

The background of the slide is a solid red color. Overlaid on this are several black lines. A prominent, jagged, hand-drawn style black line runs diagonally from the bottom left towards the center. Another set of black lines, including a dashed one, runs diagonally from the top left towards the bottom right. In the upper right corner, there is a solid black, irregular shape that resembles a stylized arrow or a piece of paper.

# **Syndicated Loans and Covenants: Knowing the Boundaries**

**SYNDICATED LOANS IN RUSSIA – 2012**  
**27<sup>th</sup> September 2012**

**LATHAM & WATKINS LLP**

# KEY FACTS

Latham & Watkins is a full-service international law firm with more than 2,000 lawyers in 31 offices around the world. Latham has built internationally recognized practices in a wide spectrum of areas.



## Latham's Strengths:

### The People

- More than 2,000 lawyers in 31 offices located in 14 countries.
- More than 60 languages are spoken at Latham & Watkins.

### The Practice

- Latham lawyers are spread throughout the world, servicing clients with the best-suited teams regardless of location
- More than 60 internationally recognized practices with expertise across industry

**Latham and Watkins has been serving clients in Russia for 20 years**

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# INTRODUCTION

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- Presentation based on experience across European syndicated loan market, for both investment grade and sub-investment grade borrowers
- Latham represents both borrowers and lead arrangers so expert in advising on where the boundaries of negotiation lie
- Key commercial drivers:
  - Economics
  - Flexibility
  - Administrative ease
  - Default triggers
  - Managing downside risk
- Process is also key

# ECONOMICS

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- Arrangement fees/OID – market testing
- Other fees/expenses:
  - Ticking
  - Commitment
  - Utilisation/non-utilisation
  - Documentation
  - Agency/Agent's management time
- Margin – use of ratchet
  - Typically set on net/gross leverage
  - Often limited in time/scope (e.g. not available for 12 months; limited to single step reductions)
  - Negotiations of step ups – e.g. during defaults
- No close, no fees/expenses
- Market flex
  - Negotiate overall cost cap
  - Reverse flex
- Cross guarantees/security – rationale and scope

# FLEXIBILITY

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- Negative covenants often restrict “credit affecting” corporate actions (e.g. dividends, borrowing, disposals, acquisitions, security, capex controls)
- Permitted Acquisitions:
  - often permitted with different conditions depending on size
  - pro-forma covenant compliance (taking synergies into account, but limitations)
- Permitted Dividends:
  - require satisfaction of leverage test (“once only” v. continuous test)
- Intra-Group transactions
- Use of baskets and “basket escalators”
- Maximise use of baskets – include as many separate generic exceptions as possible
- Crossover: covenant relaxation if investment grade
- Mandatory pre-payment
  - change of control – permitted categories of purchaser
  - disposal proceeds – only “exceptional” disposals
  - excess cashflow

# DEFAULT TRIGGERS

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- Financial Covenants
  - Scope – (net) leverage (gearing), interest cover, fixed charge cover, cash flow cover; bespoke
  - Headroom
  - Frequency – quarterly/semi-annual/annual
  - Ensure financial definitions optimised
  - Equity cure:
    - Prepayment of debt often required
    - Limitations on frequency
    - Use of “over-cure”
- Events of Default
  - “Obligors” v. Group wide
  - Remedy periods
  - Cross default v cross acceleration
  - “Insolvency” default can be wider than expected (e.g. commencing discussions with any creditor with respect to rescheduling indebtedness)

# ADMINISTRATION ISSUES

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- Information requirements need to be manageable
  - Monthly/quarterly/semi-annual account
  - Requirement re budgets
  - Limited access to management/required use of management time
  - Limitations on information provided to shareholders/other creditors
  - “Sweeper” requiring delivery of information requested is normal but limit e.g. by reasonableness, not confidential information etc
- Security package can raise complications for management
  - “Agreed Security Principles” customary in non-investment grade so administrative burden/cost of security package is appropriate
  - Real estate often expensive to secure
  - Equipment, plant or machinery often impractical, requiring lists of assets
  - IP can be extremely cumbersome and expensive to secure
  - Stronger non-investment grade – limit to share pledges/group guarantees
- Cross guarantees less onerous than extensive security package and gives away less leverage if difficulties arise down the road

# MANAGING DOWNSIDE RISK

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- A number of provisions negotiated up front can affect and/or advantage borrowers if financial difficulties arise
  - Control over cash (e.g. account blockage rights, clean down)
  - Transferability (consultation v. consent); “white lists”; minimum holds; competitors; rating requirements; control over sub-participations and credit derivatives
  - Governing law
  - Access provisions
  - Amendment thresholds; use of “super majorities”; incremental facilities/structural change
  - Ability for borrower/related parties to buy debt (and vote debt)
  - “Yank the bank”
  - “Snooze you lose”



# OTHER

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- Presentation is not a definitive list of areas for negotiation, other areas can include:
  - Tax – e.g. gross up of interest is minimised through syndication to “treaty lenders”
  - Regulatory – e.g. minimising increased cost risk with reference to Basel II/III; US FATCA related issues
  - Loan Mechanics – e.g. selection of optional currencies, interest rate basis etc, defaulting lender/impaired agent provisions, market disruption, KYC etc
  - Legal – repetition of representations can create further events of default/drawstops and need careful review

# PROCESS

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- Competition always a good thing
- Use of Borrower general term sheets/documentation
- Designated Lender Counsel
- Bilateral v. syndicated facilities
- Fees/costs
- LMA form is a “bank friendly” document

# LATHAM AND WATKINS

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## Banking Practice

- Clients from around the world come to Latham & Watkins' Banking Practice for strategic, focused and efficient representation on their most significant financing transactions.
  - > Latham's global Banking Practice can adeptly structure and execute the most complex financings across industries and around the globe.
  - > Latham's banking lawyers have a sophisticated understanding of the expectations and requirements of both sides to a financing transaction and provide counsel tailored to each client's needs.
  - > Clients trust Latham to take a practical, business-oriented approach to achieving their objectives.
- Latham's lawyers represent investment banks and other financial institutions in their capacities as agents, arrangers and lenders, as well as corporate borrowers and private equity firms.
- Latham represents clients in a wide variety of financing transactions, including:
  - > Asset-based loans
  - > Bridge loans
  - > Cash flow loans
  - > Cross-border financings
  - > Investment grade loans
  - > Leveraged financings
  - > Multi-currency financings
  - > Secured loans
  - > Syndicated loans
  - > Working capital facilities
- The team works in tandem with lawyers in the firm's capital markets, insolvency, mergers and acquisitions and other practices to develop innovative structures and to facilitate the smooth consummation of transactions.



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*Chambers 2012*

*"This firm's hard work in the finance sector has paid tremendous dividends; it is taking center stage in the global market."*

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