Easier with the LMA

English loans are beginning to contemplate debt repurchases at the outset. There are similar moves in New York, but they are localised

This article is part of a series comparing and contrasting New York and English law and market practice relating to syndicated lending.

In the December/January issue of IFLR, we considered the differences between New York and English law and practice relating to the transfers of interests in loans in the secondary market. This article discusses the application of those mechanisms to debt repurchases.

In both the English and US markets, debt repurchases have become common. Where existing loan documentation does not contemplate a repurchase programme, it is more likely to be achievable without lender consent under an LMA-style transaction than one based on LSTA documentation, where transfers to borrowers and their affiliates are likely to be expressly or effectively prohibited. With the recent changes to the standard LMA documentation, the trend in the English market seems to provide for repurchase mechanisms at the outset of a transaction, without the need for subsequent amendment. While there has been some movement in this regard in the US, it is less widespread. In both markets, parties are willing to consider debt repurchase programmes under certain conditions and to address the various concerns associated with them.

For purposes of this article, a debt repurchase refers to the sale of syndicated loans by one or more lenders to the borrower or an affiliate of the borrower. In this economic environment, where many loans are trading at a discount (albeit less steep than last year), a debt repurchase may still be an appealing way to retire a borrower's debt at a discount, to reduce its debt service costs and to enable an affiliate to profit from debt capital market distortions unrelated to the borrower's financial condition. This in turn can lead to improved cash flows and ratios.

On the downside, borrower affiliates need to consider the credit rating implications of owning distressed debt and should take advice prior to commencing a repurchase programme on matters such as market abuse, insider dealing restrictions and public disclosure requirements. The borrower and its affiliates should also consider tax implications, including the taxable profit to the borrower upon the debt being extinguished or released and the interest on any extinguished or released debt ceasing to be deductible.

The primary loan documentation forming the basis of comparison in this article is the Primary Market Model Transfer Provision of the Loan Syndications and Trading Association (LSTA) and the senior multicurrency term and revolving facilities agreement for leveraged acquisition finance transactions of the Loan Market Association (LMA).

> **"The trend in the English market seems to provide for repurchase mechanisms at the outset of a transaction"**

The LMA Form

There are several questions that arise under English law in connection with debt repurchases, principally: whether the borrower or any of its affiliates meet the criteria for being a permitted transferee under the loan documentation; whether loans bought by a borrower are automatically extinguished; and whether a repurchase by a borrower could be re-characterised as a prepayment and therefore subject to contractual provisions governing prepayments, such as the sharing and turnover provisions amongst the lenders, the pro rata prepayment requirements and other conditions to which voluntary prepayments are subject.

The earlier LMA documentation did not contemplate debt repurchases in any form, nor did it expressly prohibit transfers to borrowers or their affiliates. Although the loan documentation for any particular transaction needs to be examined closely, it is possible that borrowers or their affiliates may be able to effect repurchase programmes under many LMA-based loan transactions trading in the market without the need to obtain any consent from lenders on the basis of the following analysis.

Criteria for being a permitted transferee

The standard LMA criteria are that the purchasing entity is a "bank or financial institution or . . . a trust, fund or other entity which is regularly engaged in or established for the purpose of making, purchasing or investing in loans, securities or other financial assets". The words following "financial institution" were added in 2001 to clarify the range of permitted transferees. In LMA transactions using the pre-2001 language, the actual business of the proposed transferee must be assessed (see the Court of Appeal decision in *The Argo Fund Ltd v Essar Steel Ltd* [2005] that the term financial institution means an institution "having a legally recognised form or being, which carries on its business in accordance with the laws of its place of creation and business and whose business concerns commercial finance"). In the context of post-2001 LMA documentation, where the words "or established for the purpose of..." are included, the constitutional objects of the putative transferee provide an additional basis to allow the transfer.

Extinguishment of debt

A loan obligation is a *chose in action* and as such cannot be owed by a person to itself (see *Ellis v Kerr* [1910]). Although arguments have been made that a loan obligation could be characterised as akin to a bond obligation (it being well established that an issuer can hold and trade its own bonds), it is more likely that a loan purchased by the borrower would be regarded as extinguished from and after the time of the purchase.

Characterisation as pre-payment

The question of whether or not a purchase of a debt by the borrower would be re-characterised as pre-payment (and therefore fall within the scope of the pre-payment provisions) has not been put before the English courts and although academic opinion is divided, were the question to come before an English court, much would depend on whether or not the court was minded to take a literal approach and construe the contracts in accordance with the actual words used or a more purposive approach and consider the underlying intentions of the parties.

The borrower's group will need to review the covenants binding on them under the loan documentation, and particularly the extent to which the borrower (or group members) can use free cash or raise further indebtedness to fund the repurchase. In addition, borrowers or affiliates looking to repurchase mezzanine or subordinated debt will need to give consideration to the provisions of any related intercreditor deed and any restrictions on the release or discharge of that debt ahead of senior debt. To the extent that such restrictions exist, they are more likely to apply to a borrower, to other obligors on the debt and to their respective subsidiaries, rather than to other affiliates of the borrower, since creditors have less of an interest in the use by such other affiliates of their own resources.

There are also softer issues that arise in connection with a debt purchase programme, such as whether the borrower should be sensitive to lenders feeling that a repurchase programme should be offered across the lender group, in order to retain the spirit of syndicated lending where risk is borne rateably by all lenders (and, in the context of a repurchase of mezzanine debt, where lenders may only be repaid in an agreed order of priority). In addition, lenders are likely to be uncomfortable with an affiliate purchaser having voting rights equivalent to those held by the rest of the lender group, participating in lender meetings or benefitting from mandatory

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prepayments; and lenders may believe that loans held by affiliates should be subordinated to loans held by non-affiliates. Of course, in a transaction where lender consent or an amendment is required to allow a repurchase (or to achieve a purpose discussed in the following paragraph), lenders may condition their consent or their agreement to an amendment on these issues being dealt with in a manner satisfactory to them.

While it is often possible under the old-style LMA documentation to effect a repurchase by a group member without lender consent, achieving the full benefit of the repurchase may require an amendment or waiver of the documentation. In late 2008/early 2009 a number of groups approached lenders for amendments or waivers in conjunction with debt repurchase programmes. The resulting media attention suggested that debt repurchases are not always palatable to the remaining lenders and that challenges to the process as a whole or to the incidental implications will continue.

Examples of such repurchase programmes mentioned in the press include those launched by Mauser, which reportedly hoped to include the benefit of a repurchase in its Ebitda calculation and Truvo, which reportedly hoped to persuade bondholders to approve a repurchase of junior debt. Earlier this year, it was reported that Endemol's lenders challenged its attempt to apply the gains reaped through a debt repurchase programme to the improvement of the group's Ebitda and that ultimately Endemol agreed that it would not apply the gains in that way, conceding to the lenders' position.

It was a welcome move on the part of the LMA to introduce changes to its form documentation to address many of these uncertainties. Following the LMA's statement in 2008 proposing the alternative language for an absolute prohibition on debt repurchases and a mechanism for implementing a repurchase programme, the most recent LMA form (November 2009) contains two possible options.

The first is an absolute prohibition on any member of the borrower group becoming a lender or taking a sub-participation in any loan and a disenfranchisement of any other affiliate of a sponsor that becomes a lender or sub-participant.

The second permits repurchases and sub-participations, subject to compliance with certain conditions. Where the repurchase is made by the borrower, the purchase must occur at a discount and at a time when there is no ongoing default. Further, the repurchase is to be funded from new equity injections or from excess cash flow not required for prepayment of the loans. It goes on to specify two means by which a debt repurchase may be effected: a solicitation process (under which the lenders indicate how much they will sell and at what price) and an open order process (under which the borrower indicates the price at which it is prepared to buy). Both processes are designed to enable all lenders in the affected facility to take part in the repurchase. The provisions state expressly that loans repurchased by the borrower are extinguished, that such extinguishment does not constitute prepayment and that the sharing provisions are not applicable. In the case of any repurchase by another member of the group, the purchaser is disenfranchised.

The public nature of the processes set out in the new LMA form are intended to address possible concerns about fairness and best practice.

The new LMA form does not propose adjustments to the financial ratios or definitions to account for the fact that some of the senior debt has now become inter-company debt, nor does it exclude affiliated lenders from receiving mandatory or voluntary prepayments. In addition, no language is included restricting the ability of a group member or affiliate to on-sell the repurchased debt at a profit. Lenders may give consideration to some or all of such matters during negotiation of the documents.

The LSTA form

Unlike the LMA form, the LSTA form effectively precludes debt repurchases in the absence of waivers or amendments of the

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underlying loan documentation. The standard assignment provisions explicitly prohibit assignments to the borrower, its affiliates and its subsidiaries. In addition, and for the avoidance of doubt, the provisions requiring the sharing of payments among lenders contain an exception for sharing the proceeds of assignments of loans, but not when those assignments are made to the borrower or any of its subsidiaries. The provisions requiring all payments by the borrower to the lenders to be made rateably may also be implicated in the case of repurchases by borrowers.

As a result of these prohibitions, an amendment is almost always required in order to allow for a debt repurchase programme. As part of the amendment process, it is typical for the lenders to insist upon many or all of the provisions discussed above, including disenfranchisement of affiliate lenders (the effectiveness of which in bankruptcy has been questioned by some market participants), prohibiting affiliate lenders from participating in lenders meetings, full disclosure of material information relating to the borrower and its subsidiaries, some form of subordination of loans held by affiliates, an open and transparent mechanism for the repurchases that allow all lenders to participate on an equal basis and limitations on the source of funds used to effect the repurchase. In exchange, the negotiation of the amendment generally includes requests by the borrower to incorporate amendments allowing it to benefit as fully as possible from any financial relief provided by the repurchase. Although almost all of the repurchases have involved term loans, a few have involved revolving credit facilities. When this is the case, the amendments can become complicated by issues concerning funding priorities (if the affiliate lenders are meant to be subordinated) and the participation by affiliate lenders in swingline and letter of credit facilities.

The LSTA form, which is not as comprehensive as the LMA form, does not prescribe standard provisions for amendments and waivers. As a result, there is only marginal conformity in loan documentation for such provisions, and a principal legal concern is often whether the requested amendment requires the consent only of a percentage of lenders or the consent of all or all affected or directly affected lenders. This analysis is frequently critical, since it is often assumed that an amendment requiring unanimous consent is likely to fail and is therefore not even worth attempting. Because amendments to the sharing provisions or the pro rata payment provisions often require unanimous consent, a possible buyback can be abandoned for this reason alone.

There has been some effort in the New York market to incorporate debt buyback provisions in the original credit agreement, beginning with a credit facility for Booz Allen last year. However, this effort has not become widespread.

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