 (*Financial Covenants*) below) are usually tested on a quarterly basis, so monthly financial statements are not always required.

The time for delivery of financial statements varies. Four to six months after the year end is usually permitted for audited statements, one to two months for quarterly statements.

The extent to which solus accounts or consolidated accounts prepared below Group level are provided to Lenders varies. Lenders may wish to see (or retain the right to request) solus accounts for certain Material Companies.

Clause 25.2: Provision and contents of Compliance Certificate

Compliance Certificates are required to be delivered quarterly, together with the relevant accounts. A form of Compliance Certificate is included at Schedule 9 to the Leveraged Facilities Agreement. The form of Compliance Certificate includes confirmation of the following matters:

- compliance with the financial covenants. This is the customary purpose of a Compliance Certificate; and
- compliance with other financial tests in the Agreement: for example the Margin ratchet, the number of companies which qualify as Material Companies and satisfaction of any Guarantor coverage test, to be included as applicable.

The form of Compliance Certificate in Schedule 9 also contains confirmation that no Default is continuing (or if any Default is continuing, details of the Default and steps being taken to remedy it).

A Compliance Certificate is required to be signed by two directors of the Parent. The Clause goes on to provide (optionally) that any Compliance Certificate accompanying audited accounts is required to be accompanied by a report from the Company's auditors in the form agreed by the Parent and the Majority Lenders.

Borrower Notes

Some Borrowers may resist including any confirmation in the Compliance Certificate as to whether any Default is continuing. This is on the basis that a Compliance Certificate is a snapshot of the Obligors' compliance with the Agreement as at a particular testing date. The appropriate mechanism for notification of Defaults is via the covenant at Clause 25.9 (*Notification of default*). It is also unclear what the statement in the Compliance Certificate is intended to confirm. If the statement relates to the existence of any Default as at the testing date, this is not a useful statement for the Lenders' purposes because the situation may have changed in the period between the testing date and the date upon which the Compliance Certificate is delivered. If the Lenders are looking for confirmation as at the date the Compliance Certificate is delivered, this could potentially delay the delivery of the relevant Compliance Certificate. Whether Borrowers are able to succeed with these arguments varies.

Borrowers may also resist the requirement for an auditor's report in relation to Compliance Certificates. If auditor involvement is agreed, Borrowers should be aware of a guidance statement issued by the Institute of Chartered Accountants in November 2000, which advises accountants that they should not report to Lenders on Borrowers' 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 provision of an auditor's report is agreed, it is important to involve the auditors at an early stage in discussions, to ensure that the exact nature of their remit is settled before signing. If the auditors will be reporting on the certificate, the form of the report needs to be

settled.

There are some difficult issues relevant to the delivery of Compliance Certificates, relating to the point at which a Default under the financial covenants is triggered. These issues are discussed at Clause 26.3 (*Financial Testing*).

Clause 25.3: Requirements as to financial statements

This Clause sets out requirements as to the content of the financial statements delivered under Clause 25.1 (*Financial statements*).

Borrower Notes

The detail of this provision, in particular, in terms of which financial statements are to be delivered, will need to be agreed. Note that in certain jurisdictions Lenders may require particular financial statements for regulatory purposes. Generally, the Borrower will be concerned to ensure that these requirements provide Lenders with what they need without being so burdensome as to inhibit the Group's ability to run its business.

When negotiating this provision, Borrowers should bear in mind the extent of the representations in relation to the financial statements (see Clause 24.13 (*Original Financial Statements*) above). For example, paragraph (a)(iii) requires that each set of quarterly financial statements includes a cashflow forecast. Borrowers should take care to ensure that any such forecast is not warranted (other than the belief that the assumptions on which it is based are reasonable and that it has been prepared in good faith).

Paragraph (b)(iii) provides two options: that the financial statements shall be prepared on the basis of the Accounting Principles or alternatively, that the financial statements are prepared on a consistent basis with the Base Case Model (in the case of the Parent) or the Original Financial Statements (in the case of any Obligor).

Paragraph (b) includes so-called "frozen GAAP" wording. This provides that if there is a change in Accounting Principles or accounting practices, the auditors must provide to the Agent a description of the changes and sufficient information to enable the Lenders to make a comparison of the most recently delivered financial statements with the Original Financial Statements or the Base Case Model (as the case may be). In particular, the Agent must be provided with sufficient information to determine whether the financial covenants have been met, to calculate the applicable Margin and to calculate the amount of any mandatory prepayment obligations.

In any case where there is a possibility that individual or group financial statements may switch to alternative Accounting Principles or accounting practices during the life of the Facilities (and leveraged facilities are usually long term facilities), it will usually be advisable to include an additional Clause, under which the parties agree, on a change in Accounting Principles, to negotiate in good faith to settle the amendments which are required to the agreement as a result. In relation to the Investment Grade Agreements, the LMA and ACT agreed the following wording in the context of the move to IFRS in the UK:

“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.

Paragraph (c) may be controversial: it gives the Agent the right to submit questions about the Group’s financial condition to the Auditors (via the Parent), at the Parent’s cost. The Parent may want to limit this right, for example, by reference to cost and such that it applies only during the continuance of a Default.

Clause 25.4: Budget

Clause 25.4 provides for an annual budget and any updates to be supplied to the Lenders.

Borrower Notes

Similar considerations apply in terms of content and the timing of delivery of budget information as described above in relation to the financial statements.

Clause 25.5: Group companies

This Clause permits the Agent to request at any time confirmation of the Group’s compliance with the Guarantor coverage test and of those companies which qualify as Material Companies.

Borrower Notes

Borrowers may resist this provision on the basis that it is unduly burdensome. This information will be provided to Lenders quarterly via the Compliance Certificates (see Clause 25.2 (*Provision and contents of Compliance Certificate*) above).

Clause 25.6: Presentations

This provision requires at least two directors of the Parent (including the chief financial officer) to make an annual presentation to the Finance Parties as to the Group’s business and financial position. More frequent presentations may be requested if the Agent suspects a Default is continuing or may have occurred or may occur.

Borrower Notes

Borrowers are likely to object to the requirement to make presentations at any time where the Agent suspects a Default. Borrowers may seek to impose the more onerous test of no Event of Default or to delete the reference to a Default which “may occur” or “may have occurred”.

Clause 25.7: Year - end

This Clause sets out requirements as to the accounting reference date of companies within the Group.

Clause 25.8: Information: miscellaneous

This Clause contains a number of information requirements including notification of any material litigation, of the occurrence of any mandatory prepayment trigger (Recovery Claims, acquisitions or disposals) plus a general requirement to supply the Security Agent with any information reasonably required in relation to security, and the Agent with any other information reasonably required.

Borrower Notes

Certain aspects of this provision may be objectionable from a Borrower perspective, for example:

- the Parent may resist copying Lenders in on information provided to its shareholders as required by paragraph (a). The obligation applies only to information provided to shareholders generally (or any class of them), but particularly in the private equity context, this may not be acceptable to Borrowers;
- the general requirements in paragraphs (d) and (e) to provide further information to the Security Agent and the Agent might be limited to such information that can be provided without material cost to the Group (at least prior to the occurrence of an Event of Default).

Additionally, Borrowers should ensure that the materiality threshold for notification of litigation and claims in paragraph (b) is consistent with that agreed in the related representation and Event of Default (see Clause 24.14 (*No proceedings pending or threatened*) and Clause 28.17 (*Litigation*)).

Clause 25.9: Notification of Default

This is a fairly customary provision obliging each Obligor to notify the Agent promptly upon becoming aware of the existence of any Default.

Borrower Notes

To ensure that this obligation is complied with on a timely basis in complex Groups, Borrowers may wish to provide that the notification requirement is triggered promptly upon the Parent

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 25.10: “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 prior to signing. Clause 25.10 requires the Obligors to provide KYC information to Lenders in one 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.

Borrower Notes

There are a couple of issues which Borrowers may raise with Lenders in relation to this provision in the context of a leveraged transaction:

- Borrowers may wish to provide that all requests for KYC information should be sent via the Agent.
- The information which the Obligors 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 . . .”); or Lenders may be prepared to concede that the aim is for them to be satisfied “acting reasonably”.

The background to the introduction of these provisions by the LMA is discussed in detail in the ACT Borrower’s Guide to the Investment Grade Documents, Part II at Clause 20.7.

CLAUSE 26: FINANCIAL COVENANTS

Introduction

Clause 26 contains the financial covenants which are most often considered appropriate for a cashflow-based leveraged financing: Cashflow Cover, Senior Interest Cover, Interest Cover, Leverage (sometimes called debt cover), Senior Leverage and limits on Capital Expenditure and finance lease exposures. The tests are described in more detail at Clause 26.2 (*Financial Condition*).

As with the rest of the Leveraged Facilities Agreement, the LMA did not seek comments from the ACT (or any other borrower representative group) in producing the financial covenant provisions, although when they were originally published, it indicated that certain sponsor term sheet provisions were considered during the documentation process. The financial covenant provisions therefore do not reflect all of the provisions which Borrowers and Investors may wish to see.

Financial covenants always need tailoring to the transaction. The financial covenants must reflect the deal structure, the Group's business sector, the Group's revenue, earnings and cashflow profile, the Investors' strategy for the Group and the Base Case Model. In particular, note that:

- Clause 26 contains financial covenant provisions appropriate for a cashflow based financing. If the financing is asset based, other types of financial covenant, for example, net worth or net asset covenants or loan to value covenants may apply. Asset-based covenants are rare in leveraged deals unless there are substantial real estate or infrastructure assets.
- The financial covenants should be consistent with the Group's Accounting Principles. Clause 26 assumes UK GAAP or IFRS applies. If a national GAAP other than UK GAAP or IFRS applies, local requirements will need to be considered.

The commentary below highlights issues which are often negotiated.

Borrower Notes

“Covenant-lite” and “mulligans”

Financial covenants are usually among the most heavily negotiated parts of any leveraged facility agreement and, in the period leading up to the credit crunch, Borrowers made significant inroads into Lenders' covenant protection. The most dramatic example of this was the arrival in the European market of the first “covenant-lite” loans in early 2007.

“Covenant-lite”, a US import, is not a term of art – there are various permutations and it can simply mean a loan agreement with fewer or looser covenants. However it is probably most commonly understood to refer to loan agreements which behave more like high yield bonds: they contain no traditional financial maintenance covenants but instead restrict the Group from taking specific action (e.g. incurring Financial Indebtedness) if agreed financial ratios might thereby be breached. The availability of covenant-lite financing in Europe has, however, been

limited to a relatively small handful of deals and covenant-lite financing terms are no longer available in the European market so covenant-lite terms are not considered in detail in this guide. For further information on covenant-lite see the “ACT explanation of cov-lite” (June 2007), available on the ACT website, (<http://www.treasurers.org/privateequity/covlite>).

Another Borrower-side concession that was much discussed prior to the crunch was covenant “mulligans”. A “mulligan” allows financial covenants to be breached one or more times without consequence. Mulligans were negotiated in a fairly small number of deals, even whilst market conditions were favourable (and are not to be confused with the more common “deemed cure” provision, discussed in relation to equity cure rights below). These provisions are not likely to be agreed in the current market.

At the time of writing, in most circumstances, Lenders are seeking a fairly full, more traditional set of financial covenants, although it would be rare to see a leveraged facility agreement containing all of the covenants in Clause 26. It would be unusual to see both a Senior Interest Cover and an Interest Cover covenant or both a Senior Leverage and a Leverage covenant for example. Outside the “cov-lite”/“cov-loose” structures seen in early 2007, the most commonly seen financial covenants are Cashflow Cover, Interest Cover, Leverage and Capital Expenditure limits.

Equity Cure Rights

Equity cure rights enable investors or sponsors to provide additional equity, which will be applied as agreed in the documentation, in order to “cure” breaches of the financial covenants applicable to the Group. Perhaps the most notable omission from Clause 26 from a Borrower perspective is an equity cure right. Such rights have become very common in the leveraged market and are often a key focus of negotiations on financial covenant provisions.

If the inclusion of an equity cure right is agreed, negotiations often focus on how any such amounts should be applied (to increase Cashflow and/or EBITDA and/or to reduce borrowings), the timing of exercise and the effects of the “cure”.

Application of Equity Cure Amounts

Equity cure rights usually operate such that financial covenants will be recalculated on a pro-forma basis for the testing period in which the breach occurs to include any equity cure amounts. To enable the recalculated figures to be determined, the agreement must specify how any equity cure amounts are to be treated.

It is fairly common for Lenders to agree to equity cure amounts being applied to increase Cashflow. If the Group has a short-term cashflow problem, the application of additional equity to increase Cashflow will solve the problem (being extra cash). However, Borrowers will usually also want to ensure that any equity cure amount is applied to increase EBITDA to cure any breach of the Leverage ratio (often the key ratio for the purposes of the Facility Agreement). Lenders dislike additional equity being added to EBITDA, as doing so can mask, but does not solve, underlying profitability issues. Nonetheless, Borrowers have often been successful in negotiating the right to apply equity cure amounts to EBITDA.

Some Lenders resist the application of equity cure amounts to Cashflow and/or EBITDA and instead argue that equity cure amounts should be applied to reduce Borrowings. From a Borrower perspective, this is obviously less attractive, as if the equity cure amount is applied to reduce debt instead of increasing EBITDA, its positive impact on the leverage ratio will be less. Additionally, if equity is applied to reduce debt for financial covenant purposes, Lenders are likely to seek to have the additional equity either applied directly to prepayment or placed in a blocked account (from which it will usually be released if the financial covenants are complied with for a certain period going forward). In these circumstances, Borrowers might seek to argue that equity cure amounts applied to reduce Borrowings for financial covenant purposes, rather than being applied to prepayment, should be treated as part of Excess Cashflow (given that only a percentage of Excess Cashflow is usually applied to prepayment).

Timing issues

The operation of any equity cure right is usually limited in terms of the permitted frequency of exercise and the time frame within which the additional equity must be provided. Lenders often impose a limit on the number of times an equity cure right can be exercised in consecutive periods: the maximum is usually two or three times. It is also fairly common to apply an overall cap on the number of times the equity cure right can be exercised during the life of the deal, usually somewhere up to around four times.

Investors are usually only permitted a certain window within which to provide additional equity. Equity is typically required to be provided within up to around 30 days of the relevant Compliance Certificate which confirms to the Lenders the existence of a breach of the financial covenants. Theoretically, there is nothing to stop Investors providing additional equity prior to the date of the relevant Compliance Certificate in order to “cure” a potential breach before it happens, although this is not always expressly stated in equity cure provisions. The concept of prevention as well as cure should not be controversial from the Lender perspective if the general concept of an equity cure right is agreed, and it is advisable to deal with the issue expressly in order that there is no argument as to the manner of application of additional equity provided in such circumstances. This might be achieved by including any additional equity provided during the period as part of the definitions of EBITDA/Cashflow etc. in the financial covenant provisions.

Borrowers should also consider the relationship between the time frame permitted for the exercise of equity cure rights and the Event of Default provision relating to the financial covenants. If a Default under the financial covenants occurs which is capable of cure (by means of equity cure or otherwise), a Borrower is likely to want to ensure that it is able to remedy the Default before it becomes an Event of Default. An Event of Default has more serious consequences under the Facility Agreement than a Default and its existence is more likely to trigger cross-default provisions or other negative consequences for the Group. It is important therefore, from the Borrower’s perspective, that the applicable grace period for curing any breach of the financial covenants matches or exceeds the period within which any equity cure right can be exercised. It is also important that any agreed grace period does not begin to run until the Borrower becomes aware of the breach (ideally, no Default should occur until the date for delivery of the relevant Compliance Certificate, by which time the extent of the Group’s compliance with the financial covenants will be apparent). This point is discussed further in the Borrower Notes to Clause 26.3 (*Financial testing*).

Scope of deemed cure

If a breach of covenant is cured by means of additional equity, Borrowers should pay particular attention to the effects of the “cure”. Lenders often seek to provide that any recalculation of the financial covenants as a result of an equity cure is solely for the purposes of determining whether the relevant breach has been cured. If the recalculation indicates that the breach has been cured, it is common to see wording along the lines that any Default/Event of Default is deemed to be remedied from the date of the Compliance Certificate. The effect of such wording can be that the equity cure does not operate to negate all effects of a Default/Event of Default under the Facility Agreement and will need to be examined carefully by Borrowers.

By way of example, attainment of certain financial ratios during a period may entitle the Borrower to certain benefits under the agreement, such as a reduction in Margin - it is common for Margin ratchets to vary according to leverage targets (see “**Margin**” at Clause 1.1. (*Definitions*) above). If a leverage target is achieved by means of the injection of additional equity, Borrowers may argue that the benefit of the Margin reduction should apply (which is a stronger argument if equity cure amounts are applied to prepayment). If the effects of the equity cure are limited to curing any relevant Default/Event of Default under the financial covenants, this may not be the case.

Additionally, under the Leveraged Facilities Agreement, the negative effects of a Default/Event of Default subsist whilst that Default/Event of Default is “**continuing**”. A Default/Event of Default is usually defined as “**continuing**” until such time as it is waived and/or remedied. An equity cure operates to remedy a Default/Event of Default under the financial covenants and if the definition of “**continuing**” in the Facility Agreement provides that an Event of Default (for example) subsists until waived, the equity cure may not have the desired effect (see definition of “**continuing**” in Clause 1.2 (*Construction*)).

If an equity cure right is exercised, Borrowers may argue that any Default/Event of Default under the agreement should be cured for all purposes under the agreement and the agreement should operate as if the financial ratios had been complied with during the relevant period. If agreed, great care must be taken to ensure that the drafting is sufficient to achieve this result.

Impact of the credit crunch on equity cure rights

Borrowers are currently having to work harder to achieve many of the concessions which would have been accepted as standard in early 2007. Borrowers and sponsors are still achieving equity cure rights in many circumstances, although they are experiencing greater resistance from Lenders in terms of the operation of such rights. Requirements for equity cure amounts to be applied to repay debt, for example, are being raised more often, together with stricter limits on the number of times such rights are exercisable.

Clause 26.1: Financial definitions

Clause 26 contains the definitions used in the financial covenants in Clause 26.2.

These definitions are usually closely negotiated in conjunction with the financial personnel who will be making the calculations and the Group’s accountants, to ensure that the provisions

reflect applicable accounting policies and that the definitions are capable of implementation. The Lenders will have prepared their Base Case Model and therefore their credit risk assessment on a set of assumptions which they will want to ensure are complied with during the life of the Facilities. Thus, the definitions need to conform with those assumptions. From the Investor/Borrower perspective, the definitions must be workable. They must make sense in the context of the Group's business and be sufficiently clear so as to enable extraction of the relevant figures from the financial information available. Attention to detail is vital.

“Adjusted EBITDA”: The purpose of this definition is to adjust EBITDA for acquisitions and disposals during the Relevant Period so that any increase or decrease can be reflected in the calculation of the Interest Cover and/or Leverage ratios.

Borrower Notes

The definition provides for the EBITDA of the acquired/disposed of asset to be included as if the acquisition or disposal had taken place on the first day of the Relevant Period. Whether this is desirable will depend on the business plan for the Group. If the business plan for the Group is to expand via acquisitions, then the net adjustment should be positive. However, if the business plan is gradually to sell the Group's assets to repay debt, the adjustment may not be appropriate.

Borrowers may wish to argue that in addition to the adjustment described above, EBITDA should reflect any projected cost savings associated with any acquisition or disposal made during the Relevant Period. If cost savings are taken into account, Lenders will most likely ask for additional costs to be taken into account.

A method for calculating pro forma EBITDA for this purpose will need to be agreed (see Clause 26.3(b) below).

“Borrowings”: This definition is the basis of the calculation of Total [Net] Debt and Debt Service for the purposes of the Leverage and Cashflow Cover ratios. It is also the figure upon which [Net] Finance Charges is calculated for the purposes of the Interest Cover ratio. The format of the definition is familiar, abbreviated from the definition of **“Financial Indebtedness”** in Clause 1.1 (*Definitions*) and many of the Borrower Notes below reiterate points made above in relation to **“Financial Indebtedness”**.

Borrower Notes

Borrowers are likely to want to ensure this definition is as narrow as possible and covers only financial debt. Some of the issues which Borrowers may feel require amendment include the following:

Prepayment premia

The introductory paragraph includes as **“Borrowings”** the amount of any prepayment premium applicable to any Borrowings. Borrowers may wish to exclude prepayment premia for this purpose. To the extent prepayment premiums are applicable, they will be included in the definition of **“Finance Charges”** and in any event, in a typical leveraged facility agreement, the

covenants restrict payments in respect of Financial Indebtedness save as expressly permitted.

Derivatives

Historically the (net) marked-to-market value of Treasury Transactions (derivatives) has often been included in the definition of “**Borrowings**”, which effectively includes the fair valuation of any hedging transactions in the calculation. From a Borrower perspective, it is preferable to exclude Treasury Transactions as they introduce volatility into the Borrowings figure and inclusion at marked-to-market value gives no indication as to the effectiveness of the hedge and the availability of hedge accounting. The LMA appears to have accepted that this argument for exclusion is usually won by the Borrower and has not included Treasury Transactions in the definition of “**Borrowings**”. This is perhaps partly because in a leveraged transaction, it is unlikely that any hedging is permitted other than for non-speculative purposes controlled by the Lenders (see Clause 27.33 (*Treasury Transactions*)) so it is unlikely that any realised liabilities will exist during the life of the loan.

The residual issue is whether, by failing to address Treasury Transactions at all, there are circumstances in which such transactions could be caught by paragraph (i) of the definition of “**Borrowings**”. Paragraph (i) is a sweep-up provision, usually phrased in terms of “any other transaction having the commercial effect of a borrowing” (see further below). Borrowers may wish to consider whether the Group is party to any Treasury Transactions that could be caught by the sweep-up provision and therefore should be specifically excluded from the definition of Borrowings.

Bonds etc.

Paragraph (c) includes note purchase facilities, bonds and similar instruments as “**Borrowings**”. There is an optional exclusion for “**Trade Instruments**”, defined as those used in the ordinary course of the trading cycle. This exclusion may not be wide enough for all purposes. If, for example, the Group is a construction group, this definition may not be sufficient to exclude trade instruments used by the Group (the Group is likely to procure performance bonds in the ordinary course of business in relation to its construction projects but not in the ordinary course of trading, a narrower concept).

Sales of receivables

Paragraph (e) excludes certain non-recourse sales of receivables from “**Borrowings**”. Borrowers may wish to clarify the meaning of “non-recourse” for this purpose (for example, most factoring arrangements considered “non-recourse” require the seller of the receivables to give warranties as to its title to the receivables). Paragraph (e) contains an optional requirement that non-recourse sales of receivables must “meet any requirements for derecognition under the Accounting Principles” in order to qualify for exclusion. The LMA wording reflects an IFRS concept, that certain derecognition requirements must be satisfied to exclude sales of receivables from a company’s borrowings in its accounts. Borrowers might argue that provided the financing is truly non-recourse, Lenders should not need to impose the additional criteria and therefore these words should be deleted.

Counter-indemnity obligations

Paragraph (f) includes counter-indemnity obligations in the “**Borrowings**” figure. Optional wording includes liabilities of the Group in relation to credit support provided for pension schemes. This wording reflects that as an alternative to borrowing to reduce a pension fund deficit, a company may reduce funding levies by putting up a letter of credit (or other agreed form of credit support) in respect of the deficit or part of it. Borrowers may argue that such liabilities should be excluded on the basis that they are not financial debts.

Redeemable Preference Shares

Paragraph (g) is an optional provision which includes redeemable preference shares as Borrowings. If the Group has outstanding redeemable preference shares it is preferable to deal with them specifically in the definition of Borrowings. The issue arises because redeemable preference shares are treated as borrowings under IFRS. If this paragraph is not included, there is a risk that all redeemable preference shares classified as borrowings under the Accounting Principles will be included as Borrowings (as a result of the catch-all in paragraph (i)). Lenders should only be concerned to include redeemable preference shares as “**Borrowings**” if redemption obligations could bite prior to repayment of the Facilities. From the Borrower’s perspective, if this optional provision is used, it might be amended to limit its application to preference shares which may be compulsorily redeemed prior to repayment of the Facilities. Consideration should also be given as to whether paragraph (g) should be widened beyond redeemable shares in case the Group has any other outstanding equity instruments that may be classified as borrowings under the Accounting Principles and thus fall within paragraph (i).

Advance or deferred purchase agreements

Paragraph (h) includes amounts owed under advance or deferred purchase agreements as Borrowings. Borrowers might seek to make clear that such amounts constitute “**Borrowings**” only if the primary reason for the transaction (rather than “one of the primary reasons”) is to raise finance and if the transaction is treated as a borrowing under the Accounting Principles (which is consistent with the rest of the definition of “**Borrowings**”).

“Sweep-up” provision

Paragraph (i) is a sweep-up provision, including as Borrowings “transactions having the commercial effect of borrowings [or otherwise classified as borrowings under the Accounting Principles]”. “Transactions having the commercial effect of borrowings” is probably the most usual formulation without the optional reference to the Accounting Principles as an alternative test. In the interests of clarity Borrowers may prefer to refer to “borrowings under the Accounting Principles” and delete “transactions having the commercial effect of borrowings”. It is also advisable to make clear that the paragraph applies only to transactions of a type not mentioned in any other paragraph of the definition of Borrowings.

Subordinated debt

The definition of “**Borrowings**” does not exclude intra-group indebtedness and subordinated indebtedness, which Borrowers often argue should be the case as payments in respect of such

indebtedness will be subordinated to the Facilities until the Facilities have been repaid (most likely in an Intercreditor Agreement). The Leveraged Facilities Agreement contemplates that this point is dealt with separately by deducting intra-group and subordinated indebtedness from Total [Net] Debt and Debt Service (see below). It is neater from a drafting perspective to deal with the adjustment in the definition of Borrowings.

“Capital Expenditure”: The definition of Capital Expenditure determines the expenditure which is relevant for the purposes of the Capital Expenditure limits in Clause 26.2 (*Financial condition*). The LMA follows the customary definition of Capital Expenditure, expenditure treated as such in accordance with the Accounting Principles.

Borrower Notes

The definition includes expenditure or “obligations” treated as Capital Expenditure under the Accounting Principles, probably in an attempt to capture committed but unspent capital expenditure. Borrowers may wish to delete the reference to “obligations”. If Lenders resist, care should be taken to ensure that there is no double counting in calculating capital expenditure limits in paragraph (f) of Clause 26.2 (*Financial Condition*): the Capital Expenditure should not count towards the limit in both the year in which it is committed and the year in which it is spent (if different).

The definition of Capital Expenditure contains an optional exclusion for Capital Expenditure comprising acquisitions of companies or assets (**“Business Acquisitions”**). This optional exclusion is useful from a Borrower perspective as it means that such Capital Expenditure will not count towards the Capital Expenditure limits in Clause 26.2. If Lenders resist, Borrowers might argue that a distinction can be drawn between Capital Expenditure funded out of **“Cashflow”** (which should be subject to the Capital Expenditure limits) and Capital Expenditure funded from “other” sources which the Lenders are not depending on for debt service (which should not). “Other” sources include dedicated debt facilities (such as acquisitions and capital expenditure facilities), other Permitted Financial Indebtedness, Retained Excess Cashflow or New Shareholder Injections (as to which see below). Expenditure on Business Acquisitions is likely to come from “other” sources (and is likely to be deducted from **“Cashflow”** for financial covenant purposes in any event: see comments below in relation to paragraph (g) of the definition of **“Cashflow”**), thus justifying the exclusion of Business Acquisitions from Capital Expenditure.

Borrowers may wish specifically to exclude any non-cash transactions from the definition of Capital Expenditure (for example, an exchange of fixed assets). This is not included in the LMA drafting but it is consistent with the exclusion of like-for-like exchanges of assets in the definition of **“Permitted Disposal”** in the Leveraged Facilities Agreement (see Clause 27.16 (*Disposals*) below).

“Cashflow”: This definition forms the basis of the Cashflow Cover ratio, which measures the Group’s cash available for debt service. As is customary, **“Cashflow”** comprises EBITDA adjusted to include all cash items and to exclude non-cash items.

Borrower Notes

General

Borrowers will want to make this definition as wide as possible in terms of additions and as narrow as possible in terms of deductions.

As a preliminary point, Borrowers should be aware of the tension between the definition of “**Cashflow**” and the definition of “**Excess Cashflow**”. Excess Cashflow is usually defined as Cashflow minus Debt Service and other deductions. Borrowers are likely to want to minimise Excess Cashflow which is used primarily for the purposes of the sweep to mandatory prepayment. Therefore Borrowers will want to ensure that any additions to Cashflow which are not intended to be part of the sweep are deducted from Excess Cashflow. See “**Excess Cashflow**” below in relation to deductions from Excess Cashflow.

Working Capital

Paragraph (a) adjusts EBITDA for changes in Working Capital during the Relevant Period. A Working Capital increase is deducted from Consolidated EBITDA to calculate Cashflow. This is because (as defined) Working Capital is a non-cash item. However, if the increase in Working Capital could have been funded by drawing on the Revolving Facility, the Group’s cashflow position has not changed and therefore no deduction should be made for this purpose. For example, if the Group uses cash to purchase stock but could have purchased that same stock by drawing on the Revolving Facility (and thus kept the cash for inclusion in “**Cashflow**”), it can argue that its available cashflow is unchanged. Borrowers may want to clarify that any increase in Working Capital should be ignored for the purposes of the Cashflow calculation to the extent that such increase could have been funded under the Revolving Facility.

Exceptional Items

Paragraph (b) adjusts EBITDA by adding back Exceptional Items. Lenders may wish to exclude Exceptional Items which comprise “**Relevant Proceeds**” (see below) from cash receipts on the basis that these amounts are required to be applied to mandatory prepayment and therefore do not form part of free cashflow in the sense of cashflow available for debt service. This is reflected in the LMA drafting, but Borrowers may seek to resist on the basis of consistency if the definition of Debt Service includes mandatory prepayment amounts. The Cashflow Cover covenant measures the ratio of Cashflow to Debt Service. If Lenders agree to exclude mandatory prepayments from Debt Service (see “**Debt Service**” below), Relevant Proceeds should rightly be excluded from Cashflow. If Lenders insist that mandatory prepayment amounts are included in Debt Service, they should also be included in Cashflow.

If “**Relevant Proceeds**” are excluded from Cashflow, Borrowers may argue that they should be excluded only to the extent they are required to be applied to mandatory prepayment.

Borrowers quite often argue that cash payments for Exceptional Items funded from the Group’s own funds (Retained Excess Cashflow, Permitted Financial Indebtedness or New Shareholder Injections), should not be deducted from Cashflow. Borrowers may wish to provide for this in paragraph (b).

Tax

Paragraph (c) adjusts EBITDA for cash payments and receipts in respect of tax. Borrowers may wish to consider whether any exclusions are required in relation to particular tax liabilities, for example:

- Private acquisition documentation usually provides that pre-Completion tax liabilities are for the account of the Vendor and therefore are covered by a tax indemnity arrangement. In that case, Borrowers may argue that cash payments of tax relating to the period before the Closing Date should not be deducted from Cashflow.
- Any tax element of Relevant Proceeds should be excluded from the Cashflow calculation for the reasons described above in relation to paragraph (b).

Repayment of Loans to Joint Ventures

Paragraph (e) adjusts EBITDA for cash received in repayment of a loan to a Joint Venture (on the basis that the latter is equivalent to a distribution). Borrowers might also argue that for the same reason, cash received in repayment of a loan to any Non-Group Entity should increase EBITDA. If relevant, the wording of this provision will require amendment to that effect.

Non-cash Items

Paragraph (f) is a generic adjustment to ensure that any non-cash items included in EBITDA are taken out of Cashflow. From a Lender's point of view the main reason behind this paragraph is to avoid provisions being taken when cashflow is healthy, and released in times of tight liquidity. The LMA's wording in paragraph (f) could be simplified to refer just to non-cash items. There is no need specifically to exclude non-cash credits and debits comprised in the Working Capital calculation (as in the LMA wording) due to the "no double counting" provision at the end of the definition.

Capex etc.

Paragraph (g) adjusts EBITDA for Capital Expenditure payments and Business Acquisitions or Joint Venture Investments. Borrowers may argue that adjustment should only be made in respect of Capital Expenditure actually made rather than Capital Expenditure made or "due to be made".

No downward adjustment should be made to Cashflow in respect of Capital Expenditure etc. which is funded from the Group's own funds, sources of cash which are not intended to be available for debt service. This is reflected in paragraph (g), although the list of sources is left blank. Examples of sources of funds that might be relevant for this purpose are dedicated Capital Expenditure and acquisition facilities, Permitted Financial Indebtedness or possibly capital contributions that may be available from landlords to fund Capital Expenditure on buildings tenanted by a member of the Group. The list of sources will need to be considered on a case-by-case basis.

Pensions Items

Paragraph (h) is optional and requires the deduction of the cash costs of Pensions Items from Cashflow to the extent not included in EBITDA. Pensions Items are defined (to paraphrase) as income or charges relating to pensions other than current service costs. From a Borrower perspective, this may be hard to resist. However, if there are no cash costs other than current service costs (which are included in EBITDA - see paragraph (i) of EBIT) or, perhaps, Exceptional Items, there is no need to have a separate provision and Borrowers might seek to delete the provision on the basis that it is duplicative.

Other adjustments

Paragraph (i) is left blank for the parties to insert any other adjustments to EBITDA required to reach the agreed definition of Cashflow. Examples of additional upwards adjustments commonly sought by Borrowers include in respect of Retained Excess Cashflow (i.e. cashflow available for the Group's purposes including disposal proceeds etc. to the extent not applied to mandatory prepayment) and in respect of any additional equity injected during the Relevant Period (applicable if an equity cure right is negotiated, see above). An adjustment in respect of Retained Excess Cashflow may be the subject of negotiation, however, as Lenders may not see Retained Excess Cashflow as part of Cashflow available for Debt Service (and is hard to justify if you are arguing that Capital Expenditure etc. funded from Retained Excess Cashflow should not be deducted from Cashflow).

The final paragraph of the definition of Cashflow contains the customary exclusions for all cash movements associated with the Acquisition.

"Current Assets" and **"Current Liabilities"**: **"Working Capital"** is defined as Current Assets less Current Liabilities. These definitions form the basis of the Working Capital adjustment in the calculation of Cashflow (see paragraph (a) of **"Cashflow"** above).

Borrower Notes

The defined term **"Cash"** is used in the definition of **"Current Assets"** in the financial covenants. See comments at Clause 1.1 (*Definitions*) above.

"Debt Service": This definition is the measurement compared to Cashflow to determine the Cashflow Cover ratio. It is intended to comprise interest and debt payments due in the Relevant Period.

Borrower Notes

The most commonly negotiated aspect of this definition is the extent to which prepayments should properly be included:

- Paragraph (b) includes voluntary prepayments as part of Debt Service. Borrowers often argue that of their nature voluntary prepayments are not debt service obligations and therefore should be excluded. Lenders argue that they are rightly included because the

Cashflow Cover test should measure liquidity in terms of all debt service payments. The outcome varies. If voluntary prepayments are included in Debt Service, an amendment will be required to the definition of Excess Cashflow (where voluntary prepayments are deducted) to ensure there is no duplication. The LMA makes this point in a footnote.

- The first sentence of paragraph (b) makes it optional to include mandatory prepayments in Debt Service, but then goes on to exclude (in sub-paragraph (ii)) any mandatory prepayment made pursuant to Clause 12.2 (*Disposal, Insurance and Acquisition Proceeds and Excess Cashflow*). This appears to indicate that it is only the inclusion of mandatory prepayments pursuant to Clause 12.1 (*Exit*) that is optional, which is slightly curious as any mandatory prepayment pursuant to Clause 12.1 will result in cancellation of the Facilities so the financial covenant provisions will no longer be an issue. The LMA User Guide indicates that the definition of Debt Service “includes an option to include or exclude.....mandatory prepayments”. Therefore it is submitted that sub-paragraph (ii) should be regarded as optional.

The inclusion of mandatory prepayments is often controversial for similar reasons as described above in relation to voluntary prepayments. From the Borrower’s perspective the inclusion of mandatory prepayments may not be desirable as their inclusion will increase the Debt Service amount. Although there are examples of Borrowers who have won the point, it may be quite hard to resist the inclusion of mandatory prepayments if the amount of Relevant Proceeds to be applied to mandatory prepayment increases the “**Cashflow**” side of the Cashflow Cover ratio by an equal amount, see “**Cashflow**” above. Many will take the view that “**Cashflow**” and “**Debt Service**” should be consistent on this point.

As mentioned above, sub-paragraph (b)(ii) contains an option to exclude any mandatory prepayment made pursuant to Clause 12.2 (*Disposal, Insurance and Acquisition Proceeds and Excess Cashflow*). If it is agreed commercially that mandatory prepayments are to be included as part of Debt Service (and thus sub-paragraph (ii) is deleted), an exclusion is still required for mandatory prepayments out of Excess Cashflow. This is because any excess cash sweep amount to be applied to mandatory prepayment is (usually) calculated as a percentage of “**Excess Cashflow**”. Excess Cashflow is cashflow over and above what is required for debt service. Therefore logically mandatory prepayments from Excess Cashflow should be excluded from Debt Service.

- Borrowers may wish to argue that scheduled repayments included in Debt Service should be adjusted downwards to reflect voluntary or mandatory prepayments. This is not contemplated specifically in the LMA drafting. From a Borrower’s perspective this may seem logical: if cashflows in the early years enable the Group to reduce its debt service burden going forward, Borrowers can argue that the Group should not be subject to financial covenants set on the assumption of a particular debt repayment schedule. Lenders may argue that they are lending (and have set the financial covenants) based on their Base Case Model, and the financial covenants should test the cashflows of the business against the debt profile as originally planned. It is quite common for Lenders to concede this point (probably on the basis that if the Debt Service figure is lower, the Excess Cashflow figure and thus the cash sweep will be higher).

The LMA’s User Guide to the Financial Covenant Provisions states that if the terms of the Facilities permit payments to the Investors, consideration should be given as to whether the

distributions should be part of Debt Service. It is contemplated that any such distributions will be included here or in the definition of Finance Charges. This is the reason for the optional wording in paragraph (c). Borrowers may well want to resist this and if Lenders take the point, similar considerations apply as in relation to voluntary and mandatory repayments above. See also “**Finance Charges**” below.

“**EBIT**” and “**EBITDA**”: The definition of EBITDA forms the basis of the Interest Cover and Leverage covenants. These are therefore important definitions: Investors and Borrowers will want EBITDA to look as healthy as possible.

Borrower Notes

Borrowers should be aware of the following general points in relation to these definitions:

- In most transactions it will be preferable to name the definition “Consolidated EBITDA” rather than “**EBITDA**” or “**EBIT**”. This is because in most leveraged transactions there will be other matters in the Agreement which use an EBITDA test on a single company basis, for example the Guarantor coverage criteria or the definition of Material Company. Hence, a separate definition (along the same lines) will be required for those purposes and the two will need to be differentiated.
- The LMA definitions separate EBIT and EBITDA. EBITDA is most often used, so the definitions are usually amalgamated.
- The LMA definition of EBIT does not include the income of joint ventures and associates, just the Group. If joint venture/associate income are to be included appropriate wording will need to be added.

The definition of EBIT follows a familiar formula. There are, however, a number of detailed points which are commonly negotiated, including, for example, the following:

- It is common to include the profits or losses of entities in which the Group has a minority interest (“**Non-Group Entities**”) in the EBIT calculation. In paragraph (f) the LMA provides two options for dealing with Non-Group Entities: either to include the Group’s share of Non-Group Entities’ profits or losses (which, assuming profitability, is the more Borrower-friendly option) or to include distributions received in cash from the relevant entity (which obviously may be less).
- Paragraph (g) makes it optional to exclude unrealised gains and losses on any financial instruments from EBITDA calculations (reflecting current market practice) other than derivatives which qualify for hedge accounting. The underlined words are optional. The option to include unrealised gains and losses relating to derivatives which qualify for hedge accounting treatment in EBITDA is on the basis that any gain or loss on the hedged item should be reflected elsewhere in the financial covenant calculations (for example in Borrowings). Therefore, for consistency, the unrealised gain or loss on the hedge should be in EBITDA. This consistency argument may not always work however, perhaps due to imperfections in the hedge. Therefore some Borrowers may prefer to exclude all unrealised

gains and losses relating to derivatives, whether they qualify for hedge accounting or not.

- Paragraph (j) excludes from EBIT any charge to profit from the expensing of stock options. Some Borrowers may wish to make this exclusion wider to cover any costs or provisions related to share option schemes (as such costs are the result of the implementation of IFRS 2).
- Paragraph (k) is blank to allow the parties to insert any further items to be included or excluded in the EBIT calculation. Some examples of further issues commonly raised by Borrowers are as follows:
 - The LMA definition of EBIT does not include gains or losses on disposals of assets (other than to the extent they might constitute Exceptional Items). Borrowers may argue that such gains or losses should be included specifically.
 - Proceeds of business interruption insurance should be included as an additional item on the basis that the proceeds of business interruption insurance replace profit for the period to which such proceeds relate.
 - Many Borrowers argue that additional equity provided during the period should increase EBITDA. This can be controversial and is discussed above in the introductory commentary to this Clause 26 on equity cure rights.

A final point for the Borrowers to note is that the definition of EBIT contains a “sweep up” at the end to the effect that items listed should be included “to the extent added, deducted or taken into account, as the case may be, for the purposes of determining operating profits of the Group before taxation”. This makes the definition circular and less certain so Borrowers may seek to delete these words.

“EBITDA”: EBITDA is EBIT with any amounts in respect of impairment, depreciation and amortisation added back. “Impairment” is an IFRS concept, and may not be relevant if the Accounting Principles are not IFRS.

“Exceptional Items”: This definition contains two alternative definitions of Exceptional Items. Which is appropriate will depend on the applicable Accounting Principles. Under UK GAAP the meaning of extraordinary and exceptional items is commonly understood and therefore historically a definition was not needed for financial covenant purposes. It is becoming more common to see a definition of Exceptional Items in financial covenants as IFRS does not define the concept. If the Accounting Principles recognise the concept of exceptional items, the first option in square brackets (“**Exceptional Items**” means any exceptional, one-off, extraordinary or non-recurring items”) should be chosen. If the Accounting Principles are IFRS, the second option should be chosen, which lists qualifying items. The list of qualifying items will need to be agreed.

“Excess Cashflow”: This definition comprises Cashflow which is not required for debt service. It comprises Cashflow subject to the following deductions: Debt Service and (optionally), voluntary prepayments and unused/carried forward Capital Expenditure. The primary function of this definition is the calculation of the amount of free cash to be applied to mandatory

prepayment (pursuant to Clause 12.2 (*Disposal, Insurance and Acquisition Proceeds and Excess Cashflow*)).

Borrower Notes

Borrowers are likely to want to ensure that the Excess Cashflow number is as small as possible, so close attention must be paid to the list of deductions.

The agreed list of deductions will to be considered on a case by case basis. As a general principle it is usually easier to negotiate additions to this list if Lenders can see (or even better insist) that the cash is applied in a particular manner which is beneficial to the Group (for example, Capital Expenditure or equity cure amounts which are to be placed in a blocked account). One issue sometimes discussed is whether additional equity contributions should form part of Excess Cashflow (and therefore applied to mandatory prepayment, see introductory commentary to this Clause 26 in relation to equity cure rights).

“Finance Charges”: This is the definition of interest payable for the purposes of calculating the Interest Cover ratio.

Borrower Notes

Again, the scope of this definition will depend on the circumstances. Points for Borrowers to consider include the following:

- The LMA drafting makes it optional to include distributions by the Company as **“Finance Charges”**. If distributions are not included as part of Finance Charges, however, the LMA contemplates that they will be included in Debt Service (see above). Lenders want to see distributions to the Investors as part of Debt Service or Finance Charges because the cash that such distributions represent will be included on the Cashflow side of the Cashflow Cover ratio. However, Borrowers and Investors may not see equity distributions as debt service obligations. To the extent they are permitted, they are usually subject to tight controls (see Clause 27.20 (*Dividends and share redemption*)) and any rights to such payments will generally be subordinated to the Facilities. Some Borrowers may argue that distributions should be ignored for the purpose of calculating debt service obligations.
- Paragraph (g) makes it optional to exclude unrealised gains and losses on any financial instruments from EBITDA calculations (reflecting current market practice) [other than derivatives which qualify for hedge accounting]. Borrowers may wish to exclude unrealised gains/losses on financial instruments completely rather than including an exception for items to which hedge accounting applies (for the same reasons as outlined in relation to paragraph (g) of EBIT, see above).
- Paragraph (h) excludes capitalised interest on the Mezzanine Debt, interest on the Loan Notes (if applicable) and contemplates that any other non-cash charges will also be specifically excluded. A definition of Finance Charges should always exclude non-cash charges (for example, capitalised interest or PIK). As this is usually accepted as a point of principle, it may be preferable to exclude non-cash finance charges generally rather than

listing applicable charges as contemplated by the LMA drafting.

“**Net Finance Charges**” are Finance Charges less the interest income of the Group. This definition will not be relevant if the financial covenants for the transaction are to be calculated on a gross basis (which is more unusual).

Borrower Notes

As drafted, the Group gets credit for interest “payable” during the Relevant Period, a more Borrower-friendly option. Some Lenders may argue that interest income should only be included on a cash basis because receivables are dependent on counterparty performance (in which case Borrowers will need to convince the Lenders of the strength and reliability of the counterparties involved).

Borrowers should note that this definition is not wide enough to catch the Group’s share of any interest income payable to any Joint Venture. If Finance Charges attributable to Joint Ventures are included in “**Finance Charges**” (see optional paragraph (f) of that definition), it is likely to be appropriate to reflect interest payable in this definition.

“**New Shareholder Injections**”: This definition comprises additional equity and is used as an exclusion from the Capital Expenditure limits (Capital Expenditure funded by New Shareholder Injections does not count towards the limits and is not a deduction from Cashflow) and as an exclusion to Total [Net] Debt (on the basis that shareholder loans will be subordinated). It is also likely to be used in conjunction with any equity cure right negotiated.

Borrower Notes

Borrowers may wish to consider whether the scope of this definition is sufficiently broad, for example:

- it contemplates that additional equity will come from shareholders – however, this may not be the case (for example, if the Group makes an acquisition, equity may form part of the consideration paid to the vendor); and
- it covers subscriptions for ordinary shares, loan notes or debt instruments. For maximum flexibility the definition could be extended to cover subscriptions for equity in cash and in kind and to cover all forms of unsecured Financial Indebtedness.

Borrowers should also be aware that any shareholder contribution taking the form of debt is required to be subordinated pursuant to the Intercreditor Agreement or otherwise on terms approved by the Majority Lenders. Lenders will argue that they want to diligence the subordination and/or will require the subordinated lender to accede to the Intercreditor Agreement. Borrowers, however, are likely to be concerned to ensure that subordination is on pre-agreed terms or other terms agreed with the Borrower if additional equity is required. Equity cure amounts, for example, are usually subject to time limits (although this may be less of an issue if the syndicate is small or if any “snooze and lose” provisions are sufficiently robust (see

Clause 41 (*Amendments and Waivers*)).

“Relevant Proceeds”: This definition captures insurance claims, disposal proceeds and proceeds of claims in relation to the Acquisition (**“Recovery Proceeds”**), discussed in detail at Clause 12 (*Mandatory Prepayment*). It is used in the financial covenants as an optional exclusion from Cashflow.

Borrower Notes

Borrowers may wish to consider whether there are any other claims which are to be applied to mandatory prepayment which should be included in this definition.

“Retained Excess Cashflow”: Retained Excess Cashflow is defined as **“Excess Cashflow”** which is not required to be applied to mandatory prepayment.

Borrower Notes

This definition is used in the Leveraged Facilities Agreement as drafted as an optional exception to paragraph (g) of Cashflow (Capital Expenditure funded out of Retained Excess Cashflow is not a deduction). **“Retained Excess Cashflow”** is the money that the Group is free to use either in its business or (possibly) to return to its shareholders, so the definition is likely to crop up in other areas in a negotiated document and Borrowers are likely to pay close attention to its use.

Borrowers are likely to want the Excess Cashflow figure to be as small as possible (given it determines the level of the cash sweep to mandatory prepayment) but the Retained Excess Cashflow figure to be as large as possible. Linking the two definitions is therefore not optimal and ideally should be avoided. For example, if additional equity is agreed to be a deduction from Excess Cashflow (so it is not applied to the cash sweep), it should still be available as Retained Excess Cashflow. It is preferable to define Retained Excess Cashflow as Cashflow which is not required to be applied in making any prepayment under the Finance Documents.

“Total [Net] Debt”: This is the figure compared to EBITDA to determine the Leverage ratio. It comprises Borrowings less subordinated debt (net of Cash and Cash Equivalent Investments if calculated on a net basis). The subordinated debt exclusion is not required if the point is dealt with in the definition of Borrowings (see above).

Clause 26.2: Financial condition

Financial Covenants

This Clause contains the financial covenants, comprising the following:

- **Cashflow Cover**, defined as Cashflow to Debt Service. The Cashflow Cover ratio compares the Group’s cashflow to its debt service obligations. It measures the ability of the

Group to generate enough cash to service its debts. The required Cashflow Cover ratio is almost invariably 1:1.

- **Senior Interest Cover/Interest Cover**, defined as EBITDA to [Senior] [Net] Finance Charges. The Interest Cover ratio measures EBITDA against the Group's interest obligations. The Interest Cover ratio confirms the ability of the Group to generate enough profit to cover its interest payment obligations. Clause 26.2 includes both an Interest Cover ratio and a Senior Interest Cover ratio. Senior Interest Cover is sometimes seen in deals with a subordinated or mezzanine element and measures the Group's profits (EBITDA) against its interest obligations in relation to the senior debt only. Clause 26.2 also includes the option to calculate the Interest Cover ratio on a gross basis or net of any interest receivable.
- **Senior Leverage/Leverage**, defined as [Senior] Total [Net] Debt to EBITDA. The Leverage ratio measures the Group's profits (again, usually consolidated EBITDA) against its total debt. Clause 26.2 provides the option to measure Total Debt on a gross basis or net of any Cash or Cash Equivalent investments held by the Group. As with the Interest Cover ratio, if the financing includes a subordinated or mezzanine element, a Senior Leverage ratio may apply which measures the Group's profits against its total senior debt, and the LMA drafting incorporates this option.

Leverage ratios are often adjusted to take account of acquisitions and disposals made by the Group during the testing period, so that any resulting increase or decrease in EBITDA can be taken into account. The LMA drafting contains optional language to make such adjustments to the Leverage ratio (see definition of "**Adjusted EBITDA**", discussed at Clause 26.1 (*Financial Definitions*) above).

Limits on Capital Expenditure and Finance Leases

This Clause also sets out applicable limits on the Group's Capital Expenditure and exposure under finance and capital leases. The Capital Expenditure limits are set as annual monetary amounts of permitted capital expenditure. Exposure under finance or capital leases treated as such by the Accounting Principles (see definition of "**Finance Leases**") is expressed as an aggregate financial cap. If the Group wishes to spend more or less than the document permits, Lender consent will be required.

Borrower Notes

In setting Capital Expenditure limits, Lenders are seeking to balance sufficient cashflow being available for debt service and sufficient cash being available to the Group to generate profits and to grow the business. The Capital Expenditure limits are therefore usually negotiated in some detail. The LMA drafting does include some of the more common concessions granted to Borrowers, although Borrowers commonly seek further flexibility, for example:

- The Capital Expenditure limits do not apply to Capital Expenditure funded from sources which the Lenders are not relying on for debt service. The specified list includes the proceeds of insurance, disposal and Recovery Claims which are not required to be applied to mandatory prepayment and New Shareholder Injections. The list of exclusions may be extended beyond those mentioned, for example the proceeds of any capital expenditure

facility may be included, Permitted Financial Indebtedness or Retained Excess Cashflow. See also “**Capital Expenditure**”, discussed at Clause 26.1 above.

- The LMA drafting permits unused Capital Expenditure amounts to be carried forward for use within a designated period. Some carry-forward rights in respect of capital expenditure allowances are common but are usually quite tightly confined both in monetary amount and in terms of the number of periods such unused amount can be carried forward. Financial limits on carry-forward rights are usually expressed in terms of a percentage of the previous/following year’s budget. In the September 2008 update of the Leveraged Facilities Agreement optional drafting was inserted to the effect that carry forward amounts may be carried forward for one year only. Typical carry-forward rights might be somewhere around fifty to one hundred per cent. of the current year’s budget, to be carried forward for one to two years.
- Borrowers may also seek rights to use future years’ Capital Expenditure amounts in the current year (“carry-back rights”). These are becoming more common but are not included in the LMA drafting. Typical carry-back rights might be around twenty to fifty per cent. of the following year’s budget, although such rights have become harder to achieve over the past year.

Borrowers should be aware that the LMA drafting does not contemplate any increase in Capital Expenditure limits as the Group expands (unless this is reflected in the monetary limits). If acquisitions are planned, the Borrower may argue that Capital Expenditure limits should increase in proportion to the increase in EBITDA resulting from any acquisition. It is not a provision seen in every facility agreement but is a useful device for a Borrower whose business plan contemplates acquisitions.

Clause 26.3: Financial testing

Paragraph (a) sets out the basis upon which the financial covenants are to be tested by reference to the frequency with which financial statements and/or Compliance Certificates are delivered pursuant to Clause 25 (*Information Undertakings*). Paragraph (b) deals with adjustments for sub-twelve month periods.

In European leveraged deals, financial statements are usually required to be delivered quarterly and thus the financial covenants will be tested quarterly for a Relevant Period via the delivery of a Compliance Certificate. Clause 25.2 (*Provision and contents of Compliance Certificate*) requires that a Compliance Certificate be delivered by the Parent to the Lenders with each set of Quarterly Financial Statements. Testing for a Relevant Period (usually) means that the covenants are tested on a twelve month rolling basis (see definition of Relevant Period), although this may vary for businesses that have very smooth cashflows.

Unless the Closing Date is also a financial year end, the Agreement will need to prescribe how the financial covenant calculations are to be adjusted in the period of less than twelve months after the Closing Date. There are various methods of making such adjustments: on a straight line basis as set out in paragraph (b) or by agreeing prior to Completion a pro-forma EBITDA for the period. Clause 26.3 leaves this provision blank for the parties to agree the appropriate basis.

Borrower Notes

There is an important timing question to be addressed in the context of agreeing the frequency of testing of the financial covenants. The question is at what point a Default resulting from a breach of the financial covenants will be deemed to occur for the purposes of the Agreement, and more particularly, the date from which any grace period will begin to run. This is important because the date that a breach of the financial covenants occurs under the Leveraged Facilities Agreement may be prior to the date upon which the breach is discovered.

The Leveraged Facilities Agreement (at Clause 28.2) provides that a breach of the financial covenants will be a Default on the date upon which the breach occurs. Therefore any agreed grace period for curing the Default will begin to run on the date of the breach rather than the date upon which the breach is discovered. The date upon which a breach occurs may be difficult to determine but is perhaps most likely to be taken to be the date at which the covenants are tested (i.e. the Quarter Date). A breach may not be discovered until or just before the Compliance Certificate is due which is likely to be a certain time after the Quarter Date. Therefore any grace period for curing the Default may have begun to run prior to the date upon which the Parent becomes aware of the breach.

If a Default under the financial covenants occurs which is capable of cure (by means of an equity cure right or otherwise), the Borrower is likely to want to ensure that it is able to remedy the Default before it becomes an Event of Default. An Event of Default has more serious consequences under the Facility Agreement than a Default and its existence is more likely to trigger cross default provisions or other negative consequences for the Group. It is likely to be important therefore from the Borrower's perspective that this issue is addressed in the following provisions in the document:

- in the information covenants (Clause 25), the period for delivery of the Compliance Certificate following the end of each quarter (or other relevant period) must be sufficient to determine whether any breach of the financial covenants exists and how any breach should be remedied;
- the Event of Default relating to the financial covenant provisions (Clause 28.2 in the Leveraged Facilities Agreement) should make clear that the applicable grace period for cure of any breach of the financial covenants does not begin to run until the Parent becomes aware of the breach (or ideally, no Default occurs until the date for delivery of the relevant Compliance Certificate);
- the agreed grace period for the remedy of any Default should match or exceed the period within which any equity cure right can be exercised; and
- the Event of Default provision relating to information covenants (Clause 28.2) should include a grace period which matches or exceeds the period applicable to breach of the financial covenant provisions (because non-delivery of a Compliance Certificate is of itself a Default).

CLAUSE 27: GENERAL UNDERTAKINGS

The Leveraged Facilities Agreement contains a comprehensive set of undertakings or restrictive covenants which are set out in Clause 27.

Borrower Notes

Introduction

Not all of the covenants in Clause 27 are relevant to every transaction and appropriate qualifications and carve-outs will need to be agreed to ensure that the Group can operate as proposed.

Qualifications may be by reference to materiality (and Material Adverse Effect) or by limiting covenants to Material Companies or particular members of the Group. Certain permitted matters will be expressly excluded from the restrictive covenants (see "*Permitted Actions*" below). Borrowers might also seek exceptions to particular covenants subject to reduced levels of Lender consent (e.g. Majority Lender consent).

The Leveraged Facilities Agreement does not contain covenants which relate to the conduct of a public offer or scheme of arrangement. These will need to be inserted as relevant. See "*Offer-related covenants*" below.

See Clause 4.5 (*Utilisations during the Certain Funds Period*) and Clause 28.21 (*Clean-Up Period*) if the financing is on a certain funds basis and/or if a Clean-Up Period is agreed post-Completion in relation to the application of the covenants to the Target Group. These provisions will have an impact on the operation of the covenants during the applicable period and the covenants need to be negotiated with this in mind.

Permitted Actions

The Leveraged Facilities Agreement contemplates that the parties will agree certain permitted actions which operate as exceptions to the negative undertakings. These permitted actions are often expressed in terms of defined exceptions to individual covenants, for example, the restrictions on Financial Indebtedness are subject to "***Permitted Financial Indebtedness***" and the negative pledge is subject to "***Permitted Security***". The Leveraged Facilities Agreement contains skeleton definitions of these various covenant exceptions, but there are invariably deal-specific points that need to be taken into account. Certain key points which are commonly agreed are highlighted in relation to the individual covenants in the commentary below. The scope of the covenant exceptions (i.e. the definitions of the various permitted actions) is likely to be a main focus of negotiations on the covenants.

In general terms, as noted by the LMA in its User Guide, the skeleton forms provided permit transactions which are not expected to be controversial (for example, transactions required in order to complete the Acquisition). Other exceptions will need to be considered on a case by case basis. These may include intra-group transactions and external transactions which are desirable from a strategic or operational perspective. In relation to the latter, a "basket" is commonly agreed, for example by reference to individual transactions or an aggregate cap by

financial value. Where such limits are set on an annual basis, Borrowers may seek flexibility to carry forward and/or carry back such amounts from year to year. In any case where assets are moving in or out of the Lenders' security net, Lenders are likely to seek to provide that their permission is conditional upon satisfactory security arrangements being put in place (subject to the Agreed Security Principles).

The covenant provisions in a leveraged transaction are complex and the matters covered by the various defined covenant exceptions sometimes overlap. For example, Permitted Security and Permitted Guarantees may also need to be excepted from the covenant restricting Financial Indebtedness in addition to the exception for Permitted Financial Indebtedness. "**Permitted Transactions**" is a general exception (discussed at Clause 1.1 (*Definitions*) above) which will be relevant to a number of covenants. To avoid the possibility of inconsistencies (a matter permitted in relation to one restrictive covenant but prohibited by another) some Borrowers argue that a general qualification to the covenants should be included in respect of all permitted matters, comprising "**Permitted Acquisitions**", "**Permitted Disposals**", "**Permitted Distributions**", "**Permitted Financial Indebtedness**", "**Permitted Guarantees**", "**Permitted Joint Ventures**", "**Permitted Loans**", "**Permitted Payments**", "**Permitted Security**", "**Permitted Share Issues**" and "**Permitted Transactions**" and any other matters that might be agreed.

Offer-related covenants

The financing terms of a public bid will include covenants intended to ensure that the bidder complies with the Takeover Code and other relevant laws and regulations. Such provisions are not included in the Leveraged Facilities Agreement. Offer-related covenants will cover the content of the offer or scheme of arrangement documentation, the conditionality of the offer and the conduct of the offer, in particular, the circumstances in which the offer can be declared unconditional as to acceptances. The acceptance condition is often agreed, initially at least, to be 90 per cent, as that is the level at which the compulsory acquisition or "squeeze out" rights under the Companies Act 2006 apply which should enable the Company to acquire minority shareholdings.

Lenders are also likely to look for specific information covenants relating to the offer, requiring the provision of copies of all documents, notices or announcements received or issued by the Company in relation to the offer or scheme, plus timely progress reports.

A covenant restricting an increase in the offer price without Lender consent is also common although Borrowers are sometimes able to negotiate a threshold and an exception to the extent the cost of the increase is covered by additional equity.

Release Conditions

Some Borrowers argue that mandatory prepayment requirements and certain of the key restrictive covenants should be released once the Group's rating reaches a certain level and/or leverage is sufficiently reduced. This is a fairly aggressive position, but the argument is soundly based; as the Lenders' credit risk diminishes, the Group is granted greater flexibility in terms of its operations.

Clauses 27.1 to 27.5: Authorisations and Compliance with Laws

Clause 27.1: 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 the Acquisition Documents, to ensure their legality, validity and enforceability and admissibility in evidence and to carry on its business.

Borrower Notes

Issues for Borrowers to consider in relation to this provision include the following:

- The LMA drafting contemplates that only the third limb of this covenant (Authorisations required to carry on business) is subject to a Material Adverse Effect qualification. Borrowers may seek also to qualify the remainder of this covenant, limiting the obligation to obtain Authorisations to those the absence of which would be materially prejudicial to the Finance Parties.
- The definition of “**Authorisations**” is wide. In so far as it might encompass filing, stamping, or other actions that might be taken in connection with the Transaction Security, Borrowers may seek to qualify the covenant by reference to the Agreed Security Principles.
- Borrowers may seek to qualify sub-paragraph (b)(ii), which relates to Authorisations necessary for the legality, enforceability and validity of the Transaction Documents, by reference to the Legal Reservations and the Perfection Requirements (see Clause 24.3 (*Binding obligations*) above).
- Each Obligor is required to provide the Agent with certified copies of all relevant consents: Obligors may argue that they should only be obliged to do so at the request of the Agent. Key Authorisations will be delivered as conditions precedent and this undertaking should not operate to extend those obligations.
- This undertaking extends to Authorisations required under any law and regulation of a “**Relevant Jurisdiction**”. “**Relevant Jurisdiction**” is defined much more widely than the Obligor’s jurisdiction of incorporation and covers, for example, any jurisdiction in which assets subject to security are situate. Borrowers are likely to seek to narrow this definition, see comments at Clause 24.6 (*Validity and admissibility in evidence*) above.

Clause 27.2: Compliance with laws

This is a customary undertaking relating to the Group’s compliance with laws and as drafted is subject to a materiality qualification, “if a failure so to comply has or is reasonably likely to have a Material Adverse Effect”.

Clause 27.3: Environmental compliance and Clause 27.4: Environmental claims

These are undertakings relating specifically to compliance with environmental laws and notification of environmental claims.

Borrower Notes

Specific covenants relating to environmental matters should not be necessary unless there are specific environmental concerns, as these covenants overlap with the general “compliance with laws” and “Authorisations” covenants (see Clauses 27.1 and 27.2 above) and the information covenant relating to litigation and claims (see paragraph (b) of Clause 25.8).

Borrowers will usually resist sub-paragraph (a)(iii) of Clause 27.3 in any event, which relates to the implementation of procedures to monitor compliance with and to prevent liability under any Environmental Law, on the basis that Lenders’ rights should only arise to the extent there is a breach which has a Material Adverse Effect, rather than as a result of the absence of appropriate monitoring procedures.

Clause 27.5: Taxation

This covenant relates to payment by each Obligor of Taxes on time and changes to their tax residency.

Borrower Notes

No threshold or materiality qualification applies to this provision as drafted and Borrowers may wish to consider appropriate limitations. Note that this covenant as drafted applies to any member of the Group.

The second limb of this undertaking, which relates to changes to tax residency, will have to be considered on a case by case basis. Some Borrowers might argue that they are unlikely to change their tax residency in a manner which increases their tax burden and therefore this provision is unnecessary. If included, it might be qualified along the lines “if to do so would materially and adversely affect the interests of the Lenders”.

Clauses 27.6 to 27.11: *Restrictions on business focus*

Clause 27.6: Merger

This covenant prohibits mergers or corporate reconstructions by any member of the Group. The wording is identical to Clause 22.5 of the Investment Grade Documents, save that an exception is contemplated for “**Permitted Transactions**”.

Borrower Notes

Borrowers will need to ensure that the definition of Permitted Transactions (discussed at Clause 1.1 (*Definitions*) above) is adequate to except any proposed reorganisation post Completion

from this covenant. The Leveraged Facilities Agreement contemplates that such actions are described in the “**Structure Memorandum**”.

Borrowers should also consider whether exceptions are required in respect of Permitted Acquisitions and Permitted Disposals (see further below).

Clause 27.7: Change of business

This undertaking prohibits any substantial change to the general nature of the business of the Group taken as a whole. The words “taken as a whole” are not included in the equivalent covenant in the Investment Grade Documents and have the effect of making the covenant slightly looser.

Borrowers Notes

There may be circumstances where a carve-out to this provision is required in the interests of certainty. For example, if a bolt-on acquisition is contemplated post-Closing in a business which is complementary but which is not the same as that of the Group.

Clause 27.8: Acquisitions

This covenant prohibits the acquisition of a company or any shares or securities or a business or undertaking or the incorporation of any new company by any member of the Group.

Borrower Notes

Paragraph (b) provides that “**Permitted Acquisitions**” and “**Permitted Transactions**” will be excepted from the restriction in paragraph (a). “**Permitted Transactions**” is discussed at Clause 1.1 (*Definitions*) above.

“Permitted Acquisitions”

The definition of “**Permitted Acquisition**” is provided in skeleton form and will need to be agreed in the context of the relevant transaction. Borrowers should also consider the interaction of this definition with the drawdown conditions in relation to any facilities dedicated to acquisitions or capital expenditure included as part of the Facilities. Issues which commonly need to be addressed by Borrowers include the following:

Transactions otherwise permitted

- Paragraphs (a) to (c) relate to disposals involved in transactions otherwise permitted under the Finance Documents and cover the Acquisition, Permitted Disposals and Permitted Share Issues. Borrowers may wish to extend these provisions to cover any other permitted action, for example, Permitted Joint Ventures and any acquisition contemplated in the Structure Memorandum.

Cash Equivalent Investments and new companies

- Paragraph (d) provides an exception for the acquisition of Cash Equivalent Investments so long as the acquired assets become subject to the Transaction Security. Paragraph (e) relates to the incorporation of new companies by a member of the Group subject to conditions, namely that the company is incorporated in specified jurisdictions to be agreed with limited liability and, if the shares are owned by an Obligor, security being provided over such shares. As a general point, where Lenders insist on acquired assets becoming subject to the Transaction Security, any such requirement should be subject to the Agreed Security Principles (see further Schedule 14 (*Agreed Security Principles*)).

Acquisition criteria

- Paragraph (f) contains suggested terms permitting other acquisitions which satisfy criteria to be agreed, which include that no Default is continuing or will arise as a result of the acquisition and that the acquired asset is in an agreed jurisdiction and in a business substantially similar to that of the Group. Other or alternative criteria may also be relevant, e.g. the provision of due diligence reports and positive EBITDA in the acquired business. This paragraph also incorporates an aggregate financial cap on Permitted Acquisitions which satisfy the criteria set forth in paragraph (f). This is an important provision from the Borrower perspective. Issues that Borrowers may wish to consider include:
 - Paragraph (f) relates only to acquisitions of whole companies or businesses or undertakings and the requirement that the acquired company/business is in a business “substantially similar to that of the Group” may be too restrictive – Borrowers may require more flexibility, for example, to make acquisitions involving say at least 50.01 per cent. of the shares or voting rights of any business similar or complementary in nature to the business of the Group. Borrowers might also resist any limitation on Permitted Acquisitions by reference to jurisdiction.
 - Borrowers may argue that acquisitions should be permitted provided that no Event of Default is continuing on the closing date for the acquisition or would occur as a result of the acquisition (rather than the more restrictive test of no Default). Strong Borrowers may be able to argue in addition that this test should be subject to a clean up period in respect of related Defaults of say, 6 months.
 - The LMA drafting contemplates that the purchase price for the permitted acquisition (for the purposes of determining compliance with the aggregate financial cap for permitted acquisitions) comprises the consideration, plus costs and expenses plus any assumed Financial Indebtedness or other assumed actual or contingent liability. Borrowers may object to the inclusion of liabilities other than Financial Indebtedness, and contingent liabilities in particular in this calculation on the basis that their inclusion as a general concept has no bearing on the likelihood of the contingency occurring. Borrowers may instead, for example, offer to provide Lenders with copies of due diligence reports as evidence of the extent of any liabilities of the target and to provide comfort that there are no contingent liabilities which are material. Due to the resulting potential uncertainties in calculating the amount of the purchase price contributing to the cap on this basis, in our experience it is quite often agreed that the purchase price should be calculated solely by reference to the consideration (sometimes net of associated costs and expenses) and

any Financial Indebtedness remaining in the relevant business on the closing date for the relevant acquisition.

- Some Borrowers agree that acquisitions should be permitted without reference to the financial cap or “basket” to the extent that the purchase price is funded out of the Group’s own funds which are not earmarked for debt service, for example, Retained Excess Cashflow, New Shareholder Injections or undrawn amounts under any term facilities dedicated for acquisition purposes (see Clause 2.1 (*The Facilities*)).
- An appropriate financial cap or basket for permitted acquisitions can be quite difficult to determine in a long term facility. If acquisitions are permitted, a suitable adjustment mechanism will need to be included in the financial covenant provisions to include the results of the acquired business in the calculations (see Clause 26 (*Financial Covenants*)). Some Borrowers may therefore argue that provided they are able to demonstrate to the Lenders that any acquisition would not result in a breach of the financial covenant provisions calculated on an adjusted basis, the basket should not apply to limit acquisitions which otherwise satisfy the agreed criteria (see optional drafting at the end of the definition).
- A de minimis general “basket” may also be agreed for acquisitions without reference to other criteria, for example, in respect of acquisition where the aggregate consideration does not exceed a certain amount in any Financial Year.
- Where acquisitions are permitted by reference to an annual basket amount, Borrowers quite commonly seek rights to carry forward unused amounts to the next financial year or (less commonly) carry back amounts to previous financial years.

The extent to which all or any of the above or any other criteria might apply, and the acquisitions to which they apply (permitted acquisitions with a greater value might be subjected to stricter criteria than smaller permitted acquisitions) depends on the circumstances.

Other issues

- Borrowers often seek to include within the definition of Permitted Acquisition the acquisition of trading assets and services in the ordinary course of business (which is wider than “**Permitted Transaction**”, which includes transactions conducted in the ordinary course of trading on arms’ length terms).
- If a member of the Target Group has entered into any contractual obligation to acquire any asset prior to Closing (or may have done so), any such Acquisition will need to be permitted by this definition. It is quite common for Borrowers to provide for this specifically.

Clause 27.9: Joint ventures

This is a prohibition on joint venture investments or the transfer of assets or provision of credit support to a joint venture by any member of the Group except for “**Permitted Joint Ventures**”,

or to the extent the action is permitted as a “**Permitted Acquisition**”, “**Permitted Disposal**” or “**Permitted Loan**”.

Borrower Notes

“Permitted Joint Venture”

This definition contemplates that investments in Joint Ventures will be permitted in specified jurisdictions, where the business of the Joint Venture is substantially the same as that of the Group and subject to an annual financial cap. Issues raised by Borrowers in relation to this definition are usually along similar lines to those raised in relation to the definition of “**Permitted Acquisition**”, see Clause 27.8 (*Acquisitions*) above.

Clause 27.10: Holding Companies

This covenant prevents the Company and the Parent from trading, carrying on any business, owning any assets or incurring any liabilities save for:

- the provision of customary holding company administrative services;
- the ownership of shares in its Subsidiaries and intra-group and cash balances which are subject to the Transaction Security; and
- any liabilities under the Transaction Documents and professional fees and administration costs in the ordinary course of business as a holding company.

Borrower Notes

Borrowers commonly seek to flesh out the list of permitted activities to reflect accurately exactly what the Parent and the Company will do. For example, they may have liabilities in respect of employees or taxes or may enter into Treasury Transactions.

The reference to the Company’s and the Parent’s assets being subject to the Transaction Security may be qualified by reference to the Agreed Security Principles.

Clause 27.11: Dormant subsidiaries

This covenant is in square brackets. It restricts any action which would result in Dormant Subsidiaries losing their status as such unless they become an Additional Guarantor.

Borrower Notes

As a general principle, Borrowers usually seek to avoid giving representations or covenants in relation to Dormant Subsidiaries.

Clauses 27.12 to 27.17: Restrictions on dealing with assets and Security

Clause 27.12: Preservation of assets

This covenant relates to the condition of the Group's assets.

Borrower Notes

Clause 27.12 is controversial and widely drafted. It is difficult to verify that all of the Group's assets are in good condition and Borrowers might argue that Lenders should rely on the financial covenants with regard to the value in the Group. Borrowers may seek to persuade Lenders that this covenant, if included should apply only to material assets which are subject to the Transaction Security and that the covenant should be limited to a reasonable endeavours obligation.

Clause 27.13: Pari passu ranking

This covenant requires each Obligor to ensure that the Finance Parties' and Hedge Counterparties' claims rank at least pari passu with the claims of its other unsecured and subordinated creditors (save those who are mandatorily preferred by law of general application to companies).

Clause 27.14: Acquisition Documents

This covenant relates to the Company's payment when due of amounts under the Acquisition Documents and the enforcement and preservation of the Company's rights under those Documents.

Borrower Notes

Many Borrowers resist giving this undertaking. It overlaps with other undertakings in the Agreement, for example, Clause 27.12 (*Preservation of Assets*). More importantly, Borrowers may be uncomfortable with a covenant which relates to the standard of its conduct of claims (which is difficult to measure) rather than the extent of the relevant liability in respect of which redress is sought.

Clause 27.15: Negative pledge

The negative pledge prevents the Group from creating Security (paragraph (a)) or "**Quasi-Security**" (paragraph (b)) over its assets save for "**Permitted Security**" or "**Permitted Transactions**" (paragraph (c)). The prohibition contained in the negative pledge is substantially

similar to that used in the Investment Grade Documents although the scope of the exceptions to the negative pledge in the Leveraged Facilities Agreement is slightly different and, in some respects, wider than the exceptions provided for in the Investment Grade Documents as currently drafted.

Note the very wide definition of “**Security**” 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 is likely to catch a wide range of arrangements, such as set-off, sale and leaseback, debt factoring and retention of title arrangements.

Clause 27.15(b) imposes further restrictions on all members of the Group on the creation of “**Quasi-Security**”, 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 Lenders 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 category catching any other “preferential” arrangement that has a similar effect. In each case the arrangement does not qualify as Security unless the primary aim is to raise Financial Indebtedness or finance the acquisition of an asset (the definition of “**Financial Indebtedness**” is discussed at Clause 1.1 (*Definitions*)).

Borrower Notes

Borrowers must ensure that the exceptions to the negative pledge are sufficiently flexible to enable the Group to carry out its business as proposed. Lenders will generally resist an exception to the negative pledge in terms of Security or Quasi-Security created in the ordinary course of business. The exceptions are contained in the definitions of “**Permitted Security**” and “**Permitted Transaction**”. In relation to the definition of “**Permitted Transaction**”, see Clause 1.1 (*Definitions*).

“Permitted Security”

General

- As a general point, Borrowers should note that certain paragraphs of “**Permitted Security**” are expressed to apply to “**Security**” and “**Quasi-Security**” (i.e. transactions which do not fall within the definition of “**Security**” but which can have a similar effect, such as sale and leaseback or set-off arrangements). In this respect, the exceptions to the negative pledge in the Leveraged Facilities Agreement are wider than those in the Investment Grade Documents.

Liens

- Paragraph (a) covers liens arising other than as a result of the default or omission of a member of the Group. 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 may wish to delete the requirement that the lien must not arise as a result of any default or omission by any member of the Group (i.e. a member of the Group fails to pay a creditor) on the basis that the effect of a default or omission should be considered by reference to the covenant

provisions and Events of Default which measure the impact of any such failure (e.g. the financial covenant provisions), not by reference to whether or not a lien arises. This requirement is not included in the equivalent provision of the Investment Grade Documents.

Netting and set-off

- Paragraph (b) relates to netting and set-off in the ordinary course of the Group's banking arrangements. Obligors will usually need this provision to be relaxed further to refer to netting and set-off arrangements in the ordinary course of the Group's financing arrangements. Specific reference to cash management arrangements and derivatives contracts may also be required.

The remainder of paragraph (b) is aimed at ensuring that any excepted netting and set-off arrangements do not have the effect of transferring assets of the Obligors into the hands of non-Obligors, thus potentially placing them outside the Lenders' guarantee and security net. The extent to which this wording is acceptable will depend on the Group's financing arrangements.

Assets acquired after Closing

- Paragraphs (c) and (d) relate to Security and Quasi-Security affecting assets acquired after the Closing Date. Borrowers may argue that these provisions should apply from the signing date rather than the Closing Date. Sub-paragraph (iii) in each case contemplates that a grace period will be permitted for discharge of such security. A grace period of around three months is commonly agreed, and Borrowers may wish to make clear that the obligation to discharge such Security or Quasi Security will only apply to the extent not permitted under any other paragraph of the definition.

Retention of title etc.

- Paragraph (e) is an exception for retention of title, hire purchase or conditional sale agreements or similar, useful for trading companies. This exception is not currently included in the Investment Grade Documents and in this respect, the negative pledge in the Leveraged Facilities Agreement is less restrictive. Note also that this exception does not apply in respect of "**Quasi-Security**", which Borrowers may wish to include.

Existing Security

- Paragraph (f) is an exception for Security or Quasi-Security over the assets of the Target Group existing as at the signing date, provided such arrangements are discharged prior to the Closing Date. The requirement to remove the Security by the Closing Date negates some of the usefulness of this provision, even taking into account any agreed Clean-Up Period (see Clause 28.21 (*Clean-Up Period*) below). If Target debt is being refinanced at the Closing Date then any security for such debt is likely to be discharged at that time. If any such refinancing is to take place post Completion, or if there are any other security arrangements within the Group which exist and which cannot in practical terms be removed before the Closing Date, a further grace period sufficient to effect the release of such Security will be required, for example, three months from the Closing Date.

Permitted Disposals and Permitted Financial Indebtedness

- Paragraphs (g) and (h) relate to Security and Quasi-Security arising in relation to other specified permitted actions, namely Permitted Disposals and finance or capital leases which constitute Permitted Financial Indebtedness.

Other issues

- Paragraph (i) is blank for any further specific exceptions that might be relevant. Examples might include, for example:
 - Security or Quasi-Security supporting a refinancing of Permitted Financial Indebtedness or trade finance arrangements (e.g. letters of credit);
 - payments into court or security for costs given in connection with legal proceedings (or Tax liabilities) which are being contested;
 - Security arising on rent deposits in connection with the occupation by a member of the Group of leasehold premises;
 - Security granted in relation to Permitted Acquisitions, for example, Security over cash paid into an escrow account;
 - a specific exception for outstanding Security or Quasi-Security which does not secure any outstanding obligation. It is not uncommon (for example) to discover old charges on a company's register. The debt they secured may have long been discharged but the relevant forms have not been filed to remove the charge from the register.

The nature of any other exceptions that are required will need to be considered in the context of the Group's business.

De minimis

- Paragraph (j) is de minimis exception for Security securing indebtedness up to a specified aggregate cap. Note, that the drafting contemplates that this exception only applies to Security. Borrowers should widen this provision to apply also to Quasi-Security.

Impact of covenant exceptions on fixed status of security

- In September 2008, the LMA added a footnote to paragraph (j) of this definition and to paragraph (j) of the definition of "**Permitted Disposal**" reminding parties that if there are assets subject to fixed charges under the Transaction Security Documents, parties should consider excluding them from the general exception permitting Security/disposals due to the risk of the fixed charges thereby being recharacterised as floating charges. This note reflects the uncertainties of the law in this area. However, the law has not changed materially on this issue since 2005, so it is difficult to see why the LMA chose to remind parties of this risk at this point.

Under English law, a fixed charge has a number of advantages over a floating charge from

the Lenders' perspective, the most important being that the claims of a fixed chargeholder will rank ahead of a floating chargeholder and preferential creditors on insolvency. The label expressed to apply to the security interest in the relevant security document is not the determining factor in distinguishing between fixed and floating security. The distinction between a fixed and floating charge essentially turns on the degree of control the Secured Parties have over the asset in question. The extent to which the Obligors are permitted to deal with the assets subject to the Transaction Security without recourse to the Secured Parties will be the chief determinant of whether the security is fixed or floating.

Re Spectrum Plus Limited [2005] 3 WLR 58 remains the most recent decision of a higher court in this area. The House of Lords was asked to consider the nature of a charge over book debts, in a common form used by high street banks. The security document restricted the borrower from dealing with the debts and it was required to pay them into an account from which it could draw freely. The House of Lords held unanimously that the borrower's freedom to use the proceeds of the book debts in the ordinary course of its business was fatal to the characterisation of the charge as fixed.

Spectrum Plus caused parties to secured lending transactions to refocus on what kinds of rights the chargor under a purportedly fixed charge might be granted to deal with the security assets before the charge runs the risk of recharacterisation, both in the context of security over cash and book debts and other types of asset.

The LMA's footnote reflects that conclusions are difficult to reach other than in very clear-cut cases (e.g. where the chargor is given no rights to dispose of or otherwise deal with the security assets). The limits of a fixed charge in this sense remain judicially untested.

However, parties should bear in mind that in Spectrum Plus and the line of cases leading to it, the courts have considered security over book debts and bank accounts in the context of general corporate financing, where chargors were permitted freedom to use the proceeds of their receivables. That situation is a long way from a sophisticated, structured leveraged transaction, where parties negotiate complex arrangements to determine the extent to which security assets may be dealt with, for what purposes and (in the case of disposals) how proceeds are to be applied. In terms of recharacterisation risk, such transactions might be said to be at the safer end of the spectrum (so to speak), although it remains the case that it is difficult to opine with any degree of certainty (which Borrowers can expect to be reflected in English law legal opinions in relation to the Transaction Security Documents).

Additionally, it must be emphasised that the Spectrum Plus judgment was given in the context of security over book debts and bank accounts. There is no express acknowledgement in any of the leading judgments in Spectrum Plus that the House of Lords intended to lay down a principle with application to classes of assets the value of which is not solely in their proceeds (such as book debts) or which are not of a class typically to be considered to be "circulating" or working capital assets, that is, the type of assets for which the floating charge was originally designed. There are circumstances where charges over "non-circulating" assets might be construed as floating, for example where a right to dispose of the assets in the ordinary course of business is granted to the chargor, but this is some way from the carefully negotiated exceptions to the restrictive covenants typically seen in leveraged financing documents.

In summary, the uncertainties in the law in this area mean that pre-agreed consents to particular types of disposal or dealing with assets subject to the Transaction Security carries a risk that security intended to be fixed might take effect as a floating charge. However, the extent of the risk is unclear and more importantly is not a new issue. Market practice illustrates that the risk has been accepted by Lenders as leveraged financing documentation invariably includes some degree of flexibility in terms of dealing with at least some of the assets subject to the Transaction Security and it is not thought that the addition of this footnote should result in any change in market practice.

Clause 27.16: Disposals

Clause 27.16 is a wide-ranging restriction on any sale, lease, transfer or other disposal by a member of the Group.

Borrower Notes

The exceptions to this undertaking are contained in the definitions of “**Permitted Disposal**” and “**Permitted Transaction**”. In relation to the definition of “*Permitted Transaction*”, see Clause 1.1 (*Definitions*).

“Permitted Disposal”

The definition of Permitted Disposal is limited, and will usually be negotiated to reflect a variety of disposals which the Group needs to be able to make to carry on its business or to comply with its Business Plan. Some of the issues commonly raised by Borrowers include the following:

Ordinary Course

- Paragraph (a) relates to disposals of trading stock or cash in the ordinary course of trading. Borrowers might wish to widen this provision, for example to apply to disposals of assets made in the ordinary course of business, to enable disposals of fixed assets to third parties for example. Lenders might resist such a general exception without further qualification, but where disposals are for cash, the proceeds of disposal are to be applied to mandatory prepayment (or to purchase an asset to replace the asset disposed of) and there is no detrimental impact on the Group’s ability to comply with the financial covenants, Borrowers might seek to persuade Lenders that greater flexibility is appropriate. Borrowers might also argue that this definition should include an express acknowledgment that Obligors are permitted to dispose of (i.e. spend) cash or Cash Equivalent Investments where not otherwise restricted from doing so under the Agreement.

Intra-Group disposals

- Paragraph (b) permits intra-group disposals, which are permitted only between Obligors, to enable the Lenders to protect the scope of their guarantee and security package. Some Borrowers may ask Lenders to permit disposals of assets to non-Obligors subject to a maximum cap by value.

Obsolete or redundant assets

- Disposals of obsolete or redundant vehicles, plant and equipment for cash are permitted by paragraph (d). Borrowers might argue that this exception should also apply to assets which are surplus to requirements in addition to those which are obsolete or redundant. In some circumstances, it might be appropriate to widen this exception to apply also to real estate (to permit the Group to dispose of buildings it no longer requires for its business).

Committed disposals

- Borrowers usually seek an exception to permit disposals of assets pursuant to contractual arrangements existing at the Closing Date (clearly if the Group is contractually committed to dispose of an asset, it will need to be able to comply with those obligations).

Other exceptions

- Further exceptions will need to be considered on a case by case basis. Examples might include disposals of book debts in the context of factoring or discounting arrangements or the lease or licence of any property owned by the Group.

Basket and cap

- Paragraph (j) contemplates an annual basket for permitted disposals, subject to an overall cap over the lifetime of the Agreement, by reference to the higher of the market or book value of the asset and the net consideration receivable in respect of the disposal. Borrowers will often seek to delete the reference to the market or book value of the asset, not least because this makes for more straightforward calculations in determining whether a transaction falls within the basket (note also the requirements of Clause 27.17 (*Arm's length basis*) below). Borrowers may seek to agree rights to carry forward or carry back unused basket amounts from year to year.

Impact of covenant exceptions on fixed status of security

- In September 2008, the LMA added a footnote to paragraph (j) regarding the impact of covenant exceptions on fixed and floating security in the same terms as the footnote to paragraph (j) of "**Permitted Security**", discussed at Clause 27.15 (*Negative Pledge*) above.

Clause 27.17: Arm's length basis

This Clause restricts any member of the Group from entering into any transaction other than on an arms' length basis and for full market value.

Borrower Notes

Borrowers may seek to limit its application to transactions between Obligors and connected parties.

The list of exceptions in paragraph (b) will need to be examined to determine whether any

further specific exceptions are necessary. For example, if the Group makes loans to directors or employees or provides a management participation or incentive scheme, these arrangements are usually provided on favourable terms and will need to be excepted.

Clauses 27.18 to 27.22: Restrictions on movement of cash-cash out

Clause 27.18: Loans or credit

This covenant prohibits any member of the Group from extending any loans or credit other than Permitted Loans or Permitted Transactions.

“**Permitted Loans**” include trade credit extended to customers in the ordinary course of trading, certain intra group lending (including loans required to facilitate payments under the Finance Documents) and an aggregate cap for other Permitted Loans.

Borrower Notes

There may be other loans falling within this negative undertaking which need to be specifically excepted. Examples include:

- advance payments arrangements (for example made in respect of Capital Expenditure);
- deferred consideration arrangements in relation to Permitted Disposals;
- loans which are acquired as part of a Permitted Acquisition and loans made by a member of the Target Group and existing at the Closing Date subject in each case, to discharge within a certain period;
- loans made as part of the Group’s cash pooling arrangements;
- credit balances held at banks because such balances technically constitute a debt owed by the bank to the customer.

Paragraph (h), contains a general exception in respect of loans made by any member of the Group subject to an aggregate cap. Borrowers may wish to extend the scope of this provision by providing that only loans which are not permitted pursuant to any other paragraph of the definition of Permitted Loan are to be including for the purposes of calculating whether the cap has been reached.

Other exceptions may be appropriate depending on the circumstances.

Clause 27.19: No Guarantees or indemnities

No member of the Group is permitted to have outstanding any guarantee obligation other than Permitted Guarantees or Permitted Transactions.

Borrower Notes

The definition of “**Permitted Guarantees**” includes the endorsement of negotiable instruments and the use of performance or similar bonds in the ordinary course of trade and guarantees in relation to other specified permitted matters (e.g. in respect of netting and set-off arrangements which constitute Permitted Security).

However, Borrowers should note that “**guarantee**” is defined extremely widely for the purposes of the Agreement in paragraph (a)(v) of Clause 1.2 (*Construction*) to encompass letters of credit, bonds, indemnities or similar assurances against loss or any other type of arrangement which involves the assumption of an obligation in order to maintain or assist another person to meet its indebtedness. The definition of “**Permitted Transaction**” (see Clause 1.1 (*Definitions*)) permits guarantees given in the ordinary course of trading, but nonetheless, this undertaking could restrict a wide range of ordinary course business activities and the exceptions will need to be considered carefully.

In the context of Permitted Acquisitions or Permitted Disposals, an Obligor may be required to give warranties or indemnities. The definition of “**guarantee**” is arguably wide enough for this covenant to restrict the giving of this kind of contractual protection. In September 2008, paragraph (f) was added to the definition of “**Permitted Guarantee**” which covers “any indemnity given in the ordinary course of the documentation of an acquisition or disposal transaction which is a Permitted Acquisition or a Permitted Disposal which indemnity is in a customary form and subject to customary limitations” was added to the definition of Permitted Guarantee. Whilst this is an acknowledgement that an exception of this type needs to apply, the drafting is not particularly helpful. First, the reference to “indemnity” might be replaced by a reference to “**guarantee**”, a defined and wider term encompassing indemnities and “similar assurances against loss”. Additionally, what is “customary” in relation to any particular acquisition or disposal depends on any number of factors including the type of transaction, its size, the market and the jurisdiction concerned and Borrowers might seek to further clarify this (or refer to something along the lines of guarantees which are reasonably required in the context of the acquisition or disposal in question).

The LMA has not addressed other exceptions which are commonly necessary for ordinary course activities, for example:

- indemnities are commonly required by a variety of service providers in their terms of engagement, for example, by accountants and other advisers, and companies commonly give indemnities in respect of the liabilities of directors and officers. Specific exceptions in respect of both may be required;
- landlords may require guarantees in respect of an Obligor’s occupation of leased premises.

Additionally, exceptions might be appropriate for guarantee liabilities which are acquired as part of a Permitted Acquisition and guarantees existing within the Target Group, subject in each case, to discharge within a certain period.

Borrowers should note that there is no de minimis basket for guarantees in the LMA definition of “**Permitted Guarantee**”, which may be advisable, in particular given the broad scope of the

definition of “*guarantee*”.

Clause 27.20: Dividends and share redemption

This Clause restricts the payment of dividends, distributions or other payments (for example, fees) to shareholders by any member of the Group.

Clause 27.20 is subject to exceptions by reference to the definitions “*Permitted Distribution*” and “*Permitted Transaction*”.

Borrower Notes

The skeleton definition of Permitted Distribution, is, as one might expect, very limited. Distributions will need to be made intra-Group in order to enable the Company and the Parent to make “*Permitted Payments*”, including to service the Facilities. Additionally, this definition will need to be tailored to reflect the commercial agreement between the parties on distributions by the Parent. Distributions to the Investors may be permitted subject to certain conditions, up to a certain amount, after a certain date, for example. This provision must be considered in conjunction with Clauses 27.21 (*Loan Notes*) and Clause 27.22 (*Mezzanine Facility and Structural Intra-Group Loans*), the definition of “*Permitted Payments*” and the provisions of the Intercreditor Agreement, which will all need to be consistent.

In September 2008 the conditions for payment of a dividend by the Company to the Parent to enable the Parent to make agreed payments in the definition of “*Permitted Distribution*” were amended to include the additional condition that “no Default is continuing or would occur immediately after the making of such payment”.

Borrowers may wish to argue that the reference in this condition to a Default should be to an Event of Default to avoid the provision having the effect of entitling the Lenders to accelerate based on a Default rather than an Event of Default or otherwise cutting through agreed cure periods. For example, if a payment were made to the Parent which caused the Group to breach the financial covenants, a Default would occur under both Clause 27.20 (*Dividends and Share Redemption*) and the relevant section of Clause 26 (*Financial Covenants*). If the agreed cure periods for Defaults under these two covenants are different, or if a cure period applies to Clause 26 but not Clause 27.20, the Borrower may lose its opportunity to cure the Default.

If Lenders accept this argument, Borrowers may wish to delete the condition altogether; if it refers to an Event of Default, the provision is not needed at all (as Lenders can accelerate based on the relevant Event of Default).

Clause 27.21: Loan Notes and Clause 27.22: Mezzanine Facility and Structural Intra-Group Loans

These provisions restrict payments being made by the Obligors to holders of subordinated debt:

- The Loan Notes (envisaged as part of the equity investment) and the Vendor Loan Notes (issued by the Parent to the Vendor as part of the consideration for the Acquisition) are

likely to be the most deeply subordinated debt in the acquisition financing structure and therefore Clause 27.21 does not contemplate any exceptions to the restrictions on payments.

- Certain payments in respect of the Mezzanine Facility and the Structural Intra-Group Loans may be permitted, for example, in respect of interest. Hence Clause 27.22 contemplates an exception for “**Permitted Payments**”.

Borrower Notes

A definition of “**Permitted Payments**” is provided in skeleton form. It contemplates payments being permitted in respect of scheduled interest on the Mezzanine Debt, payments of principal and interest on the Structural Intra-Group Loans and payments of certain fees and charges.

Permitted Payments in respect of Mezzanine Debt are quite commonly limited to interest payments and certain fees, although exceptions are often agreed in respect of payments resulting from the operation of the illegality, increased costs and tax provisions.

In relation to subordinated intra-group debt such as the Structural Intra-Group Loans, the scope of Permitted Payments varies, but in any event, distributions beyond the level of the Company in the Group structure will be subject to the restrictions in Clause 27.20 (*Dividends and share redemption*).

There may be transaction specific issues to address: payments may also be permitted in respect of subordinated debt out of specified proceeds for example, or Mezzanine Lenders may be entitled to share in other prepayments or a proportion thereof subject to certain conditions being satisfied e.g. a reduction in leverage to specified levels.

Permitted Payments are subject to the condition that no Default is continuing or would occur as a result of the payment being made and that such payment is permitted by the Intercreditor Agreement. Borrowers usually wish to alter this to refer to the existence or occurrence of an Event of Default. The arguments outlined in relation to the definition of “**Permitted Distribution**” at Clause 27.20 (*Dividends and share redemption*) above apply.

To the extent distributions are permitted as exceptions to Clause 27.20 (*Dividends and share redemption*), they will need to be included in the definition of Permitted Payments.

The extent to which payments in respect of subordinated debt are permitted will usually be set out in an Intercreditor Agreement, and an appropriate cross-reference is therefore quite commonly included in this definition (i.e. to permit payments as set out in the Intercreditor Agreement) to ensure consistency.

Clauses 27.23 to 27.24: Restrictions on movement of cash-cash in

Clause 27.23: Financial Indebtedness

This is an important covenant which prevents the Group from incurring Financial Indebtedness subject to the exceptions contained in the definition of “**Permitted Financial Indebtedness**”.

The exceptions include Financial Indebtedness arising under or in relation to the Finance Documents, Financial Indebtedness of a person acquired by the Group post-Completion (provided discharged within a specified period) and finance and capital leases within limits to be agreed. The definition also contemplates a certain amount of other Permitted Financial Indebtedness subject to a cap to be agreed.

Borrower Notes

There may be further categories or specific items of Permitted Financial Indebtedness that need to be built into the definition. Note, however that the extent to which exceptions are required will depend on the scope of the agreed definition of “**Financial Indebtedness**” (see Clause 1.1 (*Definitions*)). Further exceptions, might include, for example:

- indebtedness arising pursuant to cash pooling arrangements or pursuant to permitted debt factoring or discounting arrangements;
- indebtedness arising in relation to permitted Treasury Transactions (see Clause 27.33 (*Treasury Transactions*) below);
- financing arrangements existing at Closing that Lenders do not want to refinance or which are discharged within an agreed period after Closing, for example, three months.

In the context of a leveraged financing, Borrowers should, however, expect that Lenders will need good reasons to permit competing Financial Indebtedness and any further exceptions will need careful negotiation.

Clause 27.24: Share capital

Clause 27.24 prevents the Group from issuing shares except pursuant to a Permitted Share Issue or a Permitted Transaction. The definition of “**Permitted Share Issue**” includes the issue of non-redeemable shares in the Parent (provided a Change of Control does not thereby occur) and the issue of shares in Subsidiaries which become subject to the Transaction Security.

Borrower Notes

There are a number of further exceptions commonly sought by Borrowers in relation to the definition of “**Permitted Share Issue**”, for example:

- if Warrants are being issued to the Mezzanine (or any other) Lenders as part of the Transaction, the definition of Permitted Share Issue will need to reflect this;
- a further carve out may be necessary in respect of shares issued pursuant to any employee share schemes within the Group;
- if equity cure rights are agreed in relation to the financial covenants (see Clause 26 (*Financial Covenants*)), rights to issue shares for such purposes will need to be permitted;
- issues of shares to a member of the Group which constitute a Permitted Acquisition (e.g.

upon incorporation of a newco). Paragraph (b) of the definition permits the issue of shares by Group subsidiaries to their Holding Companies subject to security being provided. However, an additional optional condition was inserted in September 2008, that such shares will only qualify for the exception if they are issued for non-cash consideration. Whether this amendment is appropriate will depend on the transaction. There may be circumstances where the issue of shares for cash is necessary an example being where the issuer needs to capitalise a newco incorporated for the purpose of making a Permitted Acquisition;

- some Borrowers may seek to agree a carve out for issues of shares to other members of the Group (other than the issuer's immediate Holding Company);
- share issues in relation to a Flotation may need to be included in this definition, depending on whether the Facilities will survive a Flotation, see Clause 12.1 (*Exit*);
- a Permitted Share Issue of shares in the Parent is permitted provided that such shares are non-redeemable. Borrowers may argue that this should apply only to restrict the issue of shares which are redeemable prior to the Termination Date for the Facilities.

Clauses 27.25 to 27.37: Miscellaneous

Clause 27.25: Insurance

The undertakings relating to insurance are wide ranging:

- paragraph (a) requires that insurance is maintained against those risks and to the extent usual for companies carrying on the same or substantially similar businesses;
- paragraph (b) requires that all such insurance must be with "reputable" independent insurance companies or underwriters;
- paragraph (c) requires that all of the recommendations of the Insurance Report prepared for due diligence purposes are implemented; and
- paragraph (d) is an optional provision dealing with any agreed obligations in terms of obtaining or maintaining key-employee insurance cover.

These provisions will need to be considered against the background of the insurance due diligence and any recommendations made by the insurance advisers.

Borrower Notes

The main objection to these provisions from the Borrower perspective is that they might contemplate insurance cover in excess of that maintained by the Target Group as at the Closing Date with no reference to materiality or cost/benefit analysis in terms of obtaining cover. Borrowers will usually therefore seek to include appropriate qualifications. Additionally, Borrowers may argue that paragraph (b) is vague and unnecessary. If Lenders insist on control over the identity of insurers, Borrowers may prefer to name approved providers and ensure that

current providers are specifically approved.

If the insurance due diligence highlights material deficiencies in the Target Group's cover, it is likely to be in both parties' interests to agree an appropriate time frame to remedy such deficiencies and the detail of how they might be addressed. Any such issues should be dealt with specifically in the Agreement, perhaps as conditions subsequent (see Clause 27.38 (*Conditions subsequent*) below).

Clause 27.26: Pensions

Clause 27.26 is intended to ensure that on an ongoing basis the Group does not incur liabilities and complies with its obligations in relation to any pension schemes and that it notifies the Lenders of any event which might indicate any adverse change in the Group's exposure to defined benefit pension scheme liabilities. See "***Pensions Regulator***" at Clause 1.1 (*Definitions*) above by way of background to the pensions related provisions in the Leveraged Facilities Agreement.

Borrower Notes

Any provisions in the Agreement relating to pensions will need to be negotiated according to the circumstances. There is not yet any accepted market practice. Clause 27.26 is therefore quite unlikely to be agreed as drafted.

Paragraph (a) is an optional undertaking by the Parent to ensure that all pension schemes are fully funded as required by law and that no action or omission is taken by any member of the Group which has or is reasonably likely to have a Material Adverse Effect. The LMA acknowledges (in a footnote) that this provision is of limited value as a scheme can be fully funded on one basis but still have a deficit on a section 75 buy-out basis. In addition, the statutory funding regime in some circumstances clearly permits (and indeed envisages) that a scheme may be in deficit against its statutory funding objective, making this a difficult representation to give. Thus, this provision is not often used. Instead, it is perhaps more common to see an ongoing general requirement for compliance with legal and regulatory requirements in relation to scheme funding (subject to Material Adverse Effect). Lenders may also seek specific positive obligations in relation to funding requirements triggered by the deal in transactions where pensions are a key issue.

Paragraph (b) complements the representation in Clause 24.29 (*Pensions*): it confirms that (save as disclosed) the Group is not an employer nor is it "connected" or "associated" with an employer under a defined benefit pension scheme, with the purpose of obliging disclosure of any potential Group liability for pension scheme deficits. Again, the breadth of this undertaking will need to be considered carefully if given (see commentary under "***Pensions Regulator***" in Clause 1.1 (*Definitions*) in relation to the definition of "connected" and "associated" for this purpose).

The remainder of Clause 27.26 relates to the provision of information: copies of actuarial reports, material changes in required contribution levels, investigations by the Pensions Regulator and the receipt of a Financial Support Direction or Contribution Notice (as to which see "***Pensions Regulator***" at Clause 1.1 (*Definitions*) above). Certain of these obligations

duplicate more general information covenants, but Lenders may prefer that their requirements in relation to pensions matters are addressed specifically given the importance attributed to pensions issues in many transactions.

Clause 27.27: Access

This provision provides the Agent and the Security Agent and their accountants, advisers or contractors with a right of access to the premises, assets, books, accounts and records of the Group and to Senior Management within agreed limits. The purpose of the provision is to enable the Lenders' representatives to assess the Group's situation for themselves in the event that they are concerned about their investment.

Borrower Notes

Negotiations on this provision usually focus on the point at which Lenders and their advisers are entitled to a right of access. Lenders are likely to argue that they should be entitled to access if they suspect a Default has or is about to occur, to enable them to assess any deterioration in the Group's position, perhaps at the point of a Default rather than an Event of Default. The Group, however will not wish the Lenders to have free access and disrupt their business and take up management time unduly. Borrowers will therefore usually argue that Lenders should only have access whilst an Event of Default is continuing. Some Borrowers have gone further, and successfully argued that the right of access should subsist only whilst a serious Event of Default relating to non-payment, breach of the financial covenants or insolvency is continuing.

Clause 27.27 provides that the costs and risks of such investigations are for the relevant Obligor/the Company. Strong Borrowers may argue that if the results of such investigation show that no Event of Default has in fact occurred, costs should be for the Lenders.

The agreed position varies and the LMA drafting contains a variety of options (although not the most aggressive positions outlined above).

Clause 27.28: Service contracts

This covenant relates to retention of appropriate management personnel by the Group, and contemplates that the Lenders will be consulted in relation to the replacement of specified Senior Management and that their interests are borne in mind when service contracts are negotiated or altered.

Borrower Notes

Some Borrowers may find it difficult to see how compliance with a covenant as to the quality of management can be objectively monitored. As a result, these types of covenant are only used in fairly exceptional circumstances, at least in large and medium sized financings. Borrowers can usually convince Lenders that in this respect, they have a common interest. Additionally, Borrowers might argue that management underperformance will manifest itself in its impact on other covenant provisions (for example, the financial covenants).

Clause 27.29: Intellectual Property

This is a detailed covenant in relation to the maintenance of the Group's intellectual property rights and the non-infringement of the rights of others.

Borrower Notes

This provision overlaps with a number of other covenants: Clause 27.2 (*Compliance with laws*) and Clause 27.12 (*Preservation of assets*) for example. If intellectual property is of particular importance to the Group, Lenders may insist on a specific covenant, but Borrowers will wish to insert appropriate qualifications, for example, by reference to materiality or in terms of the scope of the covenant's application by limiting it to apply only to Obligor or Material Companies.

See Clause 1.1 (*Definitions*) in relation to the definition of "**Intellectual Property**" which has an impact on the scope of this undertaking.

Clause 27.30: Amendments

Any member of the Group is restricted by Clause 27.30 from amending or taking a variety of other specified actions in relation to any Transaction Document or any document delivered as a condition precedent. Clause 27.30 also prohibits any member of the Group from entering into any agreement with the shareholders of the Parent or any of their Affiliates which is not a member of the Group.

Exceptions to the general prohibition apply to the extent that the amendment or waiver is in accordance with the relevant provisions of the Facility Agreement (see Clause 41 (*Amendments and Waivers*) below) or the provisions of the Intercreditor Agreement. The Intercreditor Agreement will usually contain provisions setting out the extent to which the various classes of Lender may amend the Finance Documents without the consent of other Lenders to protect the subordination arrangements. Additionally, there is a general exception to this Clause for action subject to the prohibition which would not materially and adversely affect Lenders' interests.

Clause 27.31: Financial assistance

Many leveraged transactions involving English companies give rise to financial assistance issues pursuant to sections 151-158 of the Companies Act 1985. For example, intra-group lending arrangements put into place for the purpose of paying cash upstream and the provision of guarantees and security for the Facilities by members of the Target Group will all need to be considered in the context of these statutory rules. At the time of writing, financial assistance by private companies is permitted subject to compliance with the whitewash procedure in sections 155-158.

This covenant requires compliance with these provisions of the Companies Act plus any equivalent provisions in any other jurisdiction. A key aspect of the due diligence is likely to be to determine the extent to which the Acquisition and the proposed financing arrangements comply with applicable restrictions on financial assistance in any jurisdiction.

Borrower Notes

Financial assistance by private companies in relation to the acquisition of their own shares or shares in their private holding companies will no longer be subject to the restrictions contained in sections 151 to 158 of the Companies Act 1985 on or after 1st October 2008. The whitewash procedure will therefore no longer be statutorily required in transactions involving financial assistance by private companies after that date. This will have positive cost and timing implications for leveraged acquisition financing transactions involving the provision of upstream credit support and funding by UK target group companies such as the transaction contemplated by the Leveraged Facilities Agreement.

Borrowers should note, however that whilst, following the repeal, financial assistance within the scope of the repeal will no longer be unlawful as such, the repeal will not automatically render all such transactions lawful. The transaction must still be in the best interests of the company and the rules relating to distributions and reductions of capital, for example, continue to apply. The directors of the assisting company will still therefore need to consider its solvency position and the impact (if any) of the assistance on its accounting net assets. These issues should be addressed in board papers and due diligence and legal advice will be required in order to determine whether the proposed transaction is lawful. Shareholder approvals should also be sought to reduce the risk of the transaction being challenged as a breach of duty by the directors (although this will not eliminate the risk if the company is or may be insolvent). However, the statutory filings, declarations and perhaps most notably, auditors' reports will no longer be required by law so the documentary and procedural burden will be greatly reduced.

The repeal applies to financial assistance given on or after 1st October 2008 even (in the case of financial assistance given after such time as the relevant shares are acquired) if the shares in question were acquired, and the liability in respect of which the assistance is given incurred, before that date.

Where financial assistance is to be given after the repeal takes effect, this covenant can be deleted in transactions which do not involve public companies, together with the related provisions, for example, the condition precedent relating to whitewash documentation (see Schedule 2 (*Conditions Precedent*)). However, parties must remember that the financial assistance rules will continue to apply to public companies after 1st October 2008 and when sections 677-683 of the Companies Act 2006 come into force in October 2009, meaning that, for example, if the Target is a public company, it will have to be converted into a private company before any financial assistance can be given.

Clause 27.32: Group bank accounts

This covenant requires that all of the Group's bank accounts be transferred to a Finance Party or an Affiliate of a Finance Party and that they are subject to the Transaction Security.

Borrower Notes

Lenders sometimes ask that Group bank accounts are transferred pursuant to this Clause. Lenders impose this requirement for business reasons, to enable them to monitor the accounts and to be in a position potentially to take account of available netting and set-off rights.

Additionally, if the accounts are kept by a Finance Party, perfection of security over the accounts (in terms of service of notices of the security on and acknowledgement of the security by the account bank) is more straightforward.

Whether or not this requirement is acceptable to the Group depends on whether the Lenders can offer the banking facilities that the Group needs (e.g. does the Lender operate in all relevant jurisdictions), the administrative hassle involved in moving bank accounts and upon an appropriate time frame for transfer being agreed. It is generally not necessary for the purpose of granting effective security over the accounts.

Security over the Group's bank accounts will be provided as agreed in the Finance Documents in accordance with the Agreed Security Principles (see Schedule 14). The terms of this covenant must be consistent with the required level of Security. To avoid the possibility of confusion it is preferable to avoid reference to the Transaction Security in this Clause.

Clause 27.33: Treasury Transactions

It is customary for Lenders to require that a certain proportion of the interest rate liabilities of the Group under the Facilities are hedged, at least in the early years of the Facilities. Currency hedging requirements may also be imposed if relevant. The hedging strategy for the Facilities is usually documented in a Hedging Letter delivered as a condition precedent to the transaction.

Lenders commonly seek to impose a requirement that the interest rate hedging business (and sometimes the other hedging requirements) of the Group be given to their Affiliates (see the definition of "**Hedge Counterparty**"). The Hedge Counterparties will normally rank *pari passu* with the senior Lenders in the Intercreditor Agreement, and the Intercreditor Agreement will often contain restrictions on their actions and the terms of the Hedging Agreements.

This covenant includes an undertaking that the Hedging Agreements will be implemented and maintained as agreed (in accordance with the Hedging Letter). It also restricts the Group from entering into any other derivatives contracts ("**Treasury Transactions**") for speculative purposes.

Borrower Notes

Granting exclusivity to Lenders and their Affiliates to provide hedging arrangements can be problematic for some Borrowers in terms of obtaining the best pricing and other terms. If this is an issue, solutions might include giving Lenders and their Affiliates the right to bid for the Group's hedging business, fixing the key terms and credit spread upfront and/or ensuring that the Borrower retains control over hedging terms. Some Borrowers may agree that Lenders and their Affiliates are granted a right to match hedging terms that the Borrower is able to obtain in the market. However, the operation of a right to match may be difficult in a fast moving hedging environment. Additionally, the existence of a right to match may, of itself, inhibit the Borrower's ability to obtain quotes in the market.

Borrowers usually seek to widen the exception in paragraph (a)(iii) of this Clause, which relates to derivative contracts entered into for "the hedging of actual or projected real exposures arising in the ordinary course of trading activities of a member of the Group for a period of not more

than [*specify appropriate period*] months and not for speculative purposes". The limitation by reference to a time period is usually deleted, and the reference to exposures arising in the ordinary course of trading is quite commonly replaced with the wider reference to the ordinary course of business (which makes paragraph (iii) consistent with paragraph (ii), which provides an exception for spot and forward delivery foreign exchange contracts entered into in the ordinary course of business and not for speculative purposes).

Clause 27.34: Cash management

This provision requires the Obligors to procure that no member of the Group will hold cash balances in excess of its projected cashflow requirements for an agreed period, any excess cash being advanced to the Company pursuant to a Structural Intra-Group Loan.

Paragraph (b) contains exceptions to the extent that imposing such cash management requirements would result in a breach of law or result in a materially greater tax liability than would otherwise have been the case. It also contemplates a de minimis exception for amounts of less than a specified sum.

Borrower Notes

This provision is presented as optional and is quite often deleted or limited to apply only to members of the Group who are not Obligors. It is fairly restrictive from the Borrowers' perspective even with carefully framed exceptions. To the extent that cashflow constitutes Excess Cashflow, the Group is obliged to make arrangements to make the agreed level of prepayments in any event.

If applicable, Borrowers might attempt to make this provision more flexible, for example, by providing for the loan of excess cash to the Company to be repaid in the event that the relevant Obligor requires more cash than projected in a particular period.

Clause 27.35: Guarantors

This undertaking relates to compliance with the agreed Guarantor coverage test. The nature of this test is also discussed Clause 27.38 (*Conditions subsequent*).

Borrower Notes

Paragraph (b) is an optional provision which qualifies the obligation to provide Guarantors by reference to limitations under applicable law which cannot be overcome: this issue is also dealt with in the Agreed Security Principles so this provision may be deleted (or, if included, it should be consistent with the Agreed Security Principles: see Schedule 14).

Until the Closing Date, the sole Obligors are likely to be the Parent and Company. The Target often becomes an Obligor at or after Completion and relevant Subsidiaries will accede to the Agreement at Completion or within a pre-agreed period following the Closing Date (see Clause 27.38 (*Conditions subsequent*)). This Clause will need to be tailored to reflect the agreed arrangements. Lenders will generally insist on a longstop date by which time all guarantees

must be in place (see Clause 27.38 (*Conditions subsequent*)), but it would be unusual for all cross-guarantees to be in place on the Closing Date itself.

In terms of Guarantor coverage, Lenders are likely to seek the maximum Guarantor coverage possible within applicable legal and practical limits. The amount of coverage is usually defined by reference to financial criteria. This Clause contemplates a Guarantor coverage test by reference to a minimum proportion of the Group's total EBITDA, assets or turnover. An EBITDA-based test is probably the most common formulation although other types of test may be more appropriate depending on the circumstances. Alternatively, rather than a test being applied, Guarantors may be named, or in a simply structured Target Group, all members of the Group may accede as Guarantors.

If an EBITDA-based test is used, the requirement is usually that the combined EBITDA of the Guarantors is around 70-80 per cent. of the Group's total EBITDA. Borrowers will often seek to exclude from the total EBITDA calculation for this purpose the EBITDA of those Guarantors who are unable to give guarantees as a result of legal limitations.

As a safety buffer, Borrowers may wish to consider adding a provision to the effect that the accession of new Guarantors will only be required if the coverage drops by more than a certain percentage below the required level (say 5 per cent.).

Clause 27.36: Further assurance

Paragraph (a) of Clause 27.36 requires the Obligors to do all such acts or execute all such documents as reasonably requested by the Security Agent to perfect the Security created or intended to be created pursuant to the Transaction Security Documents or to confer equivalent Security in other jurisdictions or to facilitate the exercise of the Finance Parties' rights in relation to the Finance Documents.

Paragraph (b) requires each Obligor to take "all such action as is available to it...as may be necessary for the purpose of the creation, perfection, protection or maintenance of any Security conferred or intended to be conferred on the Security Agent or the Finance Parties by or pursuant to the Finance Documents".

Borrower Notes

Paragraph (b) overlaps with paragraph (a) of this Clause, but is of wider application: it is not qualified by reference to the Agreed Security Principles (see Schedule 14), nor by reference to the reasonableness of any such requirements.

Clause 27.37: Syndication

This is an optional undertaking from the Parent to provide reasonable assistance to the Arranger in the preparation of the Information Memorandum and in relation to the primary syndication process.

Borrower Notes

The details of the parties' roles in the primary syndication process are usually included in a separate syndication side letter. This side letter will typically set out the levels of assistance that are to be provided by the Parent and the Group, in terms of the provision of information and the availability of relevant management to make presentations to or answer questions of potential syndicate members. The syndication side letter may also contain market flex, reverse flex and clear market provisions:

- Market flex provisions set out the extent to which the Arrangers have the right to alter the pricing and possibly the structure and terms of the Facilities in order to achieve "successful syndication". "Successful syndication" is normally defined by reference to the Arrangers and the underwriters having sold down participations in the Facilities to a specified level. Such provisions are currently the subject of detailed negotiations and the precise language used is key as arrangers seek to address underwriting risks in an illiquid loan market.
- Reverse flex provisions operate in the opposite way to market flex provisions: in the event that the syndication is oversubscribed, a reverse flex provision operates to alter the pricing and/or structure of the facilities in a manner favourable to the Obligors. Such provisions were invoked on a number of deals prior to the credit crunch.
- Clear market provisions are undertakings to the effect that no member of the Group will attempt to raise any competing debt finance until after the closing of primary syndication, intended to protect the successful syndication of the Facilities.

It would be unusual to see market flex and clear market provisions in a Facility Agreement for confidentiality reasons, but if Clause 27.37 is used it should be consistent with any side letter (or may simply cross-refer).

Clause 27.38: Conditions subsequent

Conditions subsequent are conditions that are to be satisfied after the date of the Agreement.

Borrower Notes

The Parent is usually obliged to put the required Hedging Arrangements in place (see Clause 27.33 (*Treasury Transactions*) within a certain period of Completion (30 days is suggested in the LMA drafting)). This is dealt with in paragraph (a).

A proportion of the Transaction Security and guarantees from members of the Target Group will be put into place post-Completion. Members of the Target Group may also accede as Additional Borrowers after Completion. The period permitted for accession of members of the Target Group as Obligors varies, but is often around 90 days following the Closing Date, depending on the complexity of the transaction, in particular, the number of Obligors and the jurisdictions involved. Paragraphs (b) and (c) of this covenant relate to the provision of such security and guarantees. See also Clause 24.25 (*Obligors*), Clause 27.35 (*Guarantors*), Clause 30 (*Changes to the Obligors*), Schedule 2 (*Conditions Precedent*) and Schedule 14 (*Agreed Security Principles*) in relation to Guarantor coverage and accession arrangements for

Additional Borrowers and Additional Guarantors.

Paragraph (d) is left blank for any additional conditions subsequent to be inserted. Conditions subsequent often deal with specific issues uncovered in the due diligence exercise or conditions precedent which could not be satisfied in time for signing. In either case, a time frame for satisfying any relevant conditions is usually prescribed.

CLAUSE 28: EVENTS OF DEFAULT

This Clause lists the various Events of Default which primarily operate to entitle the Lenders to accelerate the Facilities and to enforce the Transaction Security.

Clause 28.1: Non-payment

This is the non-payment Event of Default which is identical to the equivalent provision in the Investment Grade Documents.

There is an exception from this Event of Default for failure to pay as a result of administrative or technical error (which is remedied within a grace period to be agreed). There is also a grace period which is expressed to apply in the event of major operational disruption.

The background to the “major operational disruption” provisions is the Government-commissioned Report of the Task Force on Major Operational Disruption in the Financial System, published in December 2003, which concluded that market participants and their trade associations should review their contracts with a view to making any amendments that might be necessary in order to cater for major operational disruption. The LMA and the ACT settled some changes to the Investment Grade Documents which were subsequently reflected in the Leveraged Facilities Agreement:

- A specific grace period was added for payment failure on the part of the Borrower when this is due to a “**Disruption Event**”. This grace period is expected usually to be about 5 Business Days, to allow time to resolve the problem.
- A provision was added (Clause 35.10 (*Disruption to Payment Systems etc*)) enabling the Agent to respond pragmatically to a “**Disruption Event**”. See further comments on that Clause below.

Borrower Notes

The grace period typically agreed for non-payment as a result of an administrative or technical error, is around five to seven Business Days.

It is common for the same grace period to apply to Disruption Events as to “administrative or technical errors”, although Obligors may feel that the grace period should last as long as the Disruption Event is continuing. The use of a simple grace period of a fixed number of Business Days might not be sufficient.

Obligors should note that the Disruption Event grace period does not apply to the cross-default

Clause. See further Clause 28.5 (*Cross default*).

In addition, a short general grace period is quite commonly agreed in relation to non-payment, of around three Business Days.

Clause 28.2: Financial covenants and other obligations

This Event of Default relates to breaches of specific covenants.

Borrower Notes

A grace period is not contemplated by the LMA in this Clause but is typically agreed in respect of any breach of the financial covenants, the information and general covenants and the provisions of the Transaction Security Documents. Grace periods vary but might typically be somewhere between 10 and 30 days. Any agreed grace period in relation to the financial covenants needs to be consistent with the period permitted for the exercise of any equity cure rights (see Clause 26 (*Financial Covenants*)).

Covenant “mulligans” are mentioned at Clause 26 (*Financial Covenants*) above. If a mulligan is agreed, any breach of the financial covenants will not be a Default unless the breach continues for two consecutive testing periods. A “double mulligan” would avoid a Default unless the breach continues for three consecutive testing periods, and so on. Mulligans are only likely to be achieved in fairly exceptional circumstances by strong Borrowers and they are unlikely to be available in the current market conditions.

See comments at Clause 26.3 (*Financial testing*) in relation to the timing of Defaults under the financial covenants.

Clause 28.3: Other obligations

This Clause makes any other breach of obligations under the Finance Documents (other than the payment provisions and covenants covered in the Events of Default at Clauses 28.1 and 28.2 above) an Event of Default. The drafting contemplates that a grace period will be agreed in relation to this provision.

Borrower Notes

A longer grace period is usually applied to breach of these obligations, which might be anywhere up to around 30 Business Days, plus a materiality qualification.

Clause 28.4: Misrepresentation

This Event of Default, as drafted, will occur if any representation or statement made by or on behalf of the Obligors in the Finance Documents or if any document delivered by or on behalf of any Obligor under or in connection with the Finance Documents proves to have been incorrect or misleading when made or deemed to be made.

Borrower Notes

There are a number of points that Borrowers might consider in relation to this question, for example:

- There is no reference to the materiality or otherwise of the misrepresentation in question. If the representations themselves contain materiality qualifications and/or a materiality qualification has been agreed in relation to the Repeating Representations when they are repeated, Lenders may resist a further materiality qualification in the Event of Default. Nonetheless, note that the equivalent Event of Default in the Investment Grade Documents does contain a materiality qualification as standard.
- A grace period for cure of a misrepresentation is usually agreed (anywhere up to around 30 Business Days might be typical).
- The application of this Event of Default to statements contained in documents delivered under or in connection with the Finance Documents is likely to be objectionable from a Borrower perspective. Whilst, clearly, the Borrower should always take great care in its communications with Lenders, various of the representations in Clause 24 (in particular Clause 24.12 (*No misleading information*) and Clause 24.13 (*Original Financial Statements*)) relate to the accuracy of the information provided to Lenders. This Event of Default may undermine concessions agreed by the Borrower in those representations (for example, as to the materiality or otherwise of the relevant document).

Clause 28.5: Cross default

This Clause makes any default under Financial Indebtedness of the Group an Event of Default under the Facilities. It reflects the equivalent Clause in the Investment Grade Documents. 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: if another lender is not paid and accelerates their debt, demanding repayment at once, or if another lender has the right to accelerate, the Lenders wish also to be able to accelerate the facilities (even if the Obligors have not otherwise defaulted), in order not to be at a disadvantage. Borrowers, however, are likely to wish to restrict the circumstances in which the Lenders can demand repayment under the Agreement on the basis of defaults under other financing arrangements.

Note that the Clause focuses on defaults relating to Financial Indebtedness. This definition is discussed at Clause 1.1 (*Definitions*).

Borrower Notes

Paragraphs (a) and (b) are quite hard to dispute: if some other Financial Indebtedness is not paid when due, or is accelerated, there will be an Event of Default under the Agreement.

Paragraph (c) provides for cross-default if another lender cancels its commitment as a result of a default. Only a very strong Borrower will usually be able to argue successfully that the

cancellation of an undrawn Commitment should not trigger a cross-default.

Paragraph (d) provides for cross-default if another lender is merely entitled to accelerate. Borrowers may argue that the Lenders do not need to be able to accelerate the Facilities 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.

Borrowers should note paragraph (e): there is no default under Clause 28.5 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 and is often the key focus of negotiations on this provision.

The Clause applies, as drafted, to defaults by any member of the Group. Some Borrowers may try to restrict the cross-default provision to defaults by Obligor only or to Material Companies.

Some Borrowers argue that non-payment of other Financial Indebtedness should not cross-default the Facilities until the end of the longer of any applicable grace period under the other indebtedness and the grace period applicable for payment defaults under the Agreement. Without such a provision, the Lenders might be able to accelerate the Facilities 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 Agreement.

The grace period which applies on a payment default following a Disruption Event (see comments on Clause 28.1 (*Non-payment*)) is not applicable to the cross-default clause. It follows that, upon a Disruption Event, even if a Borrower has the grace period in respect of payments under the Agreement, there may still be an Event of Default under the Agreement by virtue of a payment default under another agreement where there is no such grace period. It should be noted however that this issue is perhaps of less importance in the leveraged market as Obligor may have little in the way of “other” Facilities.

Clause 28.6: Insolvency, Clause 28.7: Insolvency proceedings and Clause 28.8: Creditors’ process

Each of these Events of Default relate to insolvency. They are broadly drafted and usually the subject of negotiation.

Borrowers should be aware that the insolvency related Events of Default in the Leveraged Agreement diverge in some places from those in the Investment Grade Documents as currently drafted. The differences are interesting because the effect of some is to make the Events of Default wider, and the effect of others is to make the Events of Default narrower. These differences are highlighted in the commentary below.

Clause 28.6: Insolvency

This Event of Default is intended to entitle the Lenders to accelerate the Facilities and/or exercise the other remedies available to them where an Event of Default is continuing in the event that a member of the Group is insolvent on a cashflow basis (i.e. it is unable to pay its

debts as they fall due) or on a balance sheet basis (the value of its assets is less than the amount of its liabilities, taking into account prospective and contingent liabilities).

Borrower Notes

This Event of Default is very wide ranging and Borrowers are likely to want to narrow its effects so that normal commercial activities do not trigger undesirable consequences. For example (to mention some of the points which are commonly raised):

- As a general point, Borrowers may object to the application of this Event of Default to all members of the Group: Borrowers may seek to limit it, for example, to Material Companies.
- Paragraph (a) provides that it is an Event of Default if a member of the Group is unable or admits its inability to pay its debts as they fall due or (optionally) “is deemed to or declared to be unable to pay its debts under applicable law”. Borrowers may object to this optional “deemed unable” language and argue that only the test of whether the relevant entity is actually unable to pay its debts should apply. Section 123(1) of the Insolvency Act 1986 sets out the circumstances in which a company will be deemed to be unable to pay its debts not all of which (Borrowers may argue) should automatically give rise to an Event of Default. Section 123(1) includes circumstances where a creditor has made a statutory demand on the company in excess of £750 which remains unpaid for three weeks, the existence of unsatisfied court authorised execution or other process against a company and proof to the satisfaction of a court that a company is unable to pay its debts.
- Paragraph (a) goes on to provide that if a member of the Group suspends or threatens to suspend making payment of any of its debts by reason of “actual or anticipated financial difficulties”, an Event of Default will occur. If a member of the Group has a short term cashflow issue and negotiates longer payment terms with a supplier, for example, Borrowers might argue that this should not trigger this Event of Default (the materiality of the issue can be measured by the financial covenants).
- The Event of Default is triggered by the commencement of negotiations with “one or more creditors with a view to rescheduling its indebtedness” – Borrowers may argue that the commencement of negotiations with creditors generally or a group of creditors is a more appropriate trigger. Borrowers may also wish to exclude negotiations with one or more of the Finance Parties from this provision.
- Paragraph (b) provides for an Event of Default if the value of the assets of any member of the Group is less than its liabilities (taking into account contingent and prospective liabilities). Many Borrowers object to the inclusion of this test on the basis that it is difficult to satisfy. The scope of contingent and prospective liabilities taken into account for the purposes of this test is very wide and it is possible that some members of the Group may have a negative net worth on this basis.
- Paragraph (c) relates to any moratorium being declared in respect of indebtedness of any member of the Group. This provision is duplicative of Clause 28.7 below and may be resisted by Borrowers.

Clause 28.7: Insolvency proceedings

It will be an Event of Default if specified insolvency proceedings are commenced in relation to any member of the Group in any jurisdiction. Again, this Event of Default is very wide.

An exception to this provision applies to any “frivolous or vexatious” winding-up petition which is discharged within a specified period. This concession (which is usually agreed) is not included in the Investment Grade Documents. An exception also applies to actions within paragraph (b) of the definition of Permitted Transaction, which relates to solvent liquidations or reorganisations.

Borrower Notes

Points often raised in relation to this provision include:

- it relates to all members of the Group (see Clause 28.6 above);
- the trigger point is vague. As well as corporate action or legal proceedings, any “other procedure” or “any step” taken in relation to...[relevant insolvency procedures] will trigger the Event of Default. Borrowers may argue that the trigger should be limited to the commencement of legal proceedings;
- it refers to a composition or compromise etc. with any creditor of any member of the Group (see points highlighted at Clause 28.6 above);
- it is triggered by the enforcement of any Security (which is widely defined) over any assets of any member of the Group: Borrowers may want to qualify this by reference to materiality (often a threshold amount) and the carve outs to the negative pledge (see Clause 27.15 (*Negative pledge*)); and
- the exception to this provision in respect of “frivolous or vexatious” winding-up petitions might be extended to apply also to other proceedings (for example, statutory demands) which are being contested by the appropriate means.

Clause 28.8: Creditors' process

This Event of Default deals with the expropriation, attachment or analogous process relating to assets of the Group. It deals with circumstances where the assets of the Group are subject to some kind of legal process initiated in order to seize or appropriate the relevant assets.

Borrower Notes

The drafting contemplates the parties agreeing an appropriate limitation to this provision in terms of the members of the Group to which it applies, the value of the relevant assets and in relation to circumstances where the process is discharged within a specified period. Its precise scope is therefore to be agreed.

Clause 28.9: Unlawfulness and invalidity

This Event of Default will apply in circumstances where the performance of the Obligors' obligations to the Lenders have become unlawful or unenforceable.

Borrower Notes

In considering this provision, Borrowers should have regard to the agreed definition of Material Adverse Effect (see Clause 1.1 (*Definitions*)) and the related Event of Default (see Clause 28.19 (*Material adverse change*)). This Event of Default is aimed at circumstances where performance of the Obligors' obligations to the Lenders has become unlawful or unenforceable, two of the three suggested limbs of the definition of Material Adverse Effect. Borrowers may argue that the effect of this Event of Default is to permit acceleration without appropriate materiality qualification, and therefore this provision should be deleted.

Clause 28.10: Intercreditor Agreement

This Clause provides that an Event of Default will occur if a party other than a Finance Party or an Obligor breaches the Intercreditor Agreement.

In order to reflect the agreed ranking and priority of the Facilities, all other shareholder lenders, intra group lenders and holders of Vendor Loan Notes are likely to be required to be parties to the Intercreditor Agreement as subordinated lenders. If the Parent's shareholders have provided loans to the Group, for example, they will often be parties to the Intercreditor Agreement (although many private equity houses will resist this strongly on the basis that their investment is non-recourse and subordinated in any event). Under the Intercreditor Agreement such lenders will give certain assurances to the Finance Parties that they will not make claims on the Group (save as specifically agreed) until the Group's obligations to the Finance Parties have been discharged. They will usually undertake to hold on trust and "turn over" any amounts received other than in accordance with the Intercreditor Agreement to the Finance Parties. Therefore Lenders will be concerned to ensure that if this does not happen, they are able to accelerate the Facilities.

The LMA drafting contemplates that a grace period is agreed for curing of this Event of Default.

Clause 28.11: Cessation of business

This Event of Default relates to any member of the Group ceasing to carry on business (or threatening to do so).

Borrower Notes

This Event of Default is sometimes deleted as the circumstances in which it might apply are covered by other Events of Default: for example, cessation of business is likely to involve a disposal (restricted by Clause 27.16 (*Disposals*)) or actual or impending insolvency (covered by the extensive insolvency related Events of Default, see Clauses 28.6 to 28.8 above). If it is included, Borrowers may want to limit it to apply only to Obligors (rather than to any member of

the Group).

Clause 28.12: Change of ownership

This Clause makes it an Event of Default if shares in an Obligor (other than the Parent) or a Material Company owned by an Obligor change hands after the Closing Date.

Borrower Notes

Disposals of Obligors or shares in Obligors or Material Companies are restricted by the non-disposal covenant (see Clause 27.16 (*Disposals*)). Breach of the non-disposal covenant will be an Event of Default under Clause 28.2, subject to the expiry of any agreed grace period, so Borrowers might argue that this provision is duplicative and should be deleted. In any event, care should be taken to ensure consistency.

Clause 28.13: Change of management

This Event of Default deals with the cessation of employment of key management.

Borrower Notes

This provision is optional and is often not used. From a Borrowers' perspective, it is a difficult Event of Default to agree to as it relates to circumstances which the Borrower may not be able to control (it talks about specified management ceasing to be employed by the Parent/Company or ceasing to devote the required time and attention to the business, trade and offices of the Group).

Clause 28.14: Audit qualification

Receipt of a qualified audit opinion in relation to the consolidated accounts of the Parent will be an Event of Default.

Borrower Notes

This Event of Default makes no reference to the reason for or effect of the qualification. Borrowers may seek to delete this Event of Default or limit it possibly by reference to Material Adverse Effect or other materiality qualification.

Clause 28.15: Expropriation

Clause 28.15 is aimed at the compulsory limitation or curtailment of the Group's activities as a result of the intervention of a governmental or other authority to which the Group's activities are subject.

Borrower Notes

This provision is likely only to be triggered in rare circumstances. From a Borrower perspective, however, the provision is widely drafted to encompass any limitation on the authority or ability of any member of the Group to conduct its business by “any person”. This arguably extends the Event of Default beyond its proper scope, meaning that it potentially cuts through any limitations agreed (for example) in relation to the provisions of the agreement dealing with Authorisations (e.g. Clause 27.1 (*Authorisations*)) and certain of the insolvency related Events of Default (see above)). On this basis Borrowers will wish to negotiate amendments to the wording to narrow the scope of the Event of Default, in addition, perhaps, to an appropriate materiality qualification.

Clause 28.16: Repudiation and rescission of agreements

This Event of Default applies if an Obligor or any other party to any of the documentation relating to the transaction (a Finance Document or an Acquisition Document or the Shareholders’ Agreement or a Loan Note Document) “rescinds or purports to rescind” or “repudiates or purports to repudiate” or “evidences an intention to rescind or repudiate” any of the specified documents.

Borrower Notes

This Event of Default is sometimes omitted. This is perhaps because in the situations it covers, Lenders are likely to have rights to accelerate the Facilities based on other Events of Default. Borrowers may object to it or seek to amend it because it applies to repudiation or rescission of the a Finance Document, an Acquisition Document, the Shareholders’ Agreement or a Loan Note Document by any party to those documents, so may be triggered by the actions of those over whom the Obligors have no control. Additionally, the trigger point for this Event of Default as drafted is vague: it is unclear what sort of conduct might constitute an “intention to repudiate or rescind”.

“Repudiation” is a legal concept which relates to the consequences of a party to a contract indicating either expressly or impliedly that he does not intend to perform his obligations under the contract. If a contract is repudiated, the innocent party has a legal action against the repudiating party in respect of the repudiation. A Borrower might repudiate a Facility Agreement, for example, if repayment obligations fell into serious arrears such that the Borrower might be said to have no intention of meeting future payments. In such circumstances, Lenders will want the ability to accelerate the loan (rather than prove for damages against the Obligor).

However, it is difficult to envisage circumstances in which any of the documents specified in Clause 28.16 could be repudiated and the Lenders would not have a right of action based on some other Event of Default. There is, therefore, a possibility that this Event of Default could cut through materiality thresholds, grace periods and other limitations agreed in relation to other Events of Default. If the Acquisition Agreement were repudiated by the Vendor (for example, the Vendor did not make payment in respect of any post-Closing purchase price adjustment due), the Lenders would most likely expect the Company to pursue a claim against the Vendor: if the amount in dispute were material, (the Borrower can argue) it might have an impact on the financial covenants or result in a Material Adverse Effect. If not, Lenders should not be entitled

to accelerate the Facilities.

The concept of an Event of Default resulting from rescission of an agreement is not included in the Investment Grade Documents. A right of rescission enables the innocent party to set aside a contract. The most common circumstance in which a right of rescission arises is as a result of misrepresentation. The Lenders' concern with this Event of Default is that one of the specified documents is set aside and not performed. Again, as in relation to repudiation, it is difficult to see how any of the specified documents could be rescinded in circumstances where the Lenders would be adversely affected and not have a right to accelerate the Facilities based on another Event of Default. If, for example, the Lenders had a right of rescission based on a misrepresentation in the Facility Agreement, the misrepresentation (within the agreed limits and subject to the expiry of any grace period) would be an Event of Default.

Clause 28.17: Litigation

This Event of Default is triggered by the commencement or threatened commencement of any litigation or other proceedings and disputes which have or are reasonably likely to have a Material Adverse Effect.

Borrower Notes

Borrowers should bear in mind any materiality threshold for litigation which is agreed in the "no litigation" representation and information covenant in the Agreement (see Clauses 24.14 (*No proceedings pending or threatened*) and paragraph (b) of Clause 25.8 (*Information: miscellaneous*)) when negotiating this Event of Default.

Clause 28.18: Pensions

This provision makes receipt of a Financial Support Direction or a Contribution Notice under the Pensions Act an Event of Default.

Borrower Notes

See "*Pensions Regulator*" at Clause 1.1 (*Definitions*) above by way of background to the pensions related provisions in the Leveraged Facilities Agreement.

Borrowers may seek to limit this Event of Default. A Material Adverse Effect qualification or a financial exposure threshold (as contemplated in the LMA drafting) is most appropriate. Limiting the Event of Default to receipt by particular companies in the Group may not be accepted by Lenders given the ability of the Pensions Regulator to turn to "associated" and "connected" persons in imposing liability for pension fund deficits.

Clause 28.19: Material adverse change

This is the material adverse change (“**MAC**”) event of default, making it an Event of Default if an event occurs which the Majority Lenders believe has or is reasonably likely to have a Material Adverse Effect.

Borrower Notes

An investment grade Borrower would not always have to accept a MAC Event of Default in addition to a MAC representation and generally, Borrowers dislike the vagueness of a MAC Event of Default. In the European leveraged market, however, a MAC Event of Default is once again fairly usual, although notably, the “covenant-lite” and “covenant-loose” transactions seen in early 2007 often did not include a MAC.

The formulation of the MAC varies (the LMA User Guide acknowledges that this provision is just a suggestion), and the LMA drafting is not Borrower-friendly as it puts the determination as to whether a MAC has occurred into the Lenders’ hands. It is preferable from a Borrower’s perspective to apply an objective standard, e.g. an event occurs which has or is reasonably likely to have a Material Adverse Effect. Clearly, the agreed definition of “**Material Adverse Effect**” will be key (see Clause 1.1 (*Definitions*)).

Clause 28.20: Acceleration

This provision reflects the equivalent provision in the Investment Grade Documents. It gives the Lenders the right to accelerate the Facilities and exercise the other rights set out in the provision, for example, to cancel undrawn Commitments and to direct the Security Trustee to exercise rights arising under the Transaction Security upon the occurrence of an Event of Default which is continuing.

Borrower Notes

Note that the Lenders’ right to accelerate is triggered by the occurrence of an Event of Default “[which is continuing]”. These words are generally 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, Borrowers will need to cross-refer to the definition of “**continuing**”, discussed above at Clause 1.2 (*Construction*): Borrowers 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, until a formal waiver is given by the Lenders.

Clause 28.21: Clean-Up Period

This is an optional but commonly used Clause. It provides that until a specified date following the Closing Date (the “**Clean-Up Date**”), breach of the “**Clean-Up Representations**” and the

“**Clean-Up Undertakings**” or any “**Clean-up Default**” will not constitute an Event of Default provided the specified conditions are satisfied. It is an acknowledgement that despite due diligence, the Investors and the Parent may not have full knowledge of the Target Group’s affairs until they take ownership of the Group, and therefore the Lenders allow the Obligors a certain grace period to deal with any unforeseen liabilities or issues.

Borrower Notes

The Leveraged Facilities Agreement contemplates that the scope of the representations, undertakings and Events of Default to which the clean-up disapplication applies is defined. Usually, however, this is not necessary as it is common for the clean-up right to apply to all representations, undertakings or Defaults (note, not Events of Default) to the extent the relevant conditions are satisfied. Sometimes, certain Events of Default are excluded from the clean-up provisions, in particular any Default relating to payment. This is perhaps reasonable but the point is not often taken because it is fairly unusual for the Target Group have any repayment obligations during the initial period following the Closing Date (although this obviously depends on the length of the Clean-Up Period).

The Clean-Up Period is typically a period of between three to six months from the Closing Date.

The following conditions for the application of the Clean-Up provisions appear in most agreements:

- the relevant breach relates to the Target Group (see paragraph 28.21(i)); and
- the circumstances giving rise to it have not been procured by or approved by the Parent (or, perhaps any Original Obligor) (see paragraph 28.21(iii)).

Clause 28.21 contemplates two further conditions which many Borrowers manage to argue successfully should not apply:

- the relevant breach is capable of remedy and reasonable steps are being taken to remedy it (paragraph 28.21(ii)); and
- the breach is not reasonably likely to have a Material Adverse Effect (paragraph 28.21(iv)).

In relation to the first point, Borrowers may be concerned about the possibility of technical default: that a breach is discovered and the obligation to notify the Lenders applies (pursuant to paragraph (a) of Clause 25.9 (*Notification of default*)) but the breach has not yet been investigated in sufficient detail to determine the possibility of remedy (or if it is capable of remedy), or the breach has been discovered and is capable of remedy, but that steps have not yet been taken to remedy the breach.

The second requirement, that the breach should not be reasonably likely to have a Material Adverse Effect is sometimes deleted. Borrowers may seek to use the clarity argument employed by Lenders in relation to Repeating Representations (see Clause 4.2 (*Further conditions precedent*) above) that materiality conditions are built into the relevant representations, undertakings and Events of Default and to include an additional materiality

qualification causes difficulties in interpreting the obligation.

Additionally, paragraphs (ii) and (iv) might be negotiated as alternatives: if the breach is capable of being remedied and reasonable steps are being taken to remedy it, it is not reasonably likely to have a Material Adverse Effect and vice versa.

SECTION 9: CHANGES TO PARTIES

CLAUSE 29: CHANGES TO THE LENDERS

Introduction

These provisions contain the procedure and conditions applicable to the assignment and/or transfer of participations in the Facilities by the Lenders.

Assignment and transfer provisions in loan agreements have been a key focus for Borrowers over the last few years, largely as a result of the increasing involvement of non-bank lenders in lending syndicates and much bigger syndicates. For further background see the two part article “Syndicated Loan Facilities: non-bank Lenders and the influence of credit derivatives: current opportunities for Borrowers”, published in June 2007 on the ACT website (at <http://www.treasurers.org/syndicatedloan>).

Trading in the secondary loan market usually takes one of three possible 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.

Borrower Notes

Borrowers often seek to obtain whatever level of control they can over syndicate composition. It is quite common in the leveraged market for the initial syndicate to be compiled from a pre-agreed pool of Lenders. Borrowers often also seek to obtain consent rights in relation to assignments and transfers in the secondary market. The sorts of controls Borrowers might seek to achieve are outlined in the commentary below. It must be emphasised, however, that a Borrower’s desire to control syndicate composition needs to be balanced with the Lenders and Arrangers ability to sell the debt. In the current market, Lenders are insisting on pretty much free transferability in most circumstances, and any level of control achieved by the Borrower will depend very much on the particular deal.

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 powerful economic influence of transactions “behind the scenes”, such as sub-participations and credit derivatives, should not be overlooked. This is discussed further at Clause 29.2 (*Conditions of assignment or transfer*).

Clause 29.1: Assignments and transfers by the Lenders

This Clause provides that subject to the specified conditions (see Clause 29.2 (*Conditions of assignment or transfer*) below), a Lender may assign its rights or transfer by novation its rights and obligations under any Finance Document to a very wide class of permitted assignees and transferees, including not just banks but 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.

A 2006 decision of the 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 broad.

Borrower Notes

Excluded Transferees

Borrowers may argue that certain categories of unacceptable transferees should be excluded from the wide class of permitted transferees. Examples of unacceptable transferees might be particular classes of lender, specific named lenders or competitors of the Group. Entities who used to be Lenders but have been prepaid or have become replaceable pursuant to the “yank-the-bank” provisions (see Clause 41.3 (*Replacement of Lender*)) may also be considered by way of exclusion.

Loan Buybacks

Many leveraged loans have more recently been trading at a substantial discount in the secondary market. Some borrowers have taken advantage of the value in the secondary market by buying back their own debt. This raises a number of legal issues, including the extent to which a Borrower (or other member of the Group or sponsor) might fall within the class of permitted transferees in an LMA-style document. The language of this Clause was not drafted with loan buybacks in mind, but it is reasonably wide. It is possible to argue that a Borrower who regularly engages in intra-group lending, for example, might fall within the permitted category of transferees. It is relatively common in leveraged transactions for the Borrower to act as a conduit for on-lending the proceeds of the facilities to the group, which perhaps may qualify it as “regularly engaged in...making...loans”.

Even if the transferee is an eligible transferee, there is a second, more difficult issue to consider if the transferee is the Borrower. The legal effect of a Borrower becoming its own Lender is unclear. In particular, there is doubt as to whether it is conceptually possible (since there is a general legal principle that a party cannot contract with itself but no specific case law on this situation). There is a significant risk that such an assignment or transfer could have the effect of extinguishing the transferred debt giving rise to the argument that the assignment or transfer

should properly be characterised as a prepayment. If characterised as a prepayment, the conditions applicable to prepayment in the Agreement will apply and in particular, the consideration for the “transfer”, rather than being payable to the transferring lender, should instead be shared amongst the syndicate pursuant to Clause 34 (*Sharing Among the Finance Parties*). This means that effectively, the consent of the other members of the syndicate would be required in order to complete the buyback.

The second difficulty might be overcome by a member of the Group other than the Borrower, or by an Investor or sponsor or affiliate, being the transferee (again subject to satisfaction of the eligibility criteria). However, in either case, there are likely to be further issues in terms of the operation of various provisions of the Finance Documents, due to the fact that the documentation was not prepared with this scenario in mind. For example, the Leveraged Facilities Agreement contains restrictions on the Obligors making loans, acquiring assets and upon the use of excess cashflow (see Clause 27.18 (*Loans or credit*), Clause 27.8 (*Acquisitions*) and Clause 12.2 (*Disposal, Insurance and Acquisition Proceeds and Excess Cashflow*)), which are quite likely to restrict the options available at the outset. The intercreditor arrangements will also need to be considered. Intra-group and shareholder debt is usually deeply subordinated which may mean that a related party purchaser of leveraged debt loses the benefit of the security and other rights in relation to any debt purchased. In either case, from a commercial perspective, Lenders may object to the prospect of a sponsor or borrower group member becoming entitled, as a Lender, to exercise voting rights in relation to the Facilities.

The LMA announced in May 2008 its intention to amend its primary documentation to address the buyback of debt by Borrowers. A revised version of the Leveraged Facilities Agreement incorporating these changes was published on 26th September, 2008, which includes two alternative versions of Clause 30 (*Restrictions on Debt Purchase Transactions/Debt Purchase Transactions*). Clause 29.1, which permits Lenders to assign and transfer participations in the Facilities on the terms of Clause 29, is optionally subject to the provisions of Clause 30 (if included, in whatever version). The first version of Clause 30 contains a prohibition on “**Debt Purchase Transactions**” and similar transactions by members of the Group. The second alternative permits such transactions but subject to significant restrictions. Both versions provide for the disfranchisement of any “**Sponsor Affiliate**” which purchases Group debt. This choice of two options for Clause 30, together with the significant optionality within the second option, serves to underline the extent to which negotiation of these provisions will remain essentially a commercial process, in particular at this stage where the LMA proposals have just been published. See further Clause 30 (*Restrictions on Debt Purchase Transactions/Debt Purchase Transactions*).

Clause 29.2: Conditions of assignment or transfer

This provision sets out the conditions upon which Lenders may transfer their participations in the Facilities to permitted transferees.

Borrower Notes

Borrower Consent/consultation rights

Paragraph (a) (in square brackets) gives the Parent the right to be consulted in relation to any

transfer or assignment (in contrast to the Investment Grade Documents which give the Borrower a consent right). The extent to which Borrowers are able to negotiate a consent right will vary according to the nature of the transaction and more generally, conditions and liquidity in the loan markets. As a general rule, the larger, more highly leveraged and therefore the more risky the Facilities, the greater the need for liquidity and the less likely Lenders will be to permit Borrower involvement. In the current market, Lenders are cautious and may well insist on free transferability for leveraged deals. Borrowers may, however, take some comfort from “snooze and lose” and “yank-the-bank” provisions (see Clause 41 (*Amendments and Waivers*)) which will provide some protection from the problems active secondary trading can cause if amendments and waivers are needed. If a consent right is agreed, consent is generally required not to be unreasonably withheld.

If the Parent is given consultation rights only, it may seek to prescribe the consultation process in an attempt to make the right more meaningful. For example, the process could be required to last for a minimum period to enable the Borrower to seek and suggest alternatives to an objectionable transferee. It may also ask the Agent to provide a periodic list of the Lenders of record and their participations to keep track of participants.

Lenders are likely to expect any level of control the Parent manages to secure over secondary trading to fall away where an Event of Default is continuing (see paragraph (a)(iii)), which is likely to be the point at which a Borrower is most concerned about the identity of its Lenders. Controls are also unlikely to apply to transfers of Affiliates of Lenders (see paragraph (a)(i)) or a Related Fund (the equivalent of an Affiliate where the Lender is a Fund, see paragraph (a)(ii)).

Consent of Issuing Bank

Paragraph (b) provides that the consent of the Issuing Bank is required for any assignment or transfer of participations in the Revolving Facility. It is common to provide for such consent not to be unreasonably withheld. The Issuing Bank's concern is to ensure that the incoming Lender is an acceptable credit to cover any indemnity obligations in respect of any Letter of Credit issued. This should only be a concern to the extent that Letters of Credit are not cash collateralised, so a carve out might be sought by Borrowers to that extent.

Tax/increased costs

Paragraph (f) was amended in the September 2008 revision of the Leveraged Facilities Agreement. This paragraph used to provide that the incoming Lender would only be able to claim under the tax gross-up and indemnity provisions and the increased costs provision (Clauses 18 (*Tax Gross-up and Indemnities*) and 19 (*Increased Costs*)) to the same extent as the outgoing Lender. This was a very important provision from the Borrower's perspective as it helped to ensure that the Group would not bear an additional tax/increased costs burden as a result of changes in the syndicate beyond the original Lenders.

Paragraph (f) in the current version of the Leveraged Facilities Agreement, as amended in September 2008, now limits the extent to which an Obligor is required to make payments under the increased costs provisions which arise as a result of an assignment or transfer but no longer applies the same limit to the tax gross-up and indemnity obligations. Thus the Borrower's protection in 29.2(f)(ii) i.e. the requirement that no transfer/assignment shall increase any tax gross up or indemnity obligation has been removed. The most likely consequence of the loss of

this protection for Borrowers relates to Treaty Lenders – if the transferee is a Treaty Lender who has not obtained authorisation to be paid gross under the relevant tax treaty, the Borrower will be obliged to gross up that Lender pending clearance. Obtaining treaty relief from withholding tax can take several months meaning that the obligation to gross-up may arise when a transfer or assignment is made to a Treaty Lender. Many Borrowers are likely to seek to reinstate this protection.

Additionally, Borrowers should note that paragraph (f) has been further amended to apply only to protect the Obligors from any increased burden under the increased costs indemnity in relation to transfers after the Syndication Date (i.e. not as part of the primary syndication process). Whether this is an issue or not is likely to depend on the extent to which the Borrower has control over the composition of the primary syndicate (e.g. if a list of potential members has been pre-agreed or the Borrower has approval rights (see discussion above), this issue is less important).

Sub-participation etc.

Clause 29 only applies to changes to the Lenders of record. As mentioned above, it does not operate to restrict “behind the scenes” methods of transferring credit risk in relation to the loan such as sub-participation or the use of credit derivatives. It has become more common, especially in the leveraged market, for Borrowers to seek information as to the existence of these types of transactions (if not consent or consultation rights in relation to them), for example, notice of entry into such transactions or a list of counterparties provided on a periodic basis (or perhaps following an Event of Default). To address the concern of avoiding the influence of unknown third parties on voting, some Borrowers have even successfully negotiated the condition that Lenders must retain control of voting rights under the Facilities without reference to any third party (at least, in the absence of an Event of Default). See further Part 2 of the article on this topic mentioned above.

Clause 29.3: Assignment or transfer fee

This provision contemplates that a fee will be payable by the New Lender to the Agent in respect of assignments and transfers of participations in the Facilities other than to parties connected with the Lender (“**Affiliates**” or “**Related Funds**”), in connection with primary syndication or as otherwise agreed with the Agent. Note that this provision of the Leveraged Agreement is different to the equivalent provision in the Investment Grade Documents, which contemplates simply that a fee will be payable in respect of assignments and transfers.

Clause 29.5: Procedure for transfer and Clause 29.6 Procedure for assignment

These Clauses set out the practical steps to be taken to effect a transfer or assignment, using the forms of Transfer Certificate and Assignment Agreement set out in Schedules 5 and 6.

Clause 29.9: Security over Lenders’ rights

This optional Clause entitles Lenders to use their rights under the Finance Documents as Security for their own obligations. Such obligations might be to a federal reserve or central bank or, for example, to holders of securities issued by that Lender (if the Lender is a fund). The

latter entitlement is rather widely expressed to include Security granted to “holders” of “obligations” but is aimed at securitisation type transactions, CLOs and CDOs.

From the Borrower’s perspective, its Lender of record does not change as a result of such Security being granted and the Clause makes clear that the Borrower’s obligations to the Lender cannot become more extensive as a result of the Security. The main concern, therefore, for Borrowers is similar to that arising in relation to the use of sub-participation and credit derivatives by Lenders to offset credit risk: the risk of an unknown third party influencing Lenders’ voting behaviour.

Clause 29.10: Pro-rata interest settlement

This is a new optional provision, inserted into the Leveraged Facilities Agreement in September 2008. It is a mechanical change, intended to allow the Agent to choose to distribute interest on a “pro-rata” basis when transfers between Lenders become effective in the middle of an interest period. The outgoing Lender and the incoming Lender are each paid the amount of the interest accrued during the relevant interest period which is attributable to their respective time as Lender of record during the relevant interest period.

Consequential amendments were also made to the LMA secondary market documentation in September 2008 in this regard.

CLAUSE 30: RESTRICTIONS ON DEBT PURCHASE TRANSACTIONS/DEBT PURCHASE TRANSACTIONS

Clause 30 is the most recent addition made by the LMA to the Leveraged Facilities Agreement and was published on 26th September 2008.

The purchase by Borrowers, members of the Group or related parties (e.g. private equity sponsors and their Affiliates) of participations in Facilities has become the subject of much debate in the loan markets since the onset of the credit crunch, as such transactions give rise to a number of legal and practical issues under LMA-style loan documentation, some of which are outlined above at Clause 29.1 (*Assignment and Transfers by the Lenders*). Despite the various hurdles, a number of debt buyback transactions have been effected in the European leveraged market, prompting the LMA to address the issue in its recommended forms of documentation, for the first time.

Clause 30 is provided in two alternative and mutually exclusive forms. Both are presented as optional provisions, and the LMA have emphasised that they view debt buyback transactions as a commercial matter to be agreed between the parties.

Clause 30.1 Version 1: Prohibition on Debt Purchase Transactions by the Group

“**Debt Purchase Transactions**” is widely defined to include, in relation to participations in the Facilities or the Mezzanine Facilities (if applicable), assignments and transfers, sub-participation arrangements and “any other agreement or arrangement having an economic effect substantially similar to a sub-participation”, an attempt to address derivative arrangements and the like.

The first version of Clause 30.1 (*Prohibition on Debt Purchase Transactions by the Group*) prohibits any member of the Group from entering into Debt Purchase Transactions or being a Lender or a party to sub-participation arrangements and other agreements or arrangements having an economic effect which is substantially similar.

This version of Clause 30.1 also (optionally) restricts any member of the Group from having any beneficial ownership interest in a company that is a Lender or a party to sub-participation arrangements and other agreements or arrangements having an economic effect which is substantially similar.

Borrower Notes

This version of Clause 30.1 will be appropriate where it is commercially agreed that no member of the Group will enter into Debt Purchase Transactions. Clearly it is the less flexible option from the Borrower perspective.

If this Clause is used, note that the effect of the optional wording in the third and fourth lines appears to restrict any member of the Group from having any beneficial ownership interest in any company that is a Lender or party to sub-participation and similar arrangements. This seems very wide ranging, for example it might prevent any member of the Group owning shares in a financial institution that might at some point participate in the Facilities. Borrowers may therefore wish to resist or amend this provision.

Clause 30.1 Version 2: Permitted Debt Purchase Transactions

The second version of Clause 30.1 (*Permitted Debt Purchase Transactions*) permits Debt Purchase Transactions to a limited extent. It envisages that Borrowers will be permitted to purchase participations in fully drawn Term Facilities by way of assignment on the specified terms. The terms include that the price is at a discount to par, that no Default is continuing and that the purchase is financed out of Excess Cashflow which is not required for prepayment or out of New Shareholder Injections (i.e. additional equity contributions).

The purchase can be effected by two methods. The first, the “**Solicitation Process**” entitles the Lenders, if requested, to make offers to the Borrower as to the price and the proportion of their participation that they are willing to assign. The Parent can choose the amounts and offers it accepts, but must accept the lowest offers in relation to a particular Term Facility first, and accept offers pro rata in the event of two identical offers. The second method, the “**Open Order Process**” involves the Borrower communicating to the Lenders that it wishes to purchase participations in the Term Facilities of a set aggregate amount at a set price. The offers of Lenders willing to accept the offer (if more than one accepts) will be accepted pro rata.

The provision then seeks to disapply the other provisions of the Agreement that might operate to prevent a permitted Debt Purchase Transaction by a Borrower. The Clause states that the Debt Purchase Transaction will extinguish the purchased debt, and that it shall not constitute prepayment nor a breach of relevant undertakings (which will need to be inserted as applicable). Additionally, Clause 34 (*Sharing Amongst Lenders*) shall not apply.

Borrower Notes

This provision is very likely to be the subject of detailed review by Borrowers and their advisers as the market gets to grips with the concept of Debt Purchase Transactions being expressly permitted in facility documentation. Some preliminary examples that occur to us, of some of the issues Borrowers might wish to think about, include the following:

- This provision is limited to Debt Purchase Transactions by Borrowers. It does not permit any member of the Group which is not a Borrower to enter into Debt Purchase Transactions. Additionally, the Debt Purchase Transaction can only be effected out of Excess Cashflow or New Shareholder Injections.
- If the Debt Purchase Transaction is to be effected out of Excess Cashflow, those members of the Group who have Excess Cashflow must be permitted to lend or otherwise make that Excess Cashflow available to a Borrower. Borrowers may need to ensure that this is permitted pursuant to the terms of the undertakings in the Facilities Agreement and the terms of the Intercreditor Agreement.
- Sub-paragraph (b)(iv) contains optional wording restricting Excess Cashflow available for this purpose to Excess Cashflow arising in the previous financial year of the Parent. This (as is noted in a footnote) effectively prevents purchases taking place during the period from the end of one financial year until the annual accounts for that financial year are delivered. Borrowers may wish to resist this wording and/or amend it so as to permit purchases during such period subject (perhaps) to an undertaking to procure New Shareholder Injections in the event that insufficient Excess Cashflow is available according to the annual accounts when delivered.
- As the debt purchase mechanism in this provision only contemplates repurchase by the Borrower and the debt thereby being extinguished, the provision effectively prevents Borrowers from investing in their own debt and holding it with the intention of realising further value (e.g. as a result of the secondary market value of the debt becoming further discounted). In circumstances where discounting is the result of liquidity rather than credit concerns, some Borrowers may seek more flexibility, perhaps on the basis that they are treated as Sponsor Affiliates for voting purposes (see Clause 30.2 below).
- Debt Purchase Transactions are only permitted at a discount to the par value of the debt. Many of the debt buyback transactions to date effected on the European market have arisen out of the relevant debt trading at a discount to par on the secondary market as a result of the liquidity squeeze rather than as a reflection of underlying credit concerns. If the practice becomes more developed, some Borrowers may not wish to restrict themselves to purchase at a discount, for example, purchasing debt carrying call protection or prepayment premia at par might equally present an opportunity for Borrowers to realise value and be of interest to Lenders seeking liquidity.
- The LMA does not envisage that Borrowers will be permitted to purchase participations in Revolving Facilities or term facilities which may be only partially drawn, for example, capital expenditure or acquisition facilities. There may be circumstances where Borrowers may wish to purchase such Facilities, e.g. if they are to be cancelled or are close to termination and no further drawings will be required. It is possible that some Borrowers may seek more

flexibility in the application of these provisions.

- Sub-paragraph (f)(i) provides that on completion of the assignment, the portions of the Term Loans to which it relates shall be extinguished. Borrowers may wish further to clarify that they will be under no obligation as Lender in relation to the Facilities upon completion of the assignment.
- This is most likely a drafting issue, but it is not entirely clear whether the LMA contemplates that the assignment procedure in Clause 29 is intended to apply to assignments to Borrowers. Sub-paragraph (f)(ii) provides that a Borrower which is an assignee shall be deemed to be an entity which fulfils the requirements of Clause 29.1 (*Assignments and Transfers by the Lenders*) to be a New Lender. Borrowers may wish to amend this Clause to clarify that the remainder of Clause 29 shall be deemed to have been complied with (or shall not apply).

Clause 30.2: Disenfranchisement on Debt Purchase Transactions entered into by Sponsor Affiliates

Both versions of Clause 30 contemplate that investments in the Facilities by “**Sponsor Affiliates**” are permitted, subject to the relevant Sponsor Affiliate being disenfranchised for voting purposes (see both versions of Clause 30.2 (*Disenfranchisement on Debt Purchase Transactions entered into by Sponsor Affiliates*)). The forms of Transfer Certificate and Assignment Agreement have been amended to include a confirmation from the transferee/assignee that it is or is not a Sponsor Affiliate (see Schedules 5 and 6).

Sponsor Affiliates, in addition to being excluded from voting, are also prevented from participating in Lender meetings and conference calls and from receiving Lender reports and documentation (unless the Agent agrees otherwise).

“**Sponsor Affiliates**” is defined widely to include the management company of the relevant private equity fund and its Affiliates plus related trusts and partnerships and other trusts, funds or other entities managed or under the control of the management company or its Affiliates. The wording is intended to exclude CDOs of sponsors which are run independently of the private equity businesses.

Borrower Notes

These provisions are also likely to be the subject of discussion as sponsors consider in more detail the extent to which they need flexibility to invest in the Facilities and the implications of Clause 30.2 when applied to their own business organisation. Some example of issues which may require thought from the Borrower/sponsor perspective include the following:

- Some Sponsor Affiliates may object to disenfranchisement. Some may argue that they should be entitled to participate in Lender decision making and/or communications in certain pre-agreed circumstances or at least to have prior notice of matters under consideration amongst the Lenders, even if they have no entitlement to participate in the voting process.

- The definition of “Sponsor Affiliate” will need to be considered on a case by case basis. An issue that may be relevant to a number of private equity sponsors who have portfolio investments in financial institutions or other entities which participate in the loan markets on the lender side, is whether the definition of Sponsor Affiliates is wide enough to capture such entities, and therefore make them subject to the disenfranchisement provisions. If this is the case, it is likely that the relevant sponsor will seek to amend the definition.
- If applicable, Sponsor Affiliates may wish to clarify that for the purposes of the Intercreditor Agreement, they will be treated as Lenders in relation to their participation in the Facilities as such and ensure that any subordination provisions which apply to investor debt or shareholder debt generally do not affect their status in relation to such participations.
- Clause 29.1 (*Assignments and transfers by the Lenders*) is expressed to be subject to the provisions of Clause 30. It is not clear whether the combined effect of these provisions to enable all Sponsor Affiliates to participate or invest in the Facilities as Lenders or whether only Sponsor Affiliates who fall within the class of transferees/assignees agreed for the purposes of Clause 29 are so permitted. Borrowers may seek to clarify the drafting in this respect.

CLAUSE 31: CHANGES TO THE OBLIGORS

Clause 31.1: Assignment and transfers by Obligors

This Clause is a general prohibition on the assignment or transfer of rights and obligations under the Finance Documents by Obligors.

Clause 31.2: Additional Borrowers, Clause 31.3: Resignation of a Borrower, Clause 31.4: Additional Guarantors and Clause 31.5: Resignation of a Guarantor

These Clauses provide the mechanism for Additional Obligors to accede to the Finance Documents and for existing Obligors to resign. Accession is subject to a number of conditions including delivery of an accession certificate (see Schedule 7 (*Accession Letter*)) and satisfaction of various conditions precedent (see Schedule 2 (*Conditions Precedent*)).

Resignation is permitted either as a result of a permitted disposal or a disposal made with the consent of Majority Lenders of an Obligor to a third party. If the Parent wishes that an Obligor resign other than as a result of a disposal, unanimous Lender consent will be required. Resignation is, again, subject to a number of conditions including delivery of a resignation letter (see Schedule 8 (*Resignation Letter*)).

Note that pursuant to Clause 31.4, accession of Guarantors may be voluntary or may be required, for example, if a Subsidiary becomes a Material Company according to the agreed criteria or if a Dormant Subsidiary ceases to be dormant.

The ability of the Obligors to resign and of additional Group companies to accede will be subject to the agreed requirements: see Clause 24.25 (*Obligors*), Clause 27.35 (*Guarantors*) and Clause 27.38 (*Conditions subsequent*).

Clause 31.6: Repetition of Representations

Each of the representations (subject to certain exceptions) are deemed to be made by each Additional Obligor on the date upon which it becomes an Obligor. This is unlikely to be agreeable from the perspective of members of the Target Group, see paragraph (e) of Clause 24.32 (*Times when representations made*).

Clause 31.7: Resignation and release of security on disposal

This Clause provides for the release of any relevant Transaction Security in the event that an Obligor resigns as a result of a disposal of that Obligor out of the Group.

SECTION 10: THE FINANCE PARTIES

CLAUSE 32: ROLE OF THE AGENT, THE ARRANGER, THE ISSUING BANK AND OTHERS

These provisions are substantially the same as the equivalent provisions in the Investment Grade Documents, save for some additional references to the role of the Security Agent and Clause 32.18 (*Reliance and engagement letters*) which enables the Agent to accept the terms of reliance and engagement letters on behalf of the syndicate.

Borrower Notes

- Some of the changes made to Clause 32 in the September 2008 revision of the Leveraged Facilities Agreement are worth noting:
 - In Clause 32.2 (*Duties of the Agent*) a new paragraph (b) was added which provides that the Agent's obligation in paragraph (a) to forward documents received by it to other Parties shall not apply to any Transfer Certificate or Assignment Agreement. This was apparently as a result of concerns about disclosure of trading activity. Note that this restriction does not apply to the Parent, who is entitled to a copy of Assignment Agreements/Transfer Certificates pursuant to Clause 29.7 (*Copy of Transfer Certificate or Assignment Agreement to Parent*).
 - In Clause 32.11 (*Resignation of the Agent*) paragraph (d) enables a resigning Agent (who is resigning because, it feels it is "no longer appropriate" for it to act as Agent), if necessary to persuade a successor Agent to accept the job, to make any changes necessary to Clause 32 and (optionally) other provisions of the document dealing with the rights and obligations of the Agent, consistent with market practice for the appointment and protection of corporate trustees plus "reasonable" amendments to the agency fee consistent with the successor Agent's normal fee rates. This is not an attractive provision from a Borrower perspective. In particular, the right to revise the Agency fee upwards, is to be resisted. If the Agent will not agree to delete this Clause, Borrowers might consider replacing the Agent's right to unilaterally make changes with an undertaking from the Borrower to negotiate in good faith with a view to facilitating the appointment of a successor Agent.
 - Paragraph (a) of Clause 32.13 (*Relationship with the Lenders*) has been revised. This wording, part of a package of amendments intended to facilitate the Agent's job, entitles the Agent to treat the person shown in its records at opening of business on the relevant day as a Lender of record unless it has received 5 days' notice to the contrary. Note that this Clause should be subject to Clause 29.10 (*Pro-rata Interest Settlement*) if it is agreed that that provision should be included.
 - Paragraph (d) of Clause 32.13 (*Relationship with the Lenders*) is new, and enables Lenders to appoint a person to receive communications on their behalf.

This provision is part of a package intended to address the increasing number of Lenders who wish only to receive public information in relation to their participation in

the Facility, also discussed above in the introductory commentary to Clause 25 (*Information Undertakings*). It is not yet clear how the right to appoint representatives to receive information on behalf of Lenders will operate in practice, for example in terms of the impact of the appointment of such a person on voting and requests for amendments and waivers. As a result, Borrowers might seek the right to be notified of such appointments and will want to ensure that appropriate protective provisions are included in the Agreement (e.g. yank-the-bank/snooze and lose etc, see Clause 41 (*Amendments and Waivers*) below) if public-side Lenders are likely to be included in the syndicate.

- Borrowers are likely to object to Clause 32.16 (*Agent's management time*) as it provides that claims by the Agent under Clause 20.3 (*Indemnity to the Agent*) and Clause 22 (*Costs and expenses*) will be increased to cover the costs of the Agent's management time. 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.

CLAUSE 33: CONDUCT OF BUSINESS BY THE FINANCE PARTIES

This Clause is most commonly discussed in the context of Clauses 18.4 (*Tax Credit*) and 21.1 (*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 21.1 (*Mitigation*) to take all reasonable steps to mitigate has to be read in the context of Clause 33. It can often be difficult for Borrowers to persuade the Lenders to make concessions in this area.

CLAUSE 34: SHARING AMONGST THE FINANCE PARTIES

This Clause provides a mechanism for redistributing payments received by individual Finance Parties from an Obligor amongst the Finance Parties in accordance with their agreed entitlements.

SECTION 11: ADMINISTRATION

CLAUSE 35: PAYMENT MECHANICS

The payment mechanics are substantially identical to the equivalent provision in the Investment Grade Documents. For an explanation of the payment mechanics, see the ACT Borrower's Guide to the Investment Grade Documents, Part II, Clause 29.

Clause 35.10: Disruption to Payment Systems etc.

This provision was added in 2005, as a consequence of 9/11: for background information, please see the comments on Clause 28.1 (*Non-payment*). If a Disruption Event occurs, the Agent and the Parent may confer, with a view to agreeing any changes to the operation or administration of the facility as the Agent may deem necessary. Any changes actually agreed by the Agent and the Parent are binding on the parties.

Borrower Notes

The Agent is not obliged to consult with the Parent, 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 36: SET-OFF

Clause 36(a) is identical to the equivalent provision in the Investment Grade Documents. It permits a Lender 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 the Agreement. The Lender is entitled to set-off even if the obligations are owing in different currencies, using a market rate of exchange.

Clause 36(b) is not included in the Investment Grade Documents and enables any Ancillary Lender, which operates a net limit in respect of any overdraft which is an Ancillary Facility to exercise its rights to set-off any credit balances against the overdraft on enforcement of the Finance Documents.

Borrower Notes

Sometimes Borrowers argue that they cannot give the Lenders this right, because of the terms of the negative pledges they have given to other lenders. This is less likely to be the case in the context of leveraged financing where the Facilities are likely to comprise the bulk of the Group's indebtedness.

If the Obligors have to accept set-off to some extent, as is often the case, they may seek to ensure that set-off is permitted only if there is an Event of Default continuing. The Lenders

should be required to notify the Borrower promptly after any set-off.

CLAUSE 37: NOTICES

Note that the Agreement provides that 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.

Clause 37.5: Electronic communication

This Clause allows the Agent and Lenders to agree to email communication, on a bank-by-bank basis. Note that this provision does not extend to communication with the Obligors. In the light of technological development and the new provisions in the Companies Act 2006 facilitating email communication (already in force), however, it is possible that the use of email may be extended in relation to syndicated loans.

Clause 37.6: Use of websites

This provision means that, if the Agent and the Parent agree, the Parent can post any information required to be delivered under the Agreement on a website (a “**Designated Website**”).

Borrower Notes

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 (“**Website Lenders**”). Borrowers may however now wish to alter this provision, in the light of new rules set out in the Companies Act 2006 and the new Disclosure and Transparency Rules, which are designed to facilitate electronic communication. For example, by analogy with the new provisions for shareholders and debenture holders to be deemed to consent to website communication in certain circumstances, Lenders could be deemed to agree to receive information on the website, in certain circumstances. Alternatively, technological development and usage may now mean that the consent of the Lenders is no longer necessary on an individual basis, so that all Lenders could be required to receive website information, though with a continuing right to call for paper copies.

Borrowers may want to agree some relaxation of the requirement in paragraph (a)(iii) that the information must be in a format previously agreed with the Agent.

The Parent is obliged under paragraph (c) to notify the Agent when, for example, new information is posted on the website, or it becomes aware that the website is infected by a virus. In the event of a technological problem, all information has to be supplied in paper form, unless and until the Agent and each Website Lender are satisfied that the problem has been solved. In view of the potential damage that a virus can inflict, Borrowers should take care to ensure that their liability in relation to a virus remains limited to notifying the Agent as soon as they become

aware that the website is infected.

CLAUSE 38: 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. (e.g. the day-count fraction for sterling and Hong Kong dollars is 365).

CLAUSE 41: AMENDMENTS AND WAIVERS

Introduction

This provision sets out the requirements in relation to amendments and waivers under the Finance Documents.

Lender voting majorities have been a hotly negotiated topic in the leveraged market in recent years. This has been especially true in relation to large or widely syndicated facilities where obtaining consents or waivers may be a major undertaking. There has been a trend in recent years to pare down the number of decisions which require unanimity to an absolute minimum (although this is another area where Lenders are currently pushing back following the credit crunch).

Certain mechanisms are commonly included in the Agreement to deal with Lenders who fail to respond to or refuse requests for consent. These include “yank-the-bank” or “Replacement of Lender” provisions, included in the Leveraged Facilities Agreement since 2005 (see Clause 41.3 (*Replacement of Lender*)) and voting disenfranchisement or “snooze and lose” provisions (inserted into the Leveraged Facilities Agreement in September 2008 (see Clause 41.2 (*Exceptions*) at paragraph (d))).

Clause 41.1: Required consents

This Clause provides that any term of the Finance Documents may only be amended with the consent of the Majority Lenders and the Parent, save for those matters in respect of which a different voting majority (or unanimity) is specified in Clause 41.2 (*Exceptions*).

“**Majority Lenders**” is defined (in square brackets) as Lenders whose Commitments represent more than 66 $\frac{2}{3}$ per cent. of Total Commitments. Provision is also made for Revolving Facility Lenders to vote separately in relation to the waiver of a proposed Utilisation of the Revolving Facility other than on the Closing Date (Majority Lenders then being Lenders with Revolving Facility Commitments represent more than 66 $\frac{2}{3}$ per cent. of Total Revolving Facility Commitments).

Borrower Notes

Historically, it has been rare for this general voting majority to be reduced below 66 $\frac{2}{3}$ per cent. in relation to Senior Facilities. Interestingly, the voting majority has been reduced to 50.01 per cent. in relation to Senior Facilities on some of the covenant-lite deals syndicated in Europe.

Voting majorities are sometimes reduced to 50.01 per cent. in junior (mezzanine) facilities.

Clause 41.2: Exceptions

This Clause contains a list of all of the matters which are subject to consent requirements other than Majority Lender consent.

Borrower Notes

There are a number of issues for Borrowers to consider in relation to these provisions, which to some extent do not reflect market practice (at least, prior to the credit crunch).

Decisions requiring unanimous consent

The list of unanimous and special majority decisions suggested in the Leveraged Facilities Agreement is quite a bit longer than was generally agreed prior to the onset of the credit crunch.

It had become common for unanimous Lender consent to be limited to the following matters:

- any change in the definition of Majority Lenders or pro-rata sharing clause;
- any change to the priority of distribution of the proceeds of enforcement;
- any change in the provisions relating to the Lenders' rights and obligations amongst themselves and the provisions relating to changes to the Lenders; and
- other matters specific to the deal where it is commercially agreed that all Lenders must consent.

Broadly speaking, this is an issue on which Lenders are currently pushing back in new deals, so what Borrowers are able to achieve is likely to depend on the particular circumstances.

“Structural Adjustments”

Leveraged facilities are long term facilities imposing extensive restrictions on the Group. The Investors and the Parent will want the financing arrangements to be as flexible as possible. It had become common in leveraged deals to agree that “structural adjustments” to the Facilities could be effected on the basis of Majority Lender consent plus the consent of affected Lenders. Therefore, many Borrowers sought to agree that any amendments to the Finance Documents which are required to effect (commonly) any of the following:

- a new tranche or facility;
- an increased commitment;
- an extension to the agreed Termination Dates;

- an extension to any Availability Period;
- the redenomination of a Commitment or Loan into another currency;
- the extension of scheduled repayment dates; or
- a reduction in the amount owing to a Lender (including the Margin or interest payments),

require only the consent of each Lender participating in the additional tranche or facility, or each Lender whose Commitments or amounts owing to whom are being amended (as applicable) plus Majority Lenders (usually calculated for this purpose on Lenders' Commitments prior to the amendment in question). This position is not reflected in the Leveraged Facilities Agreement: Clause 41.2(a) requires that all of these items require unanimous consent. 'Structural adjustment' provisions had become reasonably common prior to the credit crunch: as mentioned above, currently this is another area where Borrowers are facing resistance from Lenders.

Increase in Indebtedness up to a Basket Amount

As a more general point, if a basket for Permitted Financial Indebtedness is agreed (see Clause 27.23 (*Financial Indebtedness*) above), Investors and the Parent might argue that an increase in Commitments should not require the consent of Majority Lenders provided that the increase does not exceed the amount of the basket. Obviously, the consent of the Lender or Lenders whose Commitments are being increased will still apply. Lenders may resist if the increased Commitments are to be secured by the Transaction Security.

Release of Security

The release of the Transaction Security (save for a release that is expressly authorised in the Finance Documents, for example in relation to Permitted Disposals) or changes to the nature or scope of the Charged Property require unanimous Lender consent according to Clause 41.2(a) sub-paragraphs (ix) and (x). This is a further matter in respect of which a reduced consent requirement is commonly negotiated (or at least, was in pre-crunch deals). Supermajority consent had become the usually agreed requirement, around 80-90 per cent. of Lenders by Total Commitments.

Administrative and technical amendments

Borrowers should negotiate a provision which permits any amendments or waivers of a minor, technical or administrative nature (for example, drafting changes to resolve ambiguities in the document) to be corrected with the consent of the Agent and the Parent only. The use of such a provision may be limited (as the Agent will only want to invoke it in circumstances where it is very obvious that the amendment in question is minor, technical or administrative), but even with limited application, is likely to be worthwhile from a costs and time saving point of view.

Amendments affecting specified parties

Clause 41.2(b) provides that any amendment or waiver which relates to the rights or obligations of the Agent, the Arranger, the Issuing Bank, the Security Agent, any Ancillary Lender or any

Hedge Counterparty shall require the consent of the relevant party. Clause 41.2(c) provides that any amendment relating to the rights of Lenders to waive prepayment (see Clause 13.8 (*Prepayment elections*) above) shall require the consent of the affected Lenders. These requirements (if included) should be subject to any reduced voting majorities agreed in relation to structural adjustments, release of security and administrative and technical amendments.

“Snooze and lose”

Voting disenfranchisement or “snooze and lose” provisions are common in the leveraged market, the result of the increasing diversity and size of lending syndicates in recent years. Lenders who fail to respond to requests for consent are disregarded for the purposes of determining whether any relevant majority voting approval has been obtained. The obvious purpose of such provisions is to make the decision making process as smooth as possible, although some might be concerned that their existence could elicit a swift negative response to consent requests to avoid such rights arising. Such provisions can be useful in conjunction with “yank-the-bank” provisions, see Clause 41.3 (*Replacement of Lender*).

Paragraph (d) is the LMA’s snooze and lose provision, added to the Leveraged Facilities Agreement in September 2008. Its inclusion is an acknowledgement of how common these provisions have become, but the drafting will require negotiation for example, it contemplates that certain consents and waivers will be excluded.

A more aggressive variant of “snooze and lose” is “delay and it’s OK”: any Lender who fails to respond to a request for consent within the specified timeframe shall be deemed to have voted in favour of the requested amendment or waiver.

Clause 41.3: Replacement of Lender

This is the so-called “yank-the-bank” provision which gives the Parent the right to replace a Lender if the illegality, increased costs or tax gross up provisions apply or if a Lender does not consent to a decision in respect of which a certain level of consent (but not the required level of consent) has been obtained.

The provision was inserted into the Leveraged Facilities Agreement in 2005. It is a result of the perception that the increasing diversity in syndicate composition carries with it an increased risk, first of delay in obtaining consents and waivers and, secondly, of the change in circumstances provisions being triggered. It is now a standard provision in leveraged facility agreements. However, in reality it would probably be rare for a “yank-the-bank” provision to be exercised for two main reasons:

- Clause 41.3 requires the Lender being replaced to be removed at par: therefore to exercise the right in practice, the debt must be trading at par or above (otherwise, the Borrower is unlikely to find a replacement); and
- exercise is likely to be expensive. Borrowers may incur fees in finding a replacement Lender.

Nevertheless, inclusion of the provision is useful as a tool for managing Lenders to whom its provisions apply.

Borrower Notes

There are a number of issues Borrowers should consider in relation to Clause 41.3 as drafted.

Timing

The first issue is the amount of notice the Parent is required to give to the Agent in order to exercise its right to replace a Lender. Clause 41.3 contemplates that this will simply be a set period of days (the number is left blank for the parties to agree). Borrowers will want this period to be as short as possible. Borrowers may argue that a set notice period is inappropriate (especially if the proposed replacement is as a result of the applicability of the illegality, increased costs or tax gross up provisions). If the Borrower chooses to prepay rather than replace the relevant Lender, the prepayment provisions usually operate such that the Borrower may specify in its notice of prepayment the date upon which the prepayment takes effect (with a long stop of the end of the next Interest Period: see Clause 11.6 (*Right of cancellation and repayment in relation to a single Lender or Issuing Bank*) above). Borrowers can argue that there is no reason to impose different requirements if the Lender is being replaced rather than prepaid.

Clause 41.3 (at paragraph (b)(iii)) contemplates that the replacement right in relation to Non-Consenting Lenders will be exercised within a certain period of the Non-Consenting Lender notifying the Agent and the Parent of its failure or refusal to consent. This provision should be deleted. It has a significant impact on the usefulness of the provision given that one of its primary objectives is to deal with Lenders who fail to respond to requests for consent. If Lenders insist on a long stop date, the period should be long enough to enable negotiation with replacement Lenders (say one to three months) and the period should run from the date upon which the Parent makes the request for consent to the outgoing Lender (or perhaps the date upon which the Parent notifies the Agent that such Lender has become a Non-Consenting Lender).

Scope

The scope of the “yank-the-bank” clause is often negotiated.

The LMA drafting contemplates that the right to replace a Non-Consenting Lender will apply where the amendment or waiver to which the Lender has failed to consent satisfies a two-stage test:

- the amendment or waiver requires unanimous Lender consent; and
- a requisite minimum level of consent has been obtained (e.g. Majority Lender consent).

Borrowers may argue that they should have the right to replace any Lender who refuses or fails to respond to any request for consent, regardless of satisfaction of either of the above tests. Lenders will argue that the purpose of this provision is not to force them into approving every request for consent for fear of being replaced. However, a distinction can be drawn between a

Lender who refuses consent and a Lender who fails to respond to a consent request. Borrowers can argue that all Lenders who fail to respond to consent requests should be liable to be replaced as this will encourage participation in decision making: all Lenders have to do to avoid the risk of being replaced is to participate in voting. There is therefore a good reason to disapply the two-stage test above in relation to Lenders who fail to respond.

In relation to Lenders who specifically reject requests for consent, the two-fold test contemplated by the LMA drafting commonly applies, although usually in a watered down form. The Borrower is commonly given the right to replace Lenders where the following tests are satisfied:

- the amendment or waiver requires more than Majority Lender consent (not unanimity); and
- Majority Lender consent has been obtained.

It may be appropriate in some circumstances to amend this further: for example if a single Lender holds more than one-third of the Total Commitments and can veto Majority Lender decisions.

Some more recent transactions have seen Borrowers seeking to extend the scope of this provision:

- Some Borrowers have sought to apply the "yank-the-bank" clause to non-funding Lenders: Lenders who for whatever reason have failed or have indicated that they will not fund as required under the Facilities. Such Lenders will be in breach of their obligations under the Facility Agreement but the "yank-the-bank" provision may be a convenient mechanism for dealing with the problem Lender without prejudice to any other rights the Borrower may have against the Lender in question.
- Borrowers have sought rights to replace Lenders who are involved in a merger or reorganisation or who become subject to insolvency proceedings.
- Some Borrowers have successfully argued that the "yank-the-bank" right should apply if the Lender notifies the Agent that an Additional Cost Rate applies for the purposes of the Mandatory Costs calculation.

Paragraph (b)(i) of Clause 41.3 states that the right to replace Lenders shall not apply to the Agent or the Security Agent. Replacement of the Agent or the Security Agent is likely to incur greater costs than replacing any other Lender as a result of the need to transfer their administrative functions. As a compromise, Borrowers may request the right to take such action with the consent of Majority Lenders to make negotiation easier should the need arise.

Agent's right of veto

If the Parent exercises its right to replace a Lender, Clause 41.3 allows the Parent to select the replacement Lender, but requires that such replacement Lender is acceptable to the Agent (acting reasonably) and the Issuing Bank (in relation to the transfer of a Revolving Facility Commitment). Borrowers will argue that the Agent's/Issuing Bank's right to approve the replacement Lender should not apply. If the assignment and transfer provisions (see Clause 29

(*Changes to the Lenders*) permit free transferability of the loan, Borrowers can argue that it is inconsistent to provide the Agent/Issuing Bank with a right of veto in relation to replacement Lenders. The Agent's/Issuing Bank's right to approve the replacement Lender should not apply to the extent that the replacement Lender is a person to whom the outgoing Lender would be able freely to assign or transfer the relevant participation to such a Lender in any other circumstance without the involvement of the Agent or any other member of the syndicate. Additionally, the Agent's/ Issuing Bank's right of approval should not apply if the replacement Lender is already a Lender or an Affiliate of a Lender.

Execution of the transfer

The Borrower may experience practical difficulties in exercising its rights under this provision if the outgoing Lender refuses to execute the transfer/assignment certificate (or it is unable to obtain a response from the outgoing Lender to requests for signature). It is advisable therefore to insert provisions in the Agreement giving the Agent the right to execute the certificate on the outgoing Lender's behalf in these circumstances.

Borrowers may also want to impose an obligation on the outgoing Lender to provide all reasonable assistance to execute the transfer.

Alternative methods for dealing with non-consenting Lenders

The difficulties highlighted above in relation to the exercise of "yank-the-bank" rights in practice have contributed to the development of alternative mechanisms for dealing with non-consenting Lenders. These include "snooze and lose" or "delay and it's OK" provisions (see Clause 41.2 (*Exceptions*) above) or perhaps a specific option to prepay (rather than replace) a Non-Consenting Lender.

The extent to which robust "yank-the-bank" and related rights to deal with non-consenting Lenders are commercially important cannot be determined without considering other provisions of the Agreement. If the covenant exceptions and the voting provisions are Borrower-friendly (and therefore the circumstances in which Lenders need to be asked for consent are minimised) then they may not be so important. Additionally, the Borrower's ability to control the composition of the syndicate (the assignment and transfer provisions, see Clause 29 (*Changes to the Lenders*) above) will affect the extent of these rights. Tight control over syndicate composition will mean the potential need to "yank-the-bank" is less: if the Parent has no control over assignments and transfers, "yank-the-bank" provisions may be key. Whilst the effects of the credit crunch subsist and Lenders focus on free transferability, such rights are likely to be ever more important to Borrowers.

CLAUSE 42: CONFIDENTIALITY

Clause 42 contains undertakings given by each Finance Party to keep Confidential Information confidential, and not to disclose it save as specified. Clause 42.1 (*Confidential Information*) obliges each Finance Party to keep all Confidential Information confidential and not to disclose it, other than as permitted by Clause 42.2 (*Disclosure of Confidential Information*) and Clause 42.3 (*Disclosure to numbering service providers*). 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 familiar form, based on the definition used in the LMA forms of Confidentiality Undertaking. It covers all information relating to the Parent, any Obligor, the Group, the Target Group, the Finance Documents or a Facility which a Finance Party becomes aware of in that capacity or which is received in relation to the Finance Documents from any member of the Group, the Target Group or any of its advisers including via another Finance Party.

It excludes information that (i) is or becomes public (other than as a result of a breach of Clause 42 by a Finance Party), (ii) is identified at the time of delivery as non-confidential by any member of the Group, the Target Group or its advisers and (iii) is information either known by the relevant Finance Party before the date of disclosure or obtained by it after the date of disclosure from a source which is (as far as the Finance Party is aware), unconnected with the Group or Target Group and which has not (as far as the Finance Party is aware) been obtained in breach of, and is not subject to, any obligation of confidentiality.

Historically, the LMA recommended forms of Facility Agreement did not contain confidentiality undertakings by the Finance Parties on the basis that the common law provides for such a duty between banker and customer. Instead, they contained a provision (Clause 29.8 (*Disclosure of Information*)) in the pre-September 2008 version of the Leveraged Facilities Agreement) which set out the circumstances in which information perceived to be confidential was permitted to be disclosed.

Whilst there is an established duty of confidentiality between banker and customer under English law, there is some doubt as to whether the same duty applies between a Borrower and a Lender which is not a bank. Therefore the ACT, in the context of the Investment Grade Documents, argued that the Agreements should contain an express duty of confidentiality on the part of all the Lenders and in the light of the increasing involvement of non-bank Lenders in the loan markets, the LMA inserted Clause 42 (*Confidentiality*) and related definitions into the Leveraged Facilities Agreement in September 2008. Confidentiality provisions will also appear in the Investment Grade Documents when the next versions are published.

Borrower Notes

In general, the Clause is a helpful provision, but Borrowers will need to pay close attention to the detail:

Permitted classes of recipient: 42.2(a)

- Paragraph (a) of Clause 42.2 (*Disclosure of Confidential Information*) allows a Finance Party to disclose Confidential Information within its organisation, to its Affiliates and, as the case may be, Related Funds and to their officers, directors, employees, professional advisers, auditors, partners and Representatives “as that Finance Party shall consider appropriate”. “**Representative**” is defined as “any delegate, agent, manager, administrator, nominee, attorney, trustee or custodian.

The impact of the number of parties to whom this provision applies is marginally limited in

that the Finance Party has to consider it “appropriate” to disclose Confidential Information to the Representative before being permitted to do so. Additionally, each person to whom such Confidential Information is disclosed must be informed in writing of its confidential nature and that some or all of the information may be price-sensitive information.

However, this wording does not offer complete protection to the Borrower. There is no obligation to inform the recipient of the confidential nature of the information if the recipient is already subject to requirements of confidentiality in relation to the Confidential Information or is subject to professional obligations to keep such information confidential. Additionally there is no limitation on the use of Confidential Information for purposes in connection with the Facilities e.g. the “Permitted Purpose” as used in the LMA forms of Confidentiality Undertaking. Against that background, Borrowers should consider whether they are comfortable with the potential disclosure of Confidential Information to such a wide group without recipients being required to enter into a Confidentiality Undertaking.

The difficulty with this paragraph as drafted is that, as long as the recipient is informed of its obligations or is subject to confidentiality obligations, the Finance Parties’ obligations under Clause 42.2(a) will be discharged. If, subsequently, the relevant recipient chooses to disclose such information, the Borrower may not have any rights against such party according to Clause 42.2(a), for example, because it is not party to the confidentiality obligations to which such person is subject. If Lenders argue that it is not practical to expect such recipients to enter into Confidentiality Undertakings, Borrowers might seek to amend Clause 42.2(a) along the lines that Finance Parties undertake to procure that such persons comply with the terms of Clause 42 as if they were parties to it.

It is worth noting that in the pre-September 2008 versions of the LMA’s forms of Confidentiality Undertaking, the party giving the undertaking was obliged to use all reasonable endeavours to ensure that any person to whom it passed any Confidential Information acknowledges and complies with the provisions of the undertaking as if that person were also a party to it. This has changed in the latest versions of the LMA Confidentiality Undertakings published in September 2008, which have been amended in line with Clause 42. It is difficult to see why Lenders should not be able to give an undertaking along these lines if they were able to do so previously.

- A related issue is that Clause 42 does not entitle the Borrower to any information regarding entry into Confidentiality Undertakings or regarding disclosures made pursuant to Clause 42.2 (*Disclosure of Confidential Information*). 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, for example, by asking the Finance Parties to provide the Agent with information as to any Confidentiality Undertaking entered into in relation to the Facilities.

Permitted classes of recipient: Clause 42.2(b), (c) and (d) and 42.3

The remainder of Clause 42.2 and Clause 42.3 go on to list further categories of permitted recipients of Confidential Information, to whom differing conditions apply. They fall into the following categories:

- Recipients who it is contemplated will enter into Confidentiality Undertakings: actual or potential assignees/transferees (paragraph (b)(i)) or sub-participants or other silent participants in the Facilities (paragraph (b)(ii)) and their respective Affiliates, Related Funds, professional advisers and Representatives or (paragraph (b)(iii)) any person appointed by any of them to receive information on their behalf under Clause 32.13(d) (*Relationship with the Lenders*).

In relation to such recipients, note that the requirement to enter into a Confidentiality Undertaking is presented as optional which is perhaps surprising given that it is normal practice to enter into Confidentiality Undertakings in relation to secondary market transactions. Additionally, the requirement to enter into a Confidentiality Undertaking does not apply where the recipient is a professional adviser subject to professional obligations to keep the information confidential. The latter could have enforcement implications for the Borrower in the event of breach: see comments at Clause 42.2(a) above.

- Persons who invest in or finance any secondary market or “behind the scenes” transaction described in paragraph (b)(i) or (b)(ii), subject (again, optionally) to entry into a Confidentiality Undertaking or that person otherwise being bound by requirements of confidentiality in relation to the Confidential Information and being informed that some or all of that Confidential Information may be price-sensitive information. Borrowers might argue that such persons should be required to enter into Confidentiality Undertakings in the same way as the recipients of such investment/financing.
- Recipients who will not enter into Confidentiality Undertakings (or are unlikely to) because, for example, they are public or regulatory bodies: disclosure of Confidential Information is permitted where required or requested by any regulatory authority, the rules of any stock exchange or pursuant to any law or regulation, in connection with legal proceedings or to any person to whom the relevant Finance Party creates Security under optional Clause 29.9 (*Security over Lenders' rights*). Optional language makes such disclosure subject to the relevant person being informed of the confidential nature of the information and that some or all of it may be price-sensitive, although this is qualified where it would not be practicable to do so in the circumstances.
- Recipients who receive the information from Finance Parties for the purpose of providing loan market services:
 - Providers of administration or settlement services in respect of the Finance Documents to enable the service provider to supply those services. Such service providers might provide assistance with secondary market trade settlement, for example. Disclosure is subject to the service provider entering into an agreed form of confidentiality agreement (and note that the LMA has published a Master Confidentiality Undertaking for Use With Administration/Settlement Service Providers for this purpose).
 - Rating agencies (and their professional advisers) to enable the rating agency to carry out its normal rating activities in relation to the Finance Documents and/or the Obligors (optionally, subject to the rating agency being informed of the confidential nature of the information and that some or all of the Confidential Information may be price-sensitive).
 - Clause 42.3 (*Disclosure to numbering service providers*) is an optional provision

permitting the Agent to disclose certain listed information specified to any numbering service provider for the purpose of enabling a numbering services provider to allocate an identification number to a syndicated loan agreement.

A footnote explains that, once in the hands of the numbering service provider, it is assumed that it will not be subject to confidentiality obligations and should therefore not include price sensitive information (hence the information should be limited to “relatively anodyne and descriptive information”). The representation by the Borrower in paragraph (c) regarding the price-sensitivity of the information is intended (according to a footnote) as a means of ensuring that reasonable steps have been taken to avoid inside or price-sensitive information being selectively disclosed with no confidentiality restrictions.

Borrowers should consider whether this provision is necessary on a case by case basis (and perhaps in the context of how widely participations are to be spread). Some Borrowers might argue that such information should only be disclosed with their consent (not to be unreasonably withheld). Borrowers should also ensure that the list of information that may be disclosed to such persons is appropriately limited to information which is not likely to be price sensitive. A further footnote reminds users to add a copy of the Facility Agreement to the list of information to be disclosed if required by the numbering service provider. This note could have a significant impact as the intention of the clause is that only innocuous information should be provided without the protection of a Confidentiality Undertaking. Borrowers should not expand the list of information without careful consideration.

- As a general issue, where disclosure of Confidential Information is subject to the recipient entering into a Confidentiality Undertaking, Borrowers will also need to ensure that the agreed form of Confidentiality Undertaking are satisfactory to them.

Lenders' appointees

- In the September 2008 update, a new paragraph (d) was added to Clause 32.13 (*Relationship with the Lenders*) to enable Lenders to appoint a person to receive communications on their behalf. This was part of a package of amendments made to the document intended to address the concerns of Lenders who do not wish to become party to non-public information which might inhibit their public trading activities (see further Clause 32.13).

In paragraph (b)(iii) of Clause 42.2 (*Disclosure of Confidential Information*), such persons are included in the permitted class of recipients of Confidential Information. Note, however, that only information received by Finance Parties is “**Confidential Information**” pursuant to the LMA definition. Hence, if a Lender appoints a representative to receive information on its behalf in relation to the Facilities, and such person enters into a Confidentiality Undertaking as contemplated in Clause 42.2, if that Confidentiality Undertaking operates by reference to “**Confidential Information**”, information provided directly to the representative would not technically be covered (as it is not provided to a Finance Party). This is a drafting issue, but a potentially significant one which should be addressed.

Excluded recipients?

- Borrowers should consider whether there are any classes of recipient to whom they would not want Confidential Information to be disclosed under any circumstances, in which case they would need to be specifically excluded, for example, competitors. The issues to be addressed are similar to those to be considered in the context of permitted assignees and transferees (see Clause 29 (*Changes to the Lenders*)).

Application of Clause to Information received by Lenders prior to becoming Finance Parties

- The definition of “**Confidential Information**” only covers information “of which a Finance Party becomes aware in its capacity as a Finance Party”. Clause 42.4 (*Entire Agreement*) further provides that Clause 42 is the entire agreement between the parties with regard to confidentiality and the revised versions of the LMA’s forms of Confidentiality Undertaking, published in September 2008, reinforce this position as, if the signatory becomes a Finance Party, they are expressed to terminate. Accordingly, there is a gap in the Borrower’s protection: information provided prior to a Finance Party becoming a Finance Party will not be covered by the Confidentiality Undertakings. Borrowers should ensure that this issue is addressed, either in the agreed form of Confidentiality Undertaking (see Schedule 10 (*LMA Form of Confidentiality Undertaking*)) or in the Agreement (e.g. to include information provided to it “for the purpose of becoming” a Finance Party).

Termination of confidentiality obligations

- Clause 42.7 (*Continuing Obligations*) provides that the Finance Parties’ obligations under Clause 42 survive for a period of [12] months from the earlier of “termination of this Agreement” and the date on which such Finance Party ceases to be a Finance Party. The revised LMA forms of Confidentiality Undertaking have also been amended along these lines, to apply until the earlier of the date upon which the recipient becomes a Finance Party and 12 months after the date of the Confidentiality Undertaking. This period is not likely to be long enough in the context of a leveraged transaction in particular (e.g. if a Finance Party has knowledge of a long-term strategic project and the Base Case Model is built to a lengthy maturity). Borrowers should therefore resist or seek to extend this time limit. Additionally, Borrowers might request that Finance Parties return Confidential Information upon ceasing to be a Finance Party or termination of the Facilities.

SCHEDULES

Schedule 1: The Original Parties

This Schedule will contain the details of the Obligors and Lenders who are party to the Agreement at the signing date.

Schedule 2: Conditions Precedent

Conditions precedent in loan agreements are usually expressed as conditions precedent to funding. As already mentioned at Clause 4.1 (*Initial conditions precedent*) above, it is common in leveraged transactions (particularly where funding is to be provided on a certain funds basis), for a significant number of the conditions precedent to be satisfied at signing. The circumstances may not always warrant this: for example, if there is a long gap between signing and closing the Acquisition, but usually, it will be the case. This Schedule therefore lists the conditions precedent, divided into conditions precedent to signing (or announcement, in the case of a public offer), conditions precedent to first Utilisation and conditions precedent to be delivered by Additional Obligors prior to their accession to the Finance Documents.

Borrower Notes

Key conditions generally included as conditions precedent to signing comprise:

- evidence of the capacity of the Original Obligors to enter into the Finance Documents (constitutional documents, board and shareholder resolutions etc.);
- copies of the Transaction Documents other than the Finance Documents (e.g. the Acquisition Documents): this may require attention depending on the stage at which the Acquisition Documents are signed;
- copies of the signed Finance Documents: care needs to be taken to specify those of the Transaction Security Documents which can be delivered at signing, and those which will need to await Completion or which will be delivered after Completion; and
- appropriate legal opinions.

Key conditions generally included as conditions precedent to Closing/first Utilisation comprise:

- completed Utilisation Requests;
- the Reports and Reliance Letters entitling the Lenders to rely on the Reports. The scope of Reliance Letters will usually be negotiated with the relevant advisers, see comments in relation to the definition of "**Reports**" at Clause 1.1 (*Definitions*) above;
- the Group Structure Chart and the Structure Memorandum;
- the Original Financial Statements, the Budget and evidence of the Investors' equity

contribution;

- evidence that fees due to the Lenders and advisers have been paid;
- conditions precedent in relation to any Additional Obligors who are to accede at Closing; and
- any Transaction Security to be provided at Closing.

In relation to Additional Obligors, the Lenders will want to see evidence of their constitution and capacity and evidence of compliance with any financial assistance rules (for example, in relation to financial assistance given prior to 1st October 2008, evidence as to the completion of the whitewash procedure to the extent Additional Obligors are providing guarantees, security or loans which contravene sections 151-158 of the Companies Act 1985, see Clause 27.31 (*Financial assistance*) where the impending repeal is discussed in more detail).

The LMA Leveraged Facilities Agreement contemplates that a wide variety of other documents are delivered as conditions precedent to signing and to first Utilisation. Not all will be relevant or desirable. Other conditions precedent may be relevant to the specific transaction. The LMA in its User Guide to the Leveraged Facilities Agreement notes that conditions precedent will vary significantly from transaction to transaction. On a public bid there may be a variety of offer or scheme specific conditions precedent to contend with.

The Lenders' requirements will have to be considered to determine the timing of delivery. The need to attend to conditions precedent at an early stage in discussions with Lenders (work should start during negotiations on the Facility Agreement) cannot be over-emphasised, particularly when the transaction is multi-jurisdictional.

Note that the conditions precedent Schedule entitles the Agent to designate any other condition precedent it considers "necessary or desirable" in connection with the deal. Borrowers usually argue that this is unacceptably vague: the typical compromise is to delete the word "desirable" and for the Agent to agree to act reasonably.

Schedule 3: Requests

This Schedule contains forms of Utilisation Request to be used to draw down amounts under the Facilities and a form of Selection Notice to be used to select currencies and applicable Interest Periods.

Schedule 4: Mandatory Cost Formula

This Schedule is the LMA's standard schedule for the calculation of Lenders' Mandatory Costs. The mandatory costs Schedule is discussed in detail in the ACT Borrower's Guide to the Investment Grade Documents, Part II, Schedule 4.

Schedule 5: Form of Transfer Certificate

This is a model form of transfer agreement for use by the Lenders if they transfer their participation in the Facilities pursuant to Clause 29 (*Changes to the Lenders*).

Schedule 6: Form of Assignment Agreement

This is a model form of assignment agreement for use by the Lenders if they assign their participation in the Facilities pursuant to Clause 29 (*Changes to the Lenders*).

Schedule 7: Form of Accession Letter

This letter is used to enable Additional Obligors to accede to the Finance Documents (see Clause 31 (*Changes to the Obligors*)).

Schedule 8: Form of Resignation Letter

This letter is used to enable Obligors to resign as Obligors (see Clause 31 (*Changes to the Obligors*)).

Schedule 9: Form of Compliance Certificate

In relation to the content of the Compliance Certificate, see comments at Clause 25.2 (*Provision and contents of Compliance Certificate*).

Schedule 10: LMA Form of Confidentiality Undertaking

The LMA model forms of confidentiality undertaking were updated in September 2008 to reflect the LMA's approach to confidentiality. See Clause 42 (*Confidentiality*).

Schedule 11: Timetables

This Schedule sets out the timing (notice periods required) for various funding-related matters, by reference to the Utilisation Date for the relevant Loan.

Schedule 12: Form of Letter of Credit

The form of Letter of Credit is as provided in the LMA Letter of Credit Option. See Clauses 6 (*Utilisation – Letters of Credit*) and 7 (*Letters of Credit*) in relation to the Letter of Credit provisions of the Leveraged Facilities Agreement.

Schedule 13: Material Companies

This Schedule will contain a list of those members of the Group designated as Material Companies at the date of the Agreement. The definition of "**Material Company**" is discussed at Clause 1.1 (*Definitions*).

Schedule 14: Agreed Security Principles

It will not be possible to grant security and guarantees in relation to the Target Group until the Closing Date at the earliest (see Clause 24.25 (*Obligors*), Clause 27.35 (*Guarantors*), Clause 27.38 (*Conditions subsequent*), Clause 31 (*Changes to the Obligors*) and Schedule 2 (*Conditions Precedent*)). Therefore a large part of the Lenders' security and guarantee package will be put into place at or post-Completion. In many situations, due diligence will be subject to limitations and it may not be possible and there may not be time to determine the exact composition of the security package prior to Completion or the extent to which security and guarantees may need to be limited. Therefore the practice has developed of agreeing a set of "**Agreed Security Principles**" setting out the basis upon which the Transaction Security will be put into place and its scope. The Agreed Security Principles also often outline the extent of the guarantees to be provided in relation to the Facilities.

Schedule 14 contains a skeleton set of Agreed Security Principles.

Borrower Notes

Detail

Most negotiated documents will contain significantly more detail as to the scope of the security package, in some cases by reference to specific asset classes than provided in Schedule 14. Clearly, the more detailed the criteria the simpler it should be to put the Transaction Security into place, minimising time and costs post-Completion.

Scope of the Transaction Security

Paragraphs (A) and (B) of Schedule 14 set out the considerations to be taken into account in determining whether Security should be given in relation to specific assets and the obligations to be secured.

The LMA drafting reflects the three key legal and practical impediments to granting Security: legal or regulatory restrictions, a significant risk of the officers of the grantor incurring any liability thereby and disproportionate cost. These requirements may be fleshed out in greater detail so all parties are clear as to how they will be interpreted: for example, a more detailed definition of what might constitute disproportionate cost.

The key omission in paragraph (a) is any limitation based on practical non-cost based impediments to granting security. For example, assets may be subject to third party arrangements preventing them from being charged or the grant or perfection of security may have an adverse effect on the Group's operations or business (a commonly cited example is the giving of notice to debtors or Lenders' security). The extent of such limitations is negotiable.

To the extent that there is a legal impediment to security being granted, Obligors should anticipate that Lenders will want to explore whether the impediment can be overcome. Practical and monetary obstacles offer more scope for negotiation. Clearly it is in no-one's interests to take security where the cost of doing so is out of proportion to the value of the security. The same applies where perfection of security would impede the normal operation of the Group's business. In any event, Lenders are likely to request that the Group does what it can to mitigate

the effects of any obstacles that exist.

The LMA drafting contains no specific limitation on the Transaction Security by reference to specific assets or by reference to jurisdiction. It is sometimes the case, for example, that particular assets or a particular class of asset are agreed to be excluded, or that security will be taken only over material assets. Security may be limited by reference to jurisdiction if, for example, the laws of a relevant jurisdiction are not sophisticated or if the cost of granting the security is disproportionate.

The Agreed Security Principles will often specify whether security over Hedging Agreements is required. This is a matter for negotiation. If the Hedge Counterparties are Lenders or Affiliates of Lenders, Lenders may not be concerned as, in an enforcement situation, they will rely on set-off rights. In some deals Lenders will want security, in particular if the Hedging Counterparties are not Lenders or their Affiliates.

General

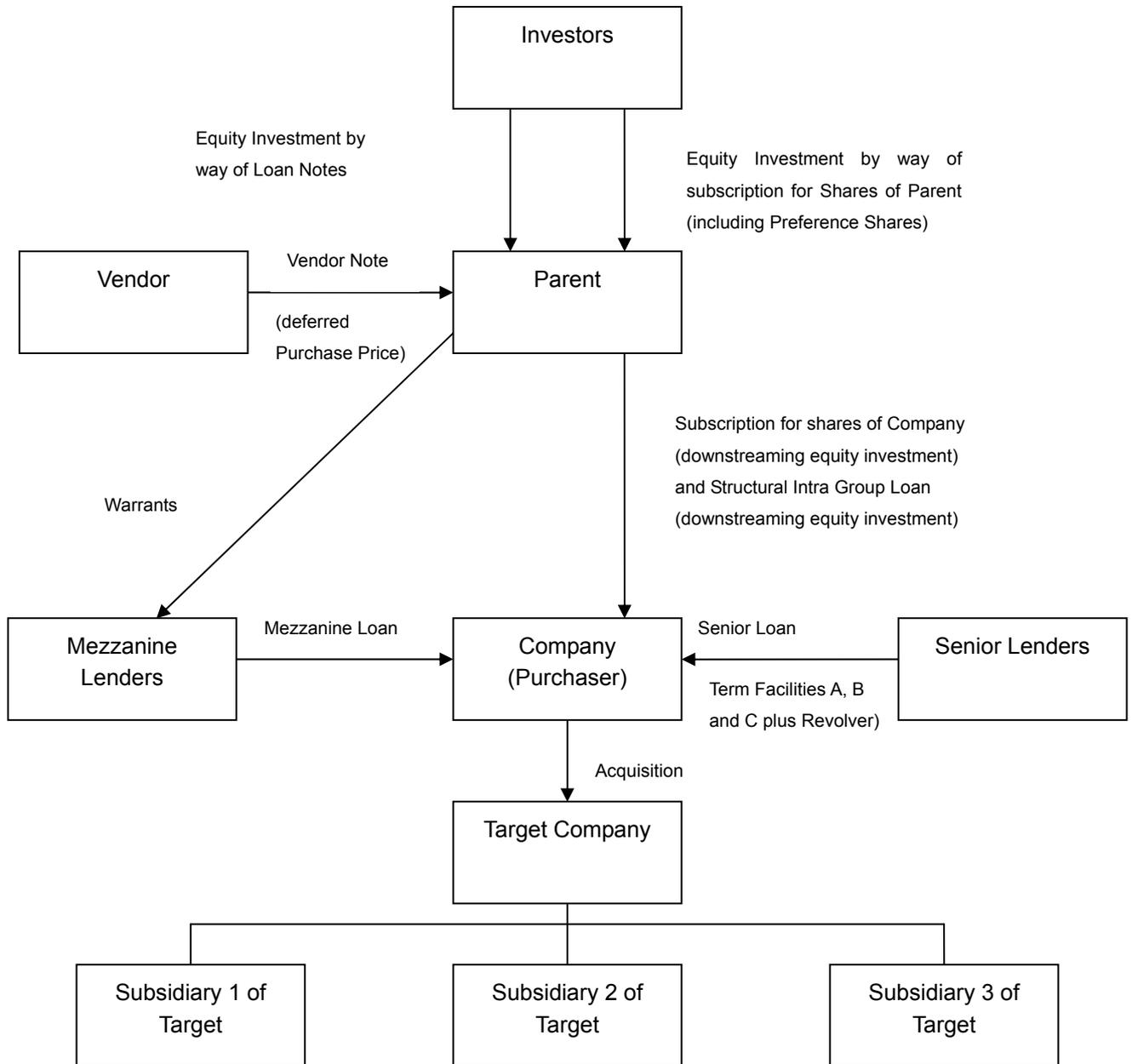
Paragraph (C) deals with the Transaction Security Documents. It provides that defined terms should mirror those in the Agreement (obviously sensible). It goes on to require that forms of security document are agreed as conditions precedent to drawdown. This provision is not always practical and should not be necessary: the purpose of the Agreed Security Principles is to ensure that the Transaction Security Documents will require minimal negotiation. Completion should not be delayed because lawyers have not agreed on the form of the relevant documents.

The final paragraph of paragraph (C) may be controversial depending on the option chosen - it provides that security will be enforceable upon the occurrence of an Event of Default or upon notice of acceleration (which will be later). The latter option is preferable from the Obligors' perspective and this point is commonly won by Borrowers.

Undertakings/Representations and Warranties

Paragraph (D) seeks to avoid conflict and duplication between the Agreement and the Transaction Security Documents. It is advisable to include an express requirement that representations and warranties in the Transaction Security Documents will not conflict with nor duplicate those contained in the Agreement and should be limited to the creation of security rather than the rather vague reference to reflecting the "commercial deal" used in the LMA drafting.

**APPENDIX 1
Assumed Transaction**



APPENDIX 2
Further information for ACT members

Users may also find the guidance materials available to ACT members referenced below helpful in relation to the provisions of the Leveraged Facilities Agreement listed. Further guidance on debt financing generally and a range of related issues is available on the ACT website (<http://www.treasurers.org>).

Clause of Leveraged Facilities Agreement	ACT Borrower's Guide to the Investment Grade Documents	Handbook
Clause 4.3: Conditions relating to Optional Currencies	Part II, Clause 6	See "Currencies" in the Introduction to Loan Finance section
Clause 4.4: Maximum number of Utilisations		See "Availability" in the Introduction to Loan Finance section
Clause 5.1: Delivery of a Utilisation Request		See "Availability" in the Introduction to Loan Finance section
Clause 14: Interest	Part II, Clause 9	
Clause 15: Interest Periods	Part II, Clause 10	
Clause 16: Changes to Calculation of Interest	Part II, Clause 11	
Clause 16.4: Break Costs	Part II, Clause 11.4	
Clause 17: Fees		See Introduction to Loan Finance section
Clause 18: Tax Gross Up and Indemnities	Part II, Clause 13	See Introduction to Loan Finance section
Clause 19: Increased Costs	Part II, Clause 14	See Introduction to Loan Finance section
Clause 25.10: "Know your customer" checks	Part II, Clause 20.7	
Clause 35: Payment Mechanics	Part II, Clause 29	
Schedule 4: Mandatory Cost	Part II Schedule 4	

Clause of Leveraged Facilities Agreement	ACT Borrower's Guide to the Investment Grade Documents	Handbook
Formula		
Schedule 10: Form of Confidentiality Undertaking	Part IV	

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