

corporate financial management

LMA BORROWER'S GUIDE

Drawing from leveraged lending

Executive summary

■ After a year of the credit crunch, lenders are seeking more restrictive lending terms. Against this backdrop, the ACT has taken the opportunity to look in more detail at the Loan Market Association's recommended form of facilities agreement for leveraged transactions. The new ACT borrower's guide to the LMA facilities agreement for leveraged transactions, produced for the ACT by Slaughter and May, is being published to coincide with the completion of the LMA's own review of this agreement. The LMA's revised version of its recommended form of facilities agreement for leveraged transactions was released in September. It is an important document in the context of leveraged financing transactions, and along with the ACT guide, will also be relevant for financing transactions for cross-over and other non-investment grade credits and, in some respects, for all acquisition financing transactions.

The LMA's recommended form of facilities agreement for leveraged transactions is a senior agreement primarily intended for leveraged buyouts (LBOs) adopting the more traditional European LBO financing structure (senior and mezzanine credit facilities plus subordinated shareholder, and possibly vendor, debt). Corporate treasurers may assume that the LMA leveraged document, as this article will refer to it, is of little relevance to them, but understanding it can be crucial if your company wants to borrow money or refinance debt.

WIDER RANGE OF TRANSACTIONS As well as being an important document in the context of leveraged financing transactions, the LMA leveraged document is likely to be relevant to a wider range of financing transactions for a number of reasons. Some lenders use it as a benchmark for the sort of protections they may seek from a crossover credit or other sub-investment grade borrower. Even in circumstances where the full LMA leveraged document is not appropriate, its provisions are likely to be relevant to other sub-investment grade financing transactions, and sub-investment grade and crossover credits may encounter loan agreements incorporating provisions derived from, based on or similar to it. Additionally, the LMA leveraged document contains provisions likely to be of interest in the context of all types of acquisition financing facilities whether



PHILIP SNELL AND KATHRINE MELONI EXPLAIN THE SIGNIFICANCE OF THE ACT BORROWER'S GUIDE TO THE LMA FACILITIES AGREEMENT FOR LEVERAGED TRANSACTIONS.

for investment-grade or non-investment grade credits.

Before the onset of the credit crunch, when the LMA leveraged document was first launched, it was more widely used for mid-market and smaller-cap LBO financings. For most larger and some mid-market transactions, many private equity houses and similar investors maintained and consistently used their own borrower-friendly term sheets and precedent financing documents, which in many respects were quite different to the terms of the LMA leveraged document. This is still often the case although the terms secured by private equity houses in the European LBO context, even in larger LBOs, have, in very broad terms, moved some way towards the terms of the LMA leveraged document. In this context the ACT asked Slaughter and May to prepare an ACT borrower's guide to the LMA leveraged document for its members, based on the most recent revision.

FORMAT OF GUIDE The guide is in a similar form to the ACT borrower's guide to the LMA's main recommended forms of facility agreement for the primary loan markets, which are primarily aimed at investment-grade borrowers. This guide was also prepared by Slaughter and May, some years ago. It contains an introduction to the LMA's suite of documentation for leveraged transactions and a clause-by-clause commentary that explains the key provisions of the LMA leveraged document and some of the issues its provisions give rise to from a borrower's perspective as well as some of the modifications to these provisions that borrowers may wish to consider. The guide is intended as a reference work from a borrower's perspective, providing commentary on individual provisions that are likely to appear in sub-investment grade and crossover credit financings as well as certain provisions relevant to any acquisition financing.



ISSUES CONSIDERED IN THE GUIDE

- **Representations, covenants and events of default.** The commentary on the quite extensive representations, covenants and events of default in the LMA leveraged document includes matters such as to whom they should apply, materiality and other qualifications, the timing and scope of repeating representations, and grace periods applicable to events of default.
- **Mandatory prepayment.** The mandatory prepayment provisions, including limitations and qualifications to these provisions that may be considered.
- **Financial covenants.** The financial covenants are designed for a cashflow-based leveraged financing but contain concepts and definitions quite widely used in the loan markets more generally; for example, leverage, cashflow and interest cover covenants and definitions of EBIT, EBITDA, borrowings, cashflow and excess cashflow.
- **Tax.** The LMA's recent changes to tax provisions, some of which may give rise to important issues for borrowers.
- **Pensions-related provisions.** In the UK, for example, 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.
- **The terms of a "certain funds" financing.** This, very broadly, means that for an agreed period, the only applicable funding drawstops are those acceptable for the purposes of a public bid in the UK to which the City Code on Takeovers and Mergers applies. "Certain

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funds" financing has become common in private acquisitions as well as public bids in recent years and these sections are likely to be relevant to many acquisition financing transactions.

- **Acquisition financing.** There is a commentary on risk allocation in acquisition financing facilities; for example, the extent to which the due diligence exercise has an impact on the provisions of the facility agreement, the relationship between the terms of the acquisition documentation and the debt financing, and the expected scope of lenders' rights against due diligence report providers.
- **Syndicate composition and lender decisions.** The extent to which borrowers may seek control or influence over syndicate composition and the provisions dealing with lender decision making. The very significant involvement of large numbers of largely non-bank lenders in the syndicated loan markets in recent years, particularly in leveraged transactions, has led borrowers to focus on the extent to which they can control or influence the identity of their lenders. A related issue is the extent to which unanimous and other thresholds of lender consent are needed for decision-making. Over the last few years borrowers have made progress in incorporating provisions designed to help smooth the process of seeking and being able to secure amendments and waivers. These can be useful when dealing with large syndicates, although the credit crunch has resulted in a weakening of some of these provisions.
- **The LMA's new confidentiality provisions.** While there is an established duty of confidentiality between banker and customer under English law, it is doubtful that the same duty applies between a borrower and a lender which is not a bank. In light of the increasing involvement of non-bank lenders in the loan markets, the LMA has added an express lender confidentiality undertaking into the LMA leveraged document (it is also expected to make similar changes to the next version of the LMA investment-grade documents) but a number of issues arise for borrowers from the detail of this.

The publication of the guide does not imply ACT endorsement of the LMA leveraged document. The LMA has not sought the endorsement or the opinions of the ACT (or indeed any other borrower interest group) in relation to its suite of leveraged loan documents. This is in contrast to the LMA investment-grade documents where the ACT is more involved in the process of settling terms and which terms are currently regarded by the ACT as a fair starting point for negotiations.

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The ACT borrower's guide to the LMA facility agreement for leveraged transactions is available to ACT members for download from the ACT website.

The full version of the ACT borrower's guide to the LMA leveraged loan agreement is available at

www.treasurers.org/loandocumentation

The guide to the LMA documentation for investment-grade borrowers is available at www.treasurers.org/node/2946