Acquisition Finance 2021

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LEXOLOGY
Getting The Deal Through

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Lexology Getting The Deal Through is delighted to publish the ninth edition of *Acquisition Finance*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes a new chapter on Denmark.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Jeffrey Goldfarb and Viktor Okasmaa of Willkie Farr & Gallagher LLP, for their continued assistance with this volume.

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GENERAL STRUCTURING OF FINANCING

Choice of law

1 What territory's law typically governs the transaction agreements? Will courts in your jurisdiction recognise a choice of foreign law or a judgment from a foreign jurisdiction?

The most common choice of law for credit and loan agreements and bond indentures is the law of the State of New York, and most broadly syndicated acquisition financings are governed by New York law.

In situations where the merger or acquisition agreement is governed by a law other than that of the State of New York (for instance, many acquisition agreements are governed by Delaware law), acquisition financing commitments will provide that the satisfaction of conditions by reference to the merger agreement or acquisition agreement (for example, that the acquisition has closed in accordance with the terms of the acquisition agreement) be interpreted in accordance with the law governing the acquisition agreement (in this case, Delaware), and require that all actions against or involving the financing sources be brought in a New York court using New York law.

New York courts will give effect to a choice of New York law in any contract involving in excess of $250,000, whether or not the parties thereto have any reasonable relationship to the State of New York under Section 5-1401 of the New York General Obligations Law.

New York courts will generally give effect to an express choice of non-US law in a contract, unless the chosen jurisdiction has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or application of the law of the chosen jurisdiction would be contrary to a fundamental policy of another jurisdiction (which may include the State of New York) that has a materially greater interest than the chosen jurisdiction.

New York courts will also generally recognise as valid and enforce a final and conclusive judgment granting or denying the recovery of a sum of money, other than judgments for taxes, fines or other penalties, rendered by a non-US court that is enforceable under the laws of the relevant non-US jurisdiction, without re-examination of the substantive issues underlying the judgment pursuant to the Uniform Foreign Money-judgments Recognition Act as adopted in the State of New York (article 53 of the New York Civil Practice Law and Rules). However, New York courts will not enforce judgments rendered under a system that does not provide impartial tribunals or procedures compatible with the requirements of due process of law or which did not have personal jurisdiction over the defendant. In addition, New York courts may decline to recognise judgments obtained by fraud, judgments under causes of action deemed repugnant to New York public policy, judgments issued by courts that did not have subject-matter jurisdiction, judgments where the defendant did not receive sufficient notice, judgments conflicting with other final judgment and judgments in situations where the parties had an agreement to settle the matter outside of a court.

Restrictions on cross-border acquisitions and lending

2 Does the legal and regulatory regime in your jurisdiction restrict acquisitions by foreign entities? Are there any restrictions on cross-border lending?

In most cases, US law does not restrict acquisitions by foreign entities or cross-border lending. Such acquisitions and loans are routine. In certain industries and areas deemed sensitive, however, acquisitions and investments by foreign entities may be subject to review under national security laws by the Federal Committee on Foreign Investment in the United States.

In addition, all acquirers and lenders (foreign or domestic) are required to comply with applicable anti-money laundering, sanctions and anti-corruption laws.

Types of debt

3 What are the typical debt components of acquisition financing in your jurisdiction? Does acquisition financing typically include subordinated debt or just senior debt?

Acquisition financings in the United States take multiple forms, depending on the size of the transaction and the relative availability of different forms of debt.

In investment grade transactions, most acquisition financing is in the form of unsecured bank loans (often this is in the form of bridge financing commitments that are replaced by a subsequent issuance of unsecured notes) or unsecured notes.

In non-investment grade transactions, including almost all private equity-led buyouts, the debt component includes senior secured term loans arranged by bank or non-bank arrangers and syndicated to institutional investors. These senior secured term loans may also be divided into first and second lien tranches and, in middle-market transactions may be incurred as unitranche obligations, where the lenders provide the borrower a single-tranche term loan and agree among themselves as to the division of economics and the priority of payments.

In addition, non-investment grade acquisition financings may also include notes issued to investors either via a registered securities offering or, more commonly, a private placement under Rule 144A under the Securities Exchange Act of 1934. Such notes may be senior secured (of various liens), senior unsecured, senior subordinated or subordinated. Customarily, because it is not practicable to obtain commitments from note investors on the timeline of most acquisitions, buyers will obtain bridge commitments in transactions, including notes from one or more arrangers in an amount equal to the expected proceeds of the issuance of the notes, which will be available to be funded on the closing of the acquisition in the event that the note proceeds are not available at that time. Such bridge commitments are expected by sellers to eliminate conditionality arising from the need to place notes prior to a closing.

Mezzanine financing is also found in middle-market and smaller acquisition financings, but it is a less common component of larger acquisition transactions.

Typical acquisition financing packages will also include a working capital facility, which is typically a revolving credit facility. Such facilities may be unsecured in high-grade transactions or may be secured by all assets or by specific assets (as in asset-backed lending transactions, which may be secured by senior liens on receivables or inventory or other valuable assets), on an equal (*pari passu*) or senior basis to other financing.

Certain funds

4 Are there rules requiring certainty of financing for acquisitions of public companies? Have 'certain funds' provisions become market practice in other transactions where not required?

The concept of certain funds (as understood in the United States) has been widely adopted in acquisition financings for public and private companies; however, there are no rules or laws that require certain funds. Instead, a combination of sellers insisting on greater deal certainty and buyers wanting both deal certainty and to provide sellers with assurance that the buyer will have the financing needed to consummate the acquisition on the specified closing date have created an expectation that certain funds provisions be included. In practice, almost all acquisition financings where there is an executory period between signing of a merger or acquisition agreement and the required closing are consummated on a certain funds basis.

It is important to note that the concept of certain funds in the United States is different from the highly regulated concept of certain funds in the United Kingdom and other European jurisdictions. In the United States, certain funds typically consists of what is known as 'SunGard conditionality', in which the conditions precedent to closing of an acquisition financing are linked as closely as possible to the conditions precedent to the closing of the underlying acquisition. Specifically, this includes limiting the representations and warranties that are required to be accurate as a condition to funding to those contained in the acquisition agreement (along with a small number of 'specified representations' from the credit agreement (notably including a representation that the combined company will be solvent upon consummation of the acquisition and related financing)) and limiting other conditions to a small set of market-tested items. There is no requirement for confirmation of funds from a financial advisor.

Notably, most US acquisition agreements provide that the requirement to consummate the acquisition is subject to there not having been a material adverse change or material adverse effect (the exact term and the definitions thereof are highly deal-specific and carefully negotiated in each transaction) with respect to the target company, as the signing of the acquisition agreement and this condition is imported into the related financing commitments. Ensuring that any such condition in the commitment documentation exactly mirrors the acquisition agreement language is crucial. In addition, most US financing commitments are subject to the negotiation of definitive documentation. Sophisticated parties have limited the related conditionality through specifying precedent documents and detailed term sheets, but the concept of an interim facility agreement has not been adopted widely.

Restrictions on use of proceeds

5 Are there any restrictions on the borrower's use of proceeds from loans or debt securities?

Most loan agreements and note purchase agreements have use of proceeds restrictions that limit borrowers to using debt proceeds for enumerated items, which in the case of acquisition financings ordinarily includes the purchase price for the acquisition, any related refinancing, and associated fees and expenses. In the case of working capital facilities, borrowers are typically limited to using proceeds for general corporate purposes or working capital purposes, which are generally viewed as encompassing all legitimate uses of such proceeds by the borrower and its subsidiaries.

In addition, most loan agreements and note purchase agreements provide that the borrower and its subsidiaries may not use the proceeds of the loans in violation of any sanctions, anti-money laundering or anti-corruption laws (in addition to containing requirements that the borrower comply with all other relevant laws). Moreover, the margin regulations promulgated by the Federal Reserve Bank limit the use of borrowed money for purposes deemed to involve the purchase or carrying of 'margin stock' – broadly defined to include all publicly traded equity securities, as well as securities convertible into publicly traded equity and related options – including, in many cases, debt secured by liens on margin stock. As a result, many credit facilities exclude margin stock from collateral granting clauses. Loans that are to be secured by margin stock require careful regulatory analysis to ensure compliance with the margin regulations.

Licensing requirements for financing

6 What are the licensing requirements for financial institutions to provide financing to a company organised in your jurisdiction?

Various US federal and state regulations apply to financial institutions seeking to provide financing in the United States. As may be expected, these regulations are most stringent with respect to banks based in the United States and foreign banks seeking to operate in the United States. The most prominent national bank regulators are the Federal Reserve Bank, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation, which share responsibility for regulating national banks. In addition, individual state-chartered banks are regulated by state banking regulators. Foreign banks seeking to operate in the United States must obtain a licence from a state regulator or the OCC, depending on the scope of services they wish to provide.

A large and increasingly important portion of acquisition financing in the United States is provided by non-bank direct lenders. These institutions are not regulated in the manner of traditional banks (though there may be licensing requirements in certain states, and certain direct lenders are subject to securities regulations or exchange rules, depending on their sources of funding).

Withholding tax on debt repayments

7 Are principal or interest payments or other fees related to indebtedness subject to withholding tax? Is the borrower responsible for withholding tax? Must the borrower indemnify the lenders for such taxes?

Payments by US borrowers to US lenders are not subject to withholding taxes.

Payments of interest (but usually not principal) by US borrowers to non-US lenders are subject to a 30 per cent withholding tax (payable by the borrower) unless the payments are subject to an exception to withholding. The most-commonly relied upon exceptions are the portfolio interest exemption (which is generally available where a lender delivers a valid certificate of its status as a non-US person to the borrower, is not the holder (or deemed holder) of 10 per cent or more of the equity of the borrower and is not carrying on a US trade or business) and the existence of a tax treaty between the United States and the jurisdiction where the relevant lender is domiciled that provides the lender with an exception to withholding. Most lenders rely on the portfolio interest exemption; however, non-US banks are not eligible for the portfolio interest exemption, and must rely on a tax treaty or, more commonly, establish and lend through a US branch.

Most US credit agreements provide that any withholding tax liability that exists on the closing date of the relevant loan is borne by the lender subject to that liability. Similarly, lenders that enter into loans by assignment are responsible for withholding liability that exists on the date of the assignment. However, if new withholding taxes are imposed as a result in a change of law after the closing date (or the date of assignment), the borrower is required to gross-up the lender such that the interest payment it receives is the same as it would have been absent the change of law.

Restrictions on interest

8 | Are there usury laws or other rules limiting the amount of interest that can be charged?

Usury is governed by state law. There is no federal usury law.

New York's usury statute provides that loans in an amount of $2.5 million or more are exempt from its civil and criminal usury statutes. Loans below $2.5 million (but above $250,000) are subject to a criminal usury cap of 25 per cent per annum.

Indemnities

9 | What kind of indemnities would customarily be provided by the borrower to lenders in connection with a financing?

In credit and loan agreements, the borrower typically indemnifies the agents, lenders and their affiliates and representatives against all losses, claims, damages and expenses of any kind (whether brought by the borrower or a third party) arising from or related to the loan documentation, the use of proceeds of the loans, any investigation or litigation in connection with the loan documentation or any other matter related to the making or administration or enforcement of the loan. Typically, the indemnity excludes matters arising from the gross negligence, bad faith or wilful misconduct of the indemnified party, material breaches by indemnified parties of the loan documentation and claims among indemnified parties (other than claims against an agent in its capacity as such), in each case as determined by a court of competent jurisdiction in a non-appealable judgment. Such indemnities generally include reimbursement for out-of-pocket expenses (including attorneys' fees, which are often limited to reasonable fees of one firm of lead counsel (and assorted special and conflicts counsels) for all similarly situated indemnified parties).

Holders of debt securities do not typically receive indemnities from the issuer. Trustees in note indentures typically receive indemnity from issuers consistent with that provided to agents in credit and loan agreements.

Assigning debt interests among lenders

10 | Can interests in debt be freely assigned among lenders?

Loans in syndicated credit facilities are typically assignable, subject to a number of requirements, including:

- the assignment must be for more than a minimum amount (unless it is made to an affiliate of the assignor or is the full amount held by the assignor);
- the assignee must be 'eligible', meaning that it must not be a natural person, a defaulting lender (that is, an existing lender that is not eligible to receive assignments because it has breached an obligation under the loan documents or has otherwise become ineligible), the borrower or one of its subsidiaries or a disqualified lender (meaning an entity that is listed on a disqualified institutions list provided by the borrower on the closing date and updated thereafter, consisting of persons not permitted to hold loans);
- unless the assignee is an existing lender or an affiliate (including certain affiliated funds) of an existing lender, so long as no event of default (sometimes, no payment or bankruptcy event of default or other subset of events of default) has occurred and is continuing, the consent (not to be unreasonably withheld or delayed (with any non-response for more than a specified period of days being deemed consent)) of the borrower (and sometimes the administrative agent, especially in the case of assignments of revolving loans) is required; and
- entry into an assignment and assumption agreement, which must be delivered to the administrative agent for registration.

Notes that are issued in a registered offering are generally freely transferrable. Most acquisition financings are privately placed, however, and require transfers to be made in accordance with specific exemptions under the Securities Act of 1933, including the ability to transfer notes to Qualified Institutional Buyers, which encompasses most active participants in the high-yield bond market.

Requirements to act as agent or trustee

11 | Do rules in your jurisdiction govern whether an entity can act as an administrative agent, trustee or collateral agent?

There are no specific rules governing administrative agents or collateral agents under New York or federal law.

Indenture trustees are governed under US securities laws, including the Trust Indenture Act of 1939, and must meet specific requirements set forth in that statute. In practice, there is a relatively small number of established indenture trustees (consisting of banks and non-bank entities) that act as trustee on the vast majority of note transactions.

Debt buy-backs

12 | May a borrower or financial sponsor conduct a debt buy-back?

Most credit agreements provide borrowers and sponsors with the ability to purchase loans, subject to significant limitations.

In the case of borrowers, lenders are generally required to be repaid on a pro rata basis and at par. Credit agreements often provide, however, that the borrower may purchase loans (which must be cancelled following purchase) on a non-pro rata basis for less than par pursuant to a Dutch auction or tender offer process made available to all lenders. Less frequently, credit agreements allow borrowers to purchase loans on the secondary market from individual lenders at prices to be negotiated on a bilateral basis.

In sponsor-led deals, the sponsor is usually permitted to purchase and hold up to a specified percentage of the outstanding term loans through open-market purchases. Term loans held by the sponsor are typically ignored in lender votes (with some exceptions) and the sponsor is not entitled to attend lender meetings or receive lender-only information. These limitations often do not apply to bona fide debt funds affiliated with the sponsor that are not under common day-to-day management with its private equity arm.

With respect to debt securities, issuers and their affiliates are generally able to purchase securities on the open market (but such securities may not be counted in holder votes) on a bilateral basis. Larger purchases, however, especially if a general solicitation is intended, must often comply with the tender offer rules promulgated under the Securities Exchange Act of 1934.

Exit consents

13 | Is it permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements?

Typically, there are no restrictions on exit consents in credit agreements or note indentures. Most operating and financial covenants can be amended or deleted with simple majority consent (though important exceptions exist and each desired amendment must be analysed under the terms of the relevant agreement).

GUARANTEES AND COLLATERAL

Related company guarantees

14 | Are there restrictions on the provision of related company guarantees? Are there any limitations on the ability of foreign-registered related companies to provide guarantees?

There are no restrictions on the ability of US entities to guarantee the obligations of related entities, other than any restrictions that would otherwise apply to debt incurrences by such guarantor entities. To the extent that such guarantees are secured, standard filing fees and recording taxes may be payable, but these are not different from those that would be payable if the guarantor were providing security for its own debt (and not a guarantee).

Guarantees and grants of liens by foreign subsidiaries in support of the indebtedness of US borrowers may trigger tax consequences under the US Internal Revenue Code, notwithstanding tax law changes that have, in some cases, reduced or eliminated the negative effects of such actions. Specifically, foreign subsidiaries that guarantee parent company debt may be deemed, for the purpose of federal taxation, to have paid a taxable dividend to the parent company in an amount equal to the greater of the earnings and profits of such subsidiary and the amount of debt guaranteed. Because no funds would actually be repatriated in such a transaction, a deemed dividend may result in tax liabilities to the parent company without providing a source for payment. The law provides a safe harbour that allows pledges of less than two-thirds of the voting equity (and 100 per cent of the non-voting equity) of first-tier foreign subsidiaries, but does not allow any guarantees or additional liens on the assets of such entities, or any credit support from indirect foreign subsidiaries. As a consequence, most acquisition financings do not require guarantees or collateral from foreign entities beyond the safe harbour equity pledges.

Assistance by the target

15 | Are there specific restrictions on the target's provision of guarantees or collateral or financial assistance in an acquisition of its shares? What steps may be taken to permit such actions?

No. US law is extremely flexible in allowing targets to guarantee and provide collateral for acquisition financing and the norm is for such support to be provided. No whitewash or similar procedure is required.

Types of security

16 | What kinds of security are available? Are floating and fixed charges permitted? Can a blanket lien be granted on all assets of a company? What are the typical exceptions to an all-assets grant?

Blanket liens on personal property – which is the general term for assets other than real property and includes accounts receivable, inventory, intellectual property, debt and equity securities, money, bank accounts, brokerage accounts, equipment, fixtures, contract rights, commercial tort claims, letter of credit rights and general intangibles and goods (catch-all terms for other personal property not included in the foregoing list), as well as proceeds thereof – are permitted in the United States. The norm in secured acquisition financings is for borrowers and guarantors to grant liens on substantially all of their assets as collateral for their obligations. As there is no distinction between fixed and floating charges on personal property in the United States, grants of security over personal property security routinely cover both presently owned and after-acquired assets.

The creation of a security interest in most forms of personal property is governed exclusively by state law, specifically by the terms of the Uniform Commercial Code (UCC) as adopted in the state where the property is located. While the terms of the UCC vary slightly among states, it is, for the most part, uniform, with the UCC of each state permitting the creation of a valid security interest in personal property using a security agreement entered into under the laws of any other state (so long as such security agreement contains a clear description of the collateral, is signed by the grantor and contains a provision granting a security interest in the collateral to the secured party). Therefore, only a single security agreement (usually governed by the same state law as the related credit agreement) is required to create security interests in all UCC-governed personal property owned by a borrower and any guarantors in the United States.

In transactions where an all-assets lien is granted, typical exclusions to the grant of collateral include:

- immaterial owned real property (which is excluded because the cost of granting a mortgage exceeds the value thereof) and leasehold interests in real property (because most leaseholds are of limited value and a leasehold mortgage typically requires consent of the property owner);
- assets that require cumbersome perfection procedures in relation to their value, such as motor vehicles, aircraft, ships and railcars (depending, in each case, on the importance of such assets to the overall collateral package);
- assets where a security interest requires the consent of a third party (including the issuer of any equity interests or any other holder of equity interests of such entity) or governmental agency;
- assets as to which a security interest would violate applicable law or binding contracts;
- deposit accounts containing funds held for the benefit of third parties;
- equity interests in foreign subsidiaries (other than up to 65 per cent of the voting interests (and 100 per cent of any non-voting interests) in any foreign subsidiary directly held by a US entity); and
- equity interests in certain non-guarantor subsidiaries.

Security interests in real property are also governed by state law, but there is significant variation among the states in the required terms of a real property mortgage (or, in some states, deed of trust) and the laws applicable thereto. Generally speaking, creation of a lien in real property though the general practice is for such a mortgage or deed of trust to be executed by the grantor (that is, the property owner) and the secured party, which is then recorded with the local (usually county-level) recording office. Lenders and borrowers will typically hire local counsel (sometimes to be shared by the parties) in each jurisdiction where real property collateral is located to navigate local requirements.

Requirements for perfecting a security interest

17 | Are there specific bodies of law governing the perfection of certain types of collateral? What kinds of notification or other steps must be taken to perfect a security interest against collateral?

Perfection of security interests in most forms of personal property is generally governed by the terms of the Uniform Commercial Code (UCC) as adopted in each state. The UCC generally provides that such security interests may be perfected by filing a UCC-1 financing statement naming the debtor and secured party and providing a general description of the collateral with the appropriate state filing office. In the case of grants of collateral by corporations and similar registered entities, the appropriate filing office is that of the state of incorporation or formation of the relevant grantor.

Perfection of security interests in copyrights (and, by custom, patents and trademarks) requires filing with the US Copyright Office or the US Patent and Trademark Office, as applicable, in accordance with federal law. For perfection of security interests in deposit accounts, the UCC requires that either the secured party is the relevant depositary bank or that the secured party, grantor and such deposit bank enter into a separate agreement granting 'control' (as such concept is understood under the UCC) over such account to the secured party. Various state and federal laws govern perfection of security interests in motor vehicles, aircraft, ships and railcars, with separate registries and perfection steps required for such categories. Mortgages in real property are perfected by recording such mortgages (or equivalent documents) with the local (usually county-level) recording office where the property is located. Security interests in insurance proceeds generally require that the insurer add the secured party as a loss payee or additional insured under the relevant policy.

In addition to the required perfection steps described above, the UCC grants priority to liens in certificated securities and certain other investment property that are perfected by delivery of such items (together with signed instruments of transfer) into the possession of the secured party. Consequently, such delivery is a required step in most US transactions.

Renewing a security interest

18 | Once a security interest is perfected, are there renewal procedures to keep the lien valid and recorded?

Perfection of liens by filing financing statements under the UCC in each state is only valid for a term of five years from the filing date. If security interests are to remain in effect for longer than five years, a continuation statement must be filed prior to the lapse of the existing filing.

Other forms of perfection generally remain in effect indefinitely (though state laws may differ in certain cases with respect to non-UCC governed property). It should be noted, however, that changes in the name of the grantor or its jurisdiction of formation will require amendments to any existing UCC financing statements to remain in effect.

Stakeholder consent for guarantees

19 | Are there 'works council' or other similar consents required to approve the provision of guarantees or security by a company?

The United States does not have any equivalent of a works council. Ordinarily, only the consent of the board of directors or similar governing body of the guarantor or grantor would be required to provide a guarantee or security.

Granting collateral through an agent

20 | Can security be granted to an agent for the benefit of all lenders or must collateral be granted to lenders individually and then amendments executed upon any assignment?

Yes. Security is commonly granted to a single agent (either an administrative agent or collateral agent) or trustee in US financings. Such common security is held for the benefit of all lenders.

Creditor protection before collateral release

21 | What protection is typically afforded to creditors before collateral can be released? Are there ways to structure around such protection?

Most credit agreements and indentures allow releases of collateral in connection with permitted dispositions of collateral. Releases of collateral that is not disposed of typically require consent of an agreed percentage of the lenders or noteholders, with releases of all or substantially all collateral typically requiring the consent of all lenders or, in some cases, a substantial majority thereof.

In the case of secured notes, the Trust Indenture Act (TIA) may be implicated in releases of collateral. It is common to structure secured notes as second lien or otherwise junior, so that releases of collateral may be approved by the first lien lenders and binding on the second lien noteholders and trustee. In this manner, TIA requirements such as appraisals and legal opinions are not required.

Fraudulent transfer

22 | Describe the fraudulent transfer laws in your jurisdiction.

The US Bankruptcy Code provides that a transfer (which includes the incurrence or guarantee of indebtedness, the granting of a lien and the transfer of assets) may be avoided if it occurred within two years of the filing of a bankruptcy petition and the debtor, voluntarily or involuntarily:

- made such transfer with actual intent to hinder, delay, or defraud any creditor; or
- received less than a reasonably equivalent value in exchange for such transfer or obligation; and
  - was insolvent on the date that such transfer was made or became insolvent as a result of such transfer;
  - such transfer resulted in the debtor having unreasonably small capital to engage in its business; or
  - the debtor intended to incur, or believed that it would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

Each state also has its own fraudulent transfer laws, which may also be applied in bankruptcy proceedings, and which generally include longer look-back periods (as long as six years) than the Bankruptcy Code.

DEBT COMMITMENT LETTERS AND ACQUISITION AGREEMENTS

Types of documentation

23 | What documentation is typically used in your jurisdiction for acquisition financing? Are short-form or long-form debt commitment letters used and when is full documentation required?

Acquisition financing documentation can be divided into components required upon signing of the acquisition agreement and those required upon the closing of the acquisition.

At signing of the acquisition, the financing documentation typically consists of:

- a commitment letter pursuant to which the signatory lenders commit to provide the financing and which governs the syndication process, indemnities and confidentiality provisions, among other provisions;
- term sheets attached to the commitment letter detailing the terms of the loans and specifying the conditions precedent to funding;
- one or more fee letters, setting forth the fees payable and often including flex provisions and securities demand provisions; and
- in transactions that contemplate a securities offering, an engagement letter setting forth the terms of such offering (including fees payable and credits available in connection therewith).

The definitive documentation for financings is not prepared until after the transaction has been signed. Parties rely on the terms of the commitment letter (including any provisions setting forth an agreed precedent and agreements to negotiate in good faith) for comfort that the final documentation will be prepared in time for closing.

At closing of the acquisition, additional documentation would generally include:

- one or more credit or loan agreements;
- related security and guarantee agreements, pledge agreements and other ancillary agreements;
- an intercreditor agreement in transactions with different classes of creditors; and
- in notes transactions, a purchase agreement, indenture, relevant security and guarantee agreements, if any, and notes.

Level of commitment

24 | What levels of commitment are given by parties in debt commitment letters and acquisition agreements in your jurisdiction? Fully underwritten, best efforts or other types of commitments?

The vast majority of acquisition financing commitments are fully underwritten at the insistence of both buyers and, especially, sellers. Anything less than a binding commitment for 100 per cent of the needed financing is unlikely to be acceptable. Although best efforts commitments do exist, they are not typically used in acquisition financings because of the risk that no financing will be available upon closing.

Conditions precedent for funding

25 | What are the typical conditions precedent to funding contained in the commitment letter in your jurisdiction?

Conditions precedent vary significantly from deal to deal, but they are universally expected to adhere closely to the conditions precedent in the acquisition agreement, with limited exceptions, to avoid situations where a buyer is obligated to consummate an acquisition but lacks the means to do so. Common conditions precedent in acquisition financings include the following:

- completion of the acquisition in accordance with the acquisition agreement, without any waivers or amendments to the acquisition agreement that are adverse to the lenders;
- accuracy of the representations in the acquisition agreement that are material to the interests of the lenders (to the extent that the failure of such representations to be accurate would allow the buyer to decline to close the transaction);
- delivery of a solvency certificate stating that the combined company is solvent after giving effect to the acquisition and incurrence of the financing;
- if a corresponding condition exists in the acquisition agreement, that no material adverse change has occurred with respect to the target company;
- obtaining of any required equity financing and other debt financing to complete the transaction;
- repayment of any debt not permitted to exist following the closing;
- delivery of agreed financial information;
- delivery of signed loan documents, certificates and legal opinions;
- delivery of required 'know your customer' information;
- payment of all fees and expenses borne by the borrower;
- in secured deals, perfection of liens, including delivery of any required securities certificates;
- provision of a marketing period or an 'inside date' prior to which the transaction may not close; and
- in notes deals, provision of necessary marketing documentation (or information necessary to prepare such documentation).

Flex provisions

26 | Are flex provisions used in commitment letters in your jurisdiction? Which provisions are usually subject to such flex?

Market flex provisions are common in broadly syndicated loans, as they allow the borrower to press the market for aggressive terms, while permitting the committed parties to provide more lender-favourable terms in situations where such adjustments are deemed necessary to ensure a successful syndication (normally defined as the arranger not being required to retain any portion of a term loan being placed). These terms are highly negotiated, vary significantly from deal to deal and are among the most closely guarded trade secrets of arranging banks. Common provisions subject to market flex include pricing, covenant baskets, prepayment requirements, prepayment premiums and length of term.

Securities demands

27 | Are securities demands a key feature in acquisition financing in your jurisdiction? Give details of the notable features of securities demands in your jurisdiction.

Securities demand provisions are common in acquisition financings including debt securities. In such transactions, because of the complexity of placing debt securities, arrangers typically provide a bridge commitment consisting of an agreement to make term loans to the buyer on the closing date of the acquisition in an amount equal to the expected proceeds of the proposed securities issuance. While the bridge loans are not intended to be funded, they provide both seller and buyer comfort that a failure to place the debt securities between signing of the acquisition agreement and consummation of the acquisition will not result in the buyer being unable to pay the acquisition consideration.

Because lenders are typically loath to fund a bridge facility, they reserve the right to compel the buyer to issue debt securities to the lenders to fund the acquisition instead of borrowing bridge facility loans. This right is usually exercisable by the lenders either at closing (or, rarely, prior to closing in the form of an escrow funding) or for a period after closing (to refinance a funded bridge facility), which is usually one year, in one or more (subject to a cap) separate demands. The relevant demand provisions will specify whether such debt securities are to be registered or privately placed and the overall nature of the debt securities (though the terms of demand securities are often similar to the terms of the bridge facility they are replacing with respect to security and ranking). Customarily, demand provisions limit the pricing of such securities to an agreed total cap on yield and set forth the expected range of maturity dates and economic features (such as call protection and minimum issuance amount per demand), as well as other material terms of the securities.

Key terms for lenders

28 What are the key elements in the acquisition agreement that are relevant to the lenders in your jurisdiction? What liability protections are typically afforded to lenders in the acquisition agreement?

Because most financing commitments expressly import the conditions precedent and representations and warranties contained in the associated acquisition agreement, lenders carefully review these provisions, including any condition providing that no target material adverse effect or similar term has occurred since the date of the acquisition agreement. Moreover, most acquisition agreements include specific representations regarding the financing and covenants that the buyer will maintain its financing commitments and will act to obtain the financing on the terms set forth therein in time for the closing of the acquisition. The provisions of acquisition agreements that require the seller and target to cooperate with the buyer in connection with the financing, and the inclusion of a marketing period or inside date (ie, a date prior to which the acquisition may not close), are also important to lenders, as the expectation is that the loans (or notes) will be syndicated (or placed) during the period between signing and closing, which requires the assistance of the seller and target in most cases, as well as sufficient time to market the debt.

In addition, lenders typically insist on lender-protective 'Xerox provisions' in acquisition agreements. These provisions specify that all actions arising under the acquisition agreement involving the lenders will be maintained in the jurisdiction and using the choice of law (usually New York) specified in the financing commitment letter, even if the acquisition agreement specifies different choices; trial by jury is waived by all parties in such actions; the lender is expressly exempt from liability to the seller or target (and that any provision limiting recourse to a reverse breakup fee payable by the buyer also protects the lenders); and the foregoing provisions may be enforced by, and may not be amended without the consent of, the lenders.

Public filing of commitment papers

29 Are commitment letters and acquisition agreements publicly filed in your jurisdiction? At what point in the process are the commitment papers made public?

Commitment letters and acquisition agreements are only made public in transactions where the buyer or seller is a public reporting company and the transaction is required to be disclosed in accordance with US securities laws. In the case of acquisition agreements, if the transaction is sufficiently material to warrant disclosure, either buyer or seller or both may publicly file the acquisition agreement with the Securities and Exchange Commission (SEC). Commitment letters are not viewed to be material agreements with respect to a seller (as the seller is not a party) but, in situations where they constitute a material agreement of the buyer, the buyer would file the commitment letter and term sheet (but not any associated fee letter or engagement letter, which may include sensitive deal terms) with the SEC.

Material acquisition agreements are typically filed with the SEC promptly following entry into such agreements pursuant to a filing on Form 8-K, which also includes a description of the relevant transaction. The Form 8-K might also disclose entry into a material commitment letter, but the commitment letter is not usually filed until the buyer's next scheduled quarterly or annual report.

ENFORCEMENT OF CLAIMS AND INSOLVENCY

Restrictions on lenders' enforcement

30 What restrictions are there on the ability of lenders to enforce against collateral?

Prior to a bankruptcy filing the only limitations on enforcement are set forth in either the security documentation or the statutory restrictions included in the authorising statutes (such as the UCC requirement that all enforcement actions be conducted in a commercially reasonable manner). Following a bankruptcy filing, most enforcement actions are automatically stayed and prohibited without the leave of the relevant bankruptcy court.

Debtor-in-possession financing

31 Does your jurisdiction allow for debtor-in-possession (DIP) financing?

Yes. The US Bankruptcy Code provides that a debtor in bankruptcy may enter into DIP financing, which must be approved by the Bankruptcy Court. Such financing is often entered into with existing lenders and, with their consent, benefits from superpriority liens and claims over the existing collateral and debt.

Stays and adequate protection against creditors

32 During an insolvency proceeding is there a general stay enforceable against creditors? Is there a concept of adequate protection for existing lien holders who become subject to superior claims?

There is an automatic stay imposed in connection with all debtors in bankruptcy, which is enforceable against almost all creditors. In the event that a debtor seeks to diminish the value of any collateral held by a pre-petition creditor, it must provide adequate protection to such creditor. This is customarily given in the form of replacement liens, expense reimbursements, post-petition interest payments and non-economic benefits.

Clawbacks

33 In the course of an insolvency, describe preference periods or other reasons for which a court or other authority could claw back previous payments to lenders? What are the rules for such clawbacks and what period is covered?

Under the US Bankruptcy Code, transfers of interests in a debtor's property for the benefit of a creditor (which may include payments but also granting or perfection of liens) occurring within the 90 days (one year in the case of creditors deemed to be insiders) preceding the filing of a bankruptcy petition may be avoided as preferences (and clawed back) if:

- such transfer is made on account of a debt that existed before the time of the transfer (an antecedent debt – newly incurred debt is by definition not preferential);
- the debtor was insolvent at the time of the transfer; and
- such transfer would allow the creditor to receive more than it would have in a liquidation under Chapter 7 of the Bankruptcy Code if the transfer had not been made (in practice, this means that most payments to secured creditors would not be avoidable).

Ranking of creditors and voting on reorganisation

34 In an insolvency, are creditors ranked? What votes are required to approve a plan of reorganisation?

In a bankruptcy, each group of similarly situated creditors (and equity holders) is included in a class of claims. In general, the order of priority is for secured claims to be paid first out of the relevant collateral. After secured claims are satisfied, administrative claims (such as expenses of the bankruptcy proceeding, the costs of continuing to run the business during the bankruptcy proceeding and DIP financing) are paid. Following administrative claims, unsecured claims are addressed, with certain priority claims (such as taxes and pre-petition wages) being paid before general unsecured creditors (such as unsecured lenders, trade creditors, judgments and other amounts owed). Remaining amounts, if any, flow to the equity. All claims are subject to any agreements among creditors (or equity holders) or legal provisions allocating recoveries among the parties.

A plan of reorganisation may be approved with the vote of either each class of creditors or, so long as at least one 'impaired' class of creditors (that is, a class that is not receiving full payment on its claims or is otherwise accepting changes to its rights against the bankrupt entity) has approved the plan, through a cram down, where a plan is confirmed by the Bankruptcy Court over the objections of one or more dissenting classes. For a class to support the plan, over two-thirds of the class (by monetary amount) and over half of the class (by number of claims) must vote in favour of the plan.

Intercreditor agreements on liens

35 Will courts recognise contractual agreements between creditors providing for lien subordination or otherwise addressing lien priorities?

The Bankruptcy Code allows for intercreditor agreements and subordination agreements, and these are commonly enforced in and out of bankruptcy. Certain provisions of such agreements, however, have been successfully challenged by junior creditors in Bankruptcy Court, especially where such provisions are deemed to be overreaching.

Discounted securities in insolvencies

36 How is the claim of an original issue discount (OID) or discount debt instrument treated in an insolvency proceeding in your jurisdiction?

Generally, OID is allocated across the life of the relevant instrument. Any portion attributable to a subsequent period is deemed to be unmatured interest, which is not collectable under the Bankruptcy Code.

Liability of secured creditors after enforcement

37 Discuss potential liabilities for a secured creditor that enforces against collateral.

If a creditor enforces against collateral in a traditional foreclosure outside the protection of a bankruptcy proceeding, the creditor (and any transferee of the collateral) takes the collateral subject to any existing liabilities, including environmental liabilities and other liens that have attached to the property.

In a bankruptcy proceeding under Chapter 11, most pre-petition liabilities (with very limited exceptions) are discharged prior to the collateral being transferred to creditors or purchasers.

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UPDATE AND TRENDS

Proposals and developments

38 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? If so, please give a reference to any written material, whether official or press reports. Are there any other current developments or trends that should be noted?

To address the imminent cessation of reporting of overnight rates in the London interbank market (LIBOR, EURIBOR and similar rates), the Alternative Rates Reference Committee convened by the Federal Reserve Bank and its New York Branch has promulgated various recommendations for the transfer to the use of the Secured Overnight Funding Rate (SOFR) as the principal alternative to LIBOR-based lending. These recommendations are evolving and will continue to change over the course of 2021 – borrowers and lenders should monitor developments to ensure they are benefitting from the latest proposals.

Coronavirus

39 What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

Under the Coronavirus Aid, Relief, and Economic Security (CARES) Act and the Coronavirus Response and Relief Supplemental Appropriations Act of 2021, various loan programmes have been made available to companies adversely affected by the covid-19 pandemic, including specific programmes for the airline and travel industries. These programmes are not directed toward or meant to be used for acquisition financing; however, where borrowers under the programmes become buyers or sellers in acquisition transactions, the interplay between their government loans and the acquisition financing becomes relevant and must be examined. Clients with CARES Act loans should consult their counsel to ensure that all requirements thereunder are met with respect to any acquisitions or acquisition financings.

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