Experts' View

MICHAEL S. GOLDMAN
PARTNER
CRAVATH, SWAINE & MOORE LLP

Michael is a partner in the firm's Corporate Department and serves as the leader of its Commercial Banking practice. His practice includes complex syndicated loan transactions, acquisition and leveraged finance, asset-based lending and securities offerings for both US and international clients.

STEPHEN M. KESSING
PARTNER
CRAVATH, SWAINE & MOORE LLP

Stephen is a partner in the firm's Corporate Department. His practice involves advising financial institutions and corporate clients in a wide variety of matters, including syndicated loan transactions, capital markets transactions and mergers and acquisitions.

Michael and Stephen discuss trends in large cap loan agreements, including developments relating to incremental facilities, builder baskets and mandatory prepayment provisions:

Incremental facilities provide borrowers with greater flexibility to manage their financing needs by changing their capital structures. What are the most common areas of negotiation between a borrower and its lenders regarding these provisions?

Incremental facilities are frequently, if not universally, included in large cap loan agreements. Over the first half of 2014 we have continued to see three principal areas of negotiation with respect to incremental facilities:

- **Ratio-based limits.** In recent years, many borrowers have negotiated for flexibility to incur incremental facilities based on pro forma compliance with a specified leverage ratio. Many large cap loan agreements now include an absolute dollar basket for incremental facilities, as well as additional capacity to establish incremental facilities if the borrower meets a specified pro forma leverage ratio after giving effect to the incremental facilities and any related transactions, such as an acquisition. In older loan agreements, the dollar basket was often used first, with the ratio-based amount applying only after the dollar basket was exhausted. We are seeing greater acceptance in the market for deeming the leverage-based basket to be used prior to (or in conjunction with) the fixed dollar basket.
- **Scope of "Incremental Equivalent Debt."** Borrowers continue to negotiate for flexibility in the form of incremental equivalent debt. Incremental facilities historically were limited to *pari passu* term loans or increases in commitments to an existing revolving facility, in each case to be incurred as an amendment to the existing loan agreement. Borrowers are increasingly negotiating for the ability to treat the incremental facility amount as a stand-alone debt basket to permit the incurrence of *pari passu* secured notes or junior lien, unsecured or subordinated loans or notes. To a lesser extent, borrowers are also asking for the ability to incur *pari passu* secured loans under "sidecar" loan agreements.
- **"Most Favored Nation" provisions.** It is typical for incremental facilities to be subject to most favored nation (MFN) pricing provisions that prevent a *pari*

© 2014 Thomson Reuters. All rights reserved.

passu incremental loan facility from being priced at a premium above the yield of the existing loans without increasing the interest rate on the existing loans (in most cases, subject to a permitted 50 basis point difference). Borrowers continue to negotiate for exceptions to the MFN provisions, such as:

- a "sunset" (a period of time, often one year, after which the MFN provisions cease to apply); or
- restricting the MFN provisions to apply only to loans incurred in reliance on the ratio-based incremental basket (and not to loans incurred in reliance on a fixed dollar basket).

Recently, loan agreements have started calculating builder baskets based on the borrower's cumulative consolidated net income rather than its excess cash flow. What are the implications of this change?

This is one of several areas where we are seeing provisions in large cap loan agreements trend towards provisions that are more typically found in high-yield note indentures. Many high-yield note indentures include the ability for an issuer to make restricted payments (such as certain dividends, junior debt prepayments and investments) under a builder basket equal to 50% of cumulative consolidated net income (CNI) plus certain other additional amounts, often subject to compliance with a fixed charge coverage ratio of 2.00 to 1.00.

Many large cap loan agreements have included a similar "available amount" basket, but in loan agreements the basket is often based on the borrower's share of excess cash flow and historically could only be used to make certain restricted payments if the borrower satisfied a pro forma leverage ratio and made any required excess cash flow mandatory prepayment.

Recently, however, there have been examples of the available amount basket in loan agreements building based on 50% of CNI and, in some cases, replacing the traditional leverage ratio condition with a coverage ratio condition similar to the typical high-yield note indenture formulation. The result of this is to provide borrowers with more flexibility to make restricted payments, investments and junior debt repayments, as a CNI basket is typically larger than a basket based on excess cash flow, and a coverage ratio condition is often easier to meet than a leverage ratio condition.

In addition to providing greater flexibility, adopting this construct allows a borrower with outstanding high-yield bonds to harmonize the baskets between its loans and bonds. Lenders, however, lose the protection they have traditionally received from having the available amount and the excess cash flow sweep based on the same calculation.

The mandatory prepayment provisions in loan agreements are becoming more borrower-friendly. How have these provisions changed in your recent deals?

We have continued to see deterioration of asset sale and excess cash flow prepayment requirements during the first half of 2014. Some loan agreements are including more exceptions to excess cash flow calculations, such as dollar-for-dollar credit for prepayments of other *pari passu* debt and, in some cases, junior secured debt. Borrowers are also requesting credit for expenditures made after the end of a calculation period and prior to the required excess cash flow prepayment date.

Asset sale covenants have generally become very permissive, incorporating bond-like concepts such as "designated non-cash consideration," broad reinvestment rights (for the timing and the nature of the reinvestment) and per sale and annual thresholds that limit the circumstances under which an asset sale prepayment is required to be made.

CRAVATH, SWAINE & MOORE LLP

© 2014 Thomson Reuters. All rights reserved.