Program Preservation:

Introduction to Loan Agreements

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Kerrick Seay is a partner in White & Case's Debt Finance practice, based in New York. Kerrick's practice focuses on corporate finance and high yield debt securities. Prior to joining White & Case, Kerrick spent over six years as internal legal counsel at Morgan Stanley covering the leverage and acquisition finance, liability management, Latin America and project finance business units. He has extensive experience in both public and private financing transactions, including cross-border financings, investment grade loans, high yield debt offerings, debt tender offers, exchange offers and consent solicitations, in a wide range of business sectors. This considerable experience in debt finance and debt capital markets and related legal and regulatory matters offers clients the benefit of his unique and valuable insight into a variety of financing structures.

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Please note: Today's presentation is informational only and is not intended to constitute legal advice. This presentation references both federal and state laws and regulations but primarily focuses on New York law. Please consult with appropriate counsel for guidance pertinent to your organization or situation.

WHITE & CASE

Introduction to Loan Agreements

Kerrick Seay & Rhiannon Jones

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Loan Agreements Generally

- The Loan Agreement is the main transaction document in a loan facility, which governs, among other things:
  - Terms of the loans
  - Loan borrowing, funding and repayment mechanics
  - Interest and fees
  - Liabilities and obligations of the borrower(s) and the lender(s)
- Each Loan Agreement has specific terms but most typically have similar key provisions
- This presentation provides a brief overview of such key provisions

Overview of Typical Loan Agreement Sections

Preamble

1. Definitions
2. Amount and Terms of Credit
3. Conditions Precedent
4. Representations and Warranties
5. Affirmative Covenants
6. Negative and Financial Covenants
7. Events of Default and Remedies
8. Administrative Agent
9. Miscellaneous

Schedules

Exhibits

Definitions

- Loan agreements typically have a section defining the capitalized terms used in the loan agreement
  - Definitions are helpful in reflecting complex concepts. They make the loan agreement more concise and the operative provisions clearer
- Key terms such as financial covenant definitions and the interest rate often will be specified in the definition section, as well as other key terms that are used throughout the document (such as “Applicable Margin”, “Material Adverse Change” or “Material Adverse Effect”)
- In addition to defined terms, “rules of construction” usually are described which contain important information for interpretation of the loan agreement

Amount and Terms of Credit – Borrowing and Funding Mechanics

- The loan agreement sets forth the basic economic terms of the extensions of credit and related mechanical provisions (i.e., making, funding and repayment of loans, the maximum amounts thereof, sublimits, etc.)
- Types of extensions of credit (“tranches”)
  - Term Loans (borrow, repay, no further borrowing)
  - Revolving Loans (borrow, repay, reborrow)
  - Swingline Loans (short-term revolving loans on same-day notice)
  - Letters of Credit (standby or commercial)
- Borrowing and payment procedures/mechanics
  - Funding and payment mechanics (i.e., how, when and where the lender disburses money to the borrower and the borrower pays money to the lender)
  - Notice requirements for making loans or issuing letters of credit (i.e., Notice of Borrowing)
  - Minimum borrowing amounts

Amount and Terms of Credit – Interest Rate

- The Interest Rate is often calculated as (i) SOFR or Base Rate, plus (ii) the Applicable Margin or a flat interest rate (8.00% for example)
  - "SOFR" is the secured overnight financing rate (SOFR), a benchmark interest rate for dollar-denominated derivatives and loans.
  - "Base Rate" is a rate of interest charged per annum that is usually formulated as the highest of (x) 1/2 of 1% in excess of the overnight Federal Funds Rate (rate of interest set by the Federal Reserve), (y) the Lender's Prime Lending Rate (sometimes called their 'base rate' reported, among others, by the Wall Street Journal) and (z) the one-month SOFR plus 1%
- The "Applicable Margin" is the lender's profit on the loans, which is added to SOFR/Base Rate to determine the overall Interest Rate for a loan. The Applicable Margin typically would be fixed but may include step-downs based on certain criteria

Amount and Terms of Credit – Yield Protection

- Yield Protection
  - Inability to determine interest rate (SOFR loans not available until issue resolved)
  - Increased costs (change in law, taxation, reserve requirements, SOFR does not adequately reflect cost of funding, etc.)
  - Reserve requirements
  - Market disruption
- Illegality (cancel new loans or convert existing SOFR loans to Base Rate loans)
- Breakage Costs (compensate lenders for failure to borrow/convert in SOFR on an agreed date or for a repayment on a date other than the last day of an interest period)

Amount and Terms of Credit – Letters of Credit

- A credit facility for the issuance of letters of credit usually is part of the revolving credit facility with a sublimit on the amount of letters of credit issued under such sub-facility
  - Standby letters of credit (used as a form of security/guarantee of payment)
  - Commercial letters of credit (used to enable payments for goods, often where the seller and buyer are in different countries).

Amount and Terms of Credit – Fees

- Commitment Fees – Ongoing fees payable to the Revolving Lender(s) on the available but undrawn amount under a Revolving Credit Facility)
- Facing (or “Fronting”) Fees – Payable to Issuing Lender for issuing a Letter of Credit
- Letter of Credit Fees – Payable to all Revolving Lender(s) for participating in Letters of Credit)
- Other fees – Administrative Agent fee and other fees payable per commitment letter

Amount and Terms of Credit – Reduction of Commitments

- Voluntary Reductions
  - The borrower may terminate or reduce the Total Unutilized Revolving Loan Commitment
  - Each reduction applies proportionately to permanently reduce the Revolving Loan Commitment of each Revolving Lender
- Mandatory Reductions
  - Term Loan Commitments generally terminate on the initial borrowing date
  - Revolving Loan Commitments terminate upon the Revolving Loan Maturity Date

Amount and Terms of Credit – Prepayments

- Voluntary Prepayments (borrower may prepay if certain conditions met)
- Amortization (i.e., scheduled repayments of principal)
- Mandatory Prepayments
  - Asset sale proceeds, condemnation and recovery event proceeds (i.e., insurance proceeds), equity and debt issuance proceeds, excess cash flow, etc. (subject to certain exceptions)
  - Prepayment of Revolving Loans if outstanding amount of Revolving Loans, Swingline Loans and Letters of Credit exceeds Total Revolving Loan Commitment
- Sometimes “soft” or “hard” call prepayment premiums apply to prepayments of Term Loans

Amount and Terms of Credit – Tax Gross-Up

- The borrower's payments generally are required to be made free and clear of, and without deduction or withholding for, any present or future taxes, levies, imposts, duties, fees, assessments or other charges imposed by any governmental or taxing authority
- If any such taxes are imposed, the borrower indemnifies the Lender for the full amount (i.e., "grosses up")

Lender Protections – Conditions Precedent

- Conditions Precedent to the Closing Date
  - Standard (corporate formalities, legal opinions, security, exhibits, etc.)
  - Transaction-specific (e.g., relating to an acquisition, repayment of specific existing debt, other transactions that must occur/be concurrent with financing)
- Conditions Precedent to all Extensions of Credit
  - No default or event of default
  - Accuracy of representations and warranties

Lender Protections – Representations and Warranties

- Purpose and function of representations and warranties
  - State the assumptions on which the credit was based and provide a "snapshot" of the borrower at a particular point in time
  - To shift the risk of loss, if a basic assumption turns out not to be true
- When given?
  - On the closing date
  - On the occurrence of each borrowing (subject to certain exceptions)
  - On the date of amendments, waivers and consents of loan documents
  - On the date of delivery of certain certificates (e.g., notice of borrowing and compliance certificates)

Lender Protections – Representations and Warranties

- Typical representations and warranties
  - Corporate formalities
  - No conflict with laws, contracts
  - Financial statements
  - No material adverse change/effect
  - No material litigation
  - Ownership of property
  - Compliance with law
  - Other representations and warranties relating to the condition of the business and ownership of assets (i.e., compliance with specific regulations applicable to the borrower)

Lender Protections – Representations and Warranties

- Misrepresentations can prevent the borrower from borrowing and/or constitute an event of default
- Qualifications
  - Disclosures (usually on a schedule)
  - Made "as of the Closing Date"
  - Materiality and the definition of “Material Adverse Effect”

Material Adverse Effect

- Used to qualify representations and warranties and covenants
- Usually <u>not</u> a separate event of default
- Effect on:
  - business, operations, property, assets, liabilities, condition (financial or otherwise) or prospects of the borrower and its Subsidiaries taken as a whole
  - the rights or remedies of the Lenders, the Administrative Agent or the Collateral Agent under the Loan Documents
  - the ability of any Credit Party/the Credit Parties taken as a whole to perform its/their payment and financial covenant obligations under the Loan Documents

Lender Protections – Covenants Generally

- Purpose and Function of Covenants
  - Assess the continued creditworthiness of the borrower after a loan is made (to ensure that the information on which the lenders based their decision to make the loans continues to be true – maintain the “snapshot” at closing)
  - Identify any financial or other problems with the borrower before they become events of default
  - If a covenant is violated, a lender may (i) reevaluate the credit (even if payments are still being made) and declare an event of default, (ii) decide not to make any additional loans to the borrower or (iii) commence an enforcement action
- Covenants are generally divided into Affirmative Covenants and Negative Covenants

Lender Protections – Affirmative Covenants

- Typical Affirmative Covenants (the borrower will)
  - Reporting and inspection
  - Compliance with laws (including environmental, anti-bribery (FCPA), anti-terrorism and sanctions (OFAC) and PATRIOT ACT provisions)
  - Maintenance of existence, property, franchises, etc.
  - Payment of taxes
  - Further assurances and Collateral requirements
  - Often subject to qualifications as to materiality or MAE

Lender Protections – Negative Covenants

- Typical Negative Covenants (the borrower shall not)
  - Restrictions on indebtedness
  - Restrictions on liens
  - Restrictions on dividends
  - Restrictions on investments
  - Restrictions on mergers, consolidations, sales of assets
  - Restrictions on transactions with affiliates
  - Limitations on the changes that can be made to the credit structure without the Lender's consent
  - Restrictions on amendments to certain agreements and documents and prepayments of "junior" debt

Lender Protections – Financial Covenants

- Financial Covenants (intended to measure financial performance of the borrower) include one or more of the following (deal-/industry-specific)
  - Leverage Ratio
  - Interest Expense Coverage Ratio
  - Fixed Charge Coverage Ratio
  - Restrictions on Capital Expenditures
  - Minimum Liquidity

Lender Protections – Events of Default

- Purpose and function of Events of Default
  - Specific events, circumstances or conditions that constitute breaches or violations of the loan agreement
  - Events of default are the triggers that allow the lenders to stop extending additional credit and to exercise remedies, including acceleration of the loans and termination of commitments
  - The borrower typically negotiates for certain notice, cure and grace periods, including grace periods for payment defaults with respect to interest and other amounts (but not principal), notice and cure periods for covenant defaults (other than financial or negative covenants) and cure periods for involuntary bankruptcies

Lender Protections – Events of Default

- Typical Events of Default
  - Payment
  - Misrepresentation
  - Breach of covenants (grace period vs. no grace period)
  - Cross-default vs. cross-acceleration
  - Bankruptcy
  - Unsatisfied judgment
  - Change of control
  - Failure of security or challenge to guarantees
  - ERISA

Lender Protections – Remedies

- Remedies
  - No further borrowing under revolving credit facility (also upon Default)
  - Increase interest rate to default rate
  - Termination of commitments
  - Acceleration (automatic for bankruptcy)
  - Exercise rights under guarantees and security documents
  - Cash collateralization of letters of credit

Loan Assignments and Participations

- Assignment: In an assignment, the selling lender transfers an interest in the loan to the purchasing entity by means of an assignment document that results in a direct contractual relationship ("privity") between the purchasing entity and the borrower
- Participation: A participation is an interest in a loan in which the purchaser has a contractual relationship only with the bank selling the participation, and the participant has no contractual privity with the borrower
- Eligible Assignees: Typically, cannot be Natural Persons or “Disqualified Institutions” and Borrower consent may be required for assignments

Miscellaneous – Standard Terms (Boilerplate)

- Governing law
- Foreign borrower provisions: tax "gross up", judgment currency, waiver of sovereign immunity
- Consent to jurisdiction
- Integration (written agreement supersedes all oral understandings)
- Expenses
- Notices
- Confidentiality
- Counterparts
- Captions
- Severability
- Survival
- Waiver of jury trial

Guarantee; Schedules; Exhibits

- Guarantee
  - The loan agreement may contain a guarantee or there may be a separate guarantee agreement
- Schedules to the Loan Agreement
  - Generally list items described in the representations and warranties (i.e., existing debt, liens, investments, etc. of the borrower) and exceptions to the representations and warranties. **Must be read in context with the body of the agreement.**
- Exhibits to the Loan Agreement
  - Note
  - Notice of Borrowing
  - Continuation/Conversion Notice
  - Compliance Certificate
  - Guarantee and security documents: Guarantee, Security Agreement, Equity Pledge Agreement, Intercreditor Agreement
  - Solvency Certificate

Questions?

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