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Lending & Secured Finance 2021

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Ninth Edition

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Editorial Chapters

1 **Loan Syndications and Trading: An Overview of the Syndicated Loan Market**
Bridget Marsh & Tess Virmani, Loan Syndications and Trading Association

7 **Loan Market Association – An Overview**
Hannah Vanstone, Loan Market Association

13 **Asia Pacific Loan Market Association – An Overview**
Andrew Ferguson & Rosamund Barker, Asia Pacific Loan Market Association

Expert Analysis Chapters

16 **An Introduction to Legal Risk and Structuring Cross-Border Lending Transactions**
Thomas Mellor, Marcus Marsh & Michael Byrnes, Morgan, Lewis & Bockius LLP

21 **Global Trends in Leveraged Lending**
Joshua Thompson, James Crooks & Bryan Robson, Sidley Austin LLP

31 **The Rise of the SPAC**
Michael Steinberg & Alain Dermarkar, Shearman & Sterling LLP

36 **Intellectual Property and Personal Data in Drop-Down Financings**
Frank J. Azzopardi, Scott M. Herrig, Eli J. Vonnegut & Daniel F. Forester, Davis Polk & Wardwell LLP

41 **The Pandemic: A Regulatory Perspective**
Bill Satchell & Elizabeth Leckie, Allen & Overy LLP

52 **Acquisition Financing in the United States: A Year of Panic and Rebound**
Geoffrey Peck & Mark S. Wojciechowski, Morrison & Foerster LLP

58 **A Comparative Overview of Transatlantic Intercreditor Agreements**
Miko Bradford & Benjamin Sayagh, Milbank LLP

66 **A Comparison of Key Provisions in U.S. and European Leveraged Loan Agreements**
Sarah M. Ward & Clive J. Wells, Skadden, Arps, Slate, Meagher & Flom LLP

84 **Fund Finance: 2020 Year in Review**
Michael C. Mascia, Cadwalader, Wickersham & Taft LLP

87 **Recent Developments in U.S. Term Loan B**
Denise Ryan & Kyle Lakin, Freshfields Bruckhaus Deringer LLP

96 **The Continued Prevalence of European Covenant Lite**
Jane Summers, Daniel Seale & Karan Chopra, Latham & Watkins LLP

100 **Restructuring Across the Pond and Back: A Comparison of Chapter 11 and the New UK Act**
Judah Frogel, Dan Guyder, Jennifer Marshall & Shaheen Karolia, Allen & Overy LLP

107 **Analysis and Update on the Continuing Evolution of Terms in Private Credit Transactions**
Sandra Lee Montgomery & Michelle L. Iodice, Proskauer Rose LLP

117 **Trade Finance on the Blockchain: 2021 Update**
Josias Dewey, Holland & Knight

124 **Financing Your Private Debt Platform**
Global Finance Group, Dechert LLP

134 **An Overview of Debtor in Possession Financing**
Gary L. Kaplan & Stewart A. Kagan, Fried, Frank, Harris, Shriver & Jacobson LLP

139 **Developments in Midstream Oil and Gas Finance in the United States**
Elena Maria Millerman, Charlie Ofner, Taylor Pullins & Ariel Oseasohn, White & Case LLP

147 **LIBOR – The End is Near(er)?**
Kalyan (“Kal”) Das & Y. Daphne Coelho-Adam, Seward & Kissel LLP

151 **2021 Private Credit and Middle Market Update: Pandemic Priming Shifts Debt to Defence**
Jeff Norton, Jennifer Taylor, Sung Pak & Adam Longenbach, O’Melveny & Myers LLP

155 **Bankruptcy Asset Sales & Acquisition Financing Process: Key Considerations from a Buyer’s Perspective**
Margaret (Meme) S. Peponis, Lisa M. Schweitzer, Katherine (Katie) R. Reaves & John H. Veraja, Cleary Gottlieb Steen & Hamilton LLP

Q&A Chapters

161 **Argentina**
Marval O'Farrell Mairal: Juan M. Diehl Moreno & Diego A. Chighizola

171 **Austria**
Fellner Wratzfeld & Partners: Markus Fellner & Florian Kranebitter

182 **Belgium**
Astrea: Dieter Veestraeten

189 **Bermuda**
Wakefield Quin Limited: Erik L Gotfredsen & Jemima Fearnside

197 **Bolivia**
Criales & Urcullo: Andrea Mariah Urcullo Pereira & Luis Valda Yanguas

205 **Brazil**
Veirano Advogados: Lior Pinsky, Ana Carolina Barretto & Amanda Leal

213 **British Virgin Islands**
Maples Group: Michael Gagie & Matthew Gilbert

221 **Canada**
McMillan LLP: Jeff Rogers & Don Waters

232 **Cayman Islands**
Maples Group: Tina Meigh & Bianca Leacock

240 **Chile**
Carey: Diego Peralta, Fernando Noriega & Diego Lasagna

248 **Croatia**
Macesic and Partners: Ivana Manovelo

257 **Cyprus**
S. Koukounis & Partners LLC: Stella C. Koukounis, Chara Paraskeva & Andreas Zevlaris

266 **England**
Allen & Overy LLP: Oleg Khomenko & Jane Glancy

277 **France**
Orrick Herrington & Sutcliffe LLP: Carine Mou Si Yan

287 **Germany**
SZA Schilling, Zutt & Anschütz Rechtsanwaltsgesellschaft mbH: Dr. Dietrich F. R. Stiller, Dr. Andreas Herr & Dr. Michael Maxim Cohen

297 **Greece**
Sardelas Petsa Law Firm: Panagiotis (Notis) Sardelas & Aggeliki Chatzistavrou

306 **Indonesia**
Walalangi & Partners (in association with Nishimura & Asahi): Miriam Andreta, R. Wisnu Renansyah Jenie & Raditya Pratamandika Putra

314 **Ireland**
Dillon Eustace: Conor Keaveny, Jamie Ensor & Richard Lacken

325 **Italy**
Allen & Overy Studio Legale Associato: Stefano Sennhauser & Alessandra Pirozzolo

335 **Japan**
Mori Hamada & Matsumoto: Yusuke Suehiro

343 **Jersey**
Carey Olsen Jersey LLP: Robin Smith, Laura Healy, Kate Andrews & Peter German

353 **Luxembourg**
Loyens & Loeff Luxembourg S.à r.l.: Antoine Fortier Grethen & Tina Fettes

362 **Mexico**
Gonzalez Calvillo: José Ignacio Rivero Andere & Jacinto Avalos Capin

370 **Netherlands**
Freshfields Bruckhaus Deringer LLP: Mandeep Lotay & Tim Elkerbout

378 **Russia**
Morgan, Lewis & Bockius LLP: Grigory Marinichev & Alexey Chertov

387 **Singapore**
Drew & Napier LLC: Pauline Chong, Renu Menon, Blossom Hing & Ong Ken Loon

398 **South Africa**
Allen & Overy (South Africa) LLP: Lionel Shawe

409 **Spain**
Cuatrecasas: Héctor Bros & Manuel Follía

420 **Sweden**
White & Case LLP: Carl Hugo Parment & Magnus Wennerhorn

427 **Switzerland**
Bär & Karrer Ltd.: Frédéric Bétrisey, Lukas Roesler, Micha Schilling & Tatiana Ayranova

437 **Taiwan**
Lee and Li, Attorneys-at-Law: Hsin-Lan Hsu & Odin Hsu

446 **United Arab Emirates**
Morgan, Lewis & Bockius LLP: Victoria Mesquita Wlazlo & Tomisin Mosuro

462 **USA**
Morgan, Lewis & Bockius LLP: Thomas Mellor, Katherine Weinstein & Matthew Edward Schernecke

475 **Venezuela**
Rodner, Martínez & Asociados: Jaime Martínez Estévez

Preface

Welcome to the 2021 edition of *ICLG – Lending & Secured Finance*. Morgan, Lewis & Bockius LLP is honoured to serve as the *Guide*'s Contributing Editor.

The world has changed in dramatic ways in the last 12 months; the pandemic has changed the way we live, work and play. The loan markets have also been impacted, and the chapters in this edition provide some reference points as to how markets have evolved in light of these challenges. Some of these changes, like the changes in our personal lives, may survive long after the pandemic is a distant memory.

I would like to extend my sincere appreciation and thanks to the contributing authors of this volume. It is the commitment of the LSTA, the LMA and the APLMA, and lawyers from the leading law firms of the world, that contribute to the success of this publication year after year.

We hope you find the *Guide* useful, and we encourage you to contact us with suggestions to improve future editions.

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Loan Syndications and Trading: An Overview of the Syndicated Loan Market

Bridget Marsh

Tess Virmani

Loan Syndications and Trading Association

During the past few decades, the art of corporate loan syndications, trading, and investing has changed dramatically. There was a time when banks lent to their corporate borrowers and simply kept those loans on their books, never contemplating that loans would be traded and managed by investors like stocks and bonds in a portfolio. In time, however, investors became drawn to the attractive features of loans. Unlike bonds, loans were senior secured debt obligations with a floating rate of return, and, over the years, an institutional asset class emerged. Today, such loans are not only held by banks but are also typically sold to other banks, mutual funds, insurance companies, structured vehicles, pension funds, and hedge funds. This broader investor base has brought a remarkable growth in the volume of loans being originated in the primary market and subsequently traded in the secondary market. The syndicated loan market represents one of today's most innovative capital markets.

In 2020, total corporate lending in the United States was approximately $1.5 trillion.[1] This figure encompasses all three subsectors of the syndicated loan market: the investment grade market; the leveraged loan market; and the middle market. In the investment grade market, total lending exceeded $605 billion in 2020. Most lending in the investment grade market consists of revolving credit facilities to larger, more established companies. The leveraged loan market, where loans are made to companies with non-investment grade ratings (or with high levels of outstanding debt), represented approximately $711 billion.[2] Leveraged loans are typically made to companies seeking to refinance existing debt, to finance acquisitions or leveraged buyouts ("LBOs"), or to fund projects and other corporate endeavours such as dividend recapitalisations. Leveraged loans comprise the overwhelming majority of loans that are traded in the secondary market. Then there is the middle market. As traditionally defined, middle market lending includes loans of up to $500 million that are made to companies with annual revenues of under $500 million.[3] For these companies, the loan market is a primary source of funding. In 2020, overall middle market lending totalled approximately $225 billion.[4]

Of these three market segments, it is the leveraged loan market that has evolved most dramatically over the past 30–35 years. Attracted by the higher returns of the loan asset class, the investor base expanded significantly starting from the mid-1990s and has grown increasingly more diverse. This, in turn, fuelled demand for loans, leading to a commensurate rise in loan origination volumes in the primary market. For the loan market to grow successfully, for the loan asset class to mature, and to ease the process of trading and settlement, the new entrants to the market in the 1990s needed uniform market practices and standardised trading documentation. In response to these needs, the Loan Syndications and Trading Association ("LSTA" or "Association") was formed in 1995, and its mission since inception has included the development of best practices, market standards, and trading documentation. The LSTA has thus successfully spearheaded efforts to increase the transparency, liquidity, and efficiency of the loan market; in turn, this more standardised loan asset class has directly contributed to the growth of a robust, liquid secondary market.

The LSTA's role has expanded to meet new market challenges, assuming more prominence in the loan market generally and, particularly since the global financial crisis, the LSTA has regularly engaged with the U.S. government and its regulatory bodies on legislative and regulatory initiatives. Policymaking in the wake of the financial crisis had included sweeping changes to the financial industry, including to the loan market, even though the regulatory impact on the loan market was sometimes an unintended by-product of reform legislation aimed somewhere else. The LSTA has, therefore, dedicated substantial time and energy over the past decade to building awareness amongst regulators about the loan market and how it functions, seeking to distinguish it from other markets and, at times, persuading policymakers to exempt the loan market from particular legislative measures. Having established a more mature regulatory outreach programme, the LSTA now maintains a dialogue about the loan market with regulators and promotes the many benefits of a vibrant leveraged loan market for U.S. companies.

This chapter examines: (i) the history of the leveraged loan market, focusing on the growth and maturation of the secondary trading market for leveraged loans; (ii) the role played by the LSTA in fostering that growth through its efforts to standardise the practices of, and documentation used by participants active in, the secondary loan market to bring greater transparency to the loan asset class; and (iii) the regulatory challenges faced by the loan market.

Growth of the Secondary Market for Leveraged Loans

The story of the leveraged loan market starts more than 30 years ago in the United States, with the first wave of loan market growth being driven by the corporate M&A activity of the late 1980s. Although a form of loan market had existed prior to that time, a more robust syndicated loan market did not emerge until the M&A deals of the 1980s and, in particular, those involving LBOs, which required larger loans with higher interest rates. This had two significant consequences for the loan market. First, because banks found it difficult to underwrite very large loans on their own, they formed groups of lenders – syndicates – responsible for sharing the funding of such large corporate loans. Syndication enabled the banks to satisfy market demand

while limiting their own risk exposure to any single borrower. Second, the higher interest rates associated with these large loans attracted non-bank lenders to the loan market, including traditional bond and equity investors, thus creating a new demand stream for syndicated loans. Retail mutual funds also entered the market at this time and began to structure their funds for the sole purpose of investing in bank loans. These loans generally were senior secured obligations with a floating interest rate. The resultant asset class had a favourable risk-adjusted return profile. Indeed, a non-bank appetite for syndicated leveraged loans would be the primary driver of demand that helped propel the loan market's growth.[5]

Although banks continued to dominate both the primary market (where loans are originated) and the secondary market (where loans are traded), the influx of the new lender groups in the mid-1990s saw an inevitable change in market dynamics within the syndicated loan market. In response to the demands of this new investor class, the banks, which arranged syndicated loans, began modifying traditional deal structures, and, in particular, the features of the institutional tranche or term loan B, that portion of the deal which would typically be acquired by the institutional or non-bank lenders. The size of these tranches was increased to meet (or create) demand, their maturity dates were extended to suit the lenders' investment goals, and their amortisation schedules tailored to provide for only small or nominal instalments to be made until the final year when a large bullet payment was scheduled to be made by the borrower. In return, term loan B lenders were paid a higher rate of interest. All these structural changes contributed to a more aggressive risk-return profile, which was necessary in order to still attract more liquidity to the asset class.

A true secondary market for leveraged loans in the United States emerged in the 1990s. During the recession of the early 1990s, default rates rose sharply, which severely limited the availability of financing, particularly in transactions involving financing from regional and foreign banks. Interest rates to non-investment grade borrowers thus increased dramatically. Previously, banks had carried performing loans at par or face value on their balance sheets, while valuations below par (expected sale prices) were only generally assigned to loans that were in or near default. During the credit cycle of the early 1990s, however, a new practice developed in the banking industry. As banks in the U.S. sought to reduce their risk and strengthen their balance sheets, they chose to sell those leveraged loans which had declined in value since their syndication, rather than hold the loans until their maturity date as they had in the past. In so doing, a new distressed secondary market for leveraged loans emerged, consisting of both traditional (bank) and non-traditional (non-bank) buyers. Banks were not simply originators of these loans but now were also loan traders, and thus, in their role as market makers, began to provide liquidity for the market.

Although leveraged lending volume in the primary market had reached approximately $100 billion by 1995, trading activity was still relatively low, standing at approximately $40 billion.[6] The early bank loan trading desks at this time initially acted more as brokers than traders, simply brokering or matching up buyers and sellers of loans. As liquidity improved and the lender base expanded, investors began to look to the secondary market as a more effective platform from which to manage their risk exposure to loans, and eventually active portfolio management through secondary loan trading was born. With the advent of this new and vibrant secondary loan market, there naturally was a greater need for standard trading documents and market practices which could service a fair, efficient, liquid, and professional trading market for commercial loans – a need reflected in the LSTA's creation in 1995. (The LSTA and its role in the development of a more standardised loan market are discussed more fully below, under "The Standardisation of a Market".)

Around the same time, the loan market acquired investment tools similar to those used by participants in other mature markets; for example, a pricing service, bank loan ratings, and other supporting vendor services. In 1996, the LSTA established a monthly dealer quote-based secondary mark-to-market process to value loans at a price indicative of where those loans would most likely trade. This enabled auditors and comptrollers of financial institutions that participated in secondary trading to validate the prices used by traders to mark their loan positions to "market". Within a few years, however, as leveraged lending topped $300 billion and secondary trading volume reached $80 billion, there was a need to "mark-to-market" loan positions on a more frequent basis.[7] In 1999, this led to the LSTA and Thomson Reuters Loan Pricing Corporation jointly forming the first secondary mark-to-market pricing service run by an independent third party to provide daily U.S. secondary market prices for loan market participants. Shortly thereafter, two other important milestones were reached, both of which facilitated greater liquidity and transparency. First, the rating agencies began to make bank loan ratings widely available to market participants. Second, the LSTA and Standard & Poor's together created the first loan index, the S&P/LSTA Leveraged Loan Index ("LLI"), which has become the standard benchmarking tool in the industry. Just as the market's viability was on the rise, so was its visibility. In 2000, the *Wall Street Journal* began weekly coverage of the syndicated loan market and published the pricing service's secondary market prices for the most widely quoted loans. All these tools – the pricing service, the bank loan ratings, the loan index, and the coverage of secondary loan prices by a major financial publication – were important building blocks for the loan market, positioning it for further successful growth.

At about this time, the scales tipped, and the leveraged loan market shifted from a bank-led market to an institutional investor-led market comprising finance and insurance companies, hedge, high-yield and distressed funds, loan mutual funds, and structured vehicles such as collateralised loan obligations or "CLOs". Between 1995–2000, the number of loan investor groups managing bank loans grew by approximately 130% and accounted for more than 50% of new deal allocations in leveraged lending. By the turn of the millennium, leveraged lending volume was approximately $310 billion and annual secondary loan trading volume exceeded $100 billion. With these new institutional investors participating in the market, the syndicated loan market experienced a period of rapid development that allowed for impressive growth in both primary lending and secondary trading.

Unfortunately, as the credit cycle turned and default rates increased sharply in the early 2000s, there was a temporary lull in the market's growth, with secondary loan trading stalled for a number of years. By 2003, however, leveraged lending (and trading) volumes quickly rebounded as investor confidence was restored.

Even the most bullish of loan market participants could not have predicted the rate of expansion that would take place over the next four years. Once again, this growth was driven by M&A activity and large LBOs. Increasing by nearly 200% from 2003–2007, leveraged loan outstandings were more than half a trillion dollars and secondary trading volumes reached $520 billion. Although hedge funds, loan mutual funds, insurance companies, and other investor groups played a large part in this phase of the loan market's expansion, the growth had only been possible because of the emergence of CLOs. This structured finance vehicle changed the face of the leveraged loan market and was also responsible for its revival after the Global Financial Crisis.

The 2008 Global Financial Crisis led to a recession in the United States, a contraction of global supply and demand, and record levels of default rates. Several years passed before leveraged lending issuance was restored to pre-crisis levels, finally reaching $665 billion in 2012. Although secondary trading activity had been in steady decline from 2008 through 2012, the asset classes' investment thesis (senior secured, floating rate, high risk-adjusted return) coupled with the investment tools put in place years earlier and the standardisation of legal and market practices helped the market to expand further during its next phase, which began in 2013. Since 2013, annual secondary loan trade volumes have grown almost without interruption, reaching a record $743 billion in 2019.

The Standardisation of a Market

No regulatory authority directly oversees or sets standards for the trading of loans in the United States, although, of course, loan market participants themselves are likely to be subject to other governmental and regulatory oversight. Instead, the LSTA leads the loan market by developing policies, guidelines, and standard documentation and promoting just and equitable market practices. The LSTA's focus is attuned to the distinctive structural features of the loan market which stem from the fact that corporate loans are privately negotiated debt obligations that are issued and traded subject to voluntary industry standards. Because the LSTA represents the interests of both the sellers and buyers of leveraged loans in the market, it serves as a central forum for the analysis and discussion of market issues by these different market constituents and thus is uniquely placed to balance their needs and drive consensus.

Loan market participants have generally adopted the standardised documents and best practices promulgated by the LSTA. The LSTA is active in the primary market, where agent banks originate syndicated loans, and in the secondary market, where loan traders buy and sell syndicated loans. The LSTA has an ever-growing library of documents for use in the primary market, including a form of a complete credit agreement for investment grade borrowers (and related term sheet), all of which are generally used by market participants. Over the years, the Association has published a suite of standard trading documents: "trade confirmations" are available to evidence oral loan trades made by parties and form agreements are available to document the terms and conditions upon which the parties can settle those trades. The universal adoption of the LSTA's standard trading documents by US loan market participants has directly contributed to the growth of a robust, liquid secondary market.

It is customary for leveraged loans to be traded in an over-the-counter market, and, in most instances, a trade becomes legally binding at the point the traders orally agree the material terms of the trade. Those key terms are generally accepted as including: the borrower's name; the name, facility type, and amount of the loan to be sold; and the price to be paid for the loan. For commercial reasons, most U.S. borrowers choose New York law as the law governing their credit agreements, and for similar reasons, the LSTA has chosen New York as the governing law in its trading documentation. Since 2002, loan trades agreed over the telephone, like agreements relating to derivatives contracts and certain other financial instruments, have benefitted from an exemption from a New York law which would otherwise require them to be set forth in a signed writing to be enforceable. Because of the LSTA's lobbying efforts, the applicable New York law was changed in 2002 to facilitate trading. Thus, provided both parties have traded together previously on LSTA standard documentation, even if one party fails to sign a confirmation evidencing the terms of the trade, the loan trade will be legally binding and enforceable, if it can be shown that the parties orally agreed the material trade terms. This was a critical legislative reform that contributed to legal certainty in the loan market and harmonised its status with that of other asset classes.

After agreeing the essential trade terms, loan market practice requires that parties then execute a form of LSTA trade confirmation (the legislative change discussed above merely makes it possible legally to enforce an oral trade even if a confirmation has not been signed). Loans can be traded on what is referred to as par documentation or on distressed documentation. Two forms of trade confirmations are available for this purpose and the choice of which one to use is a business decision made at the time of trade. Performing loans, where the borrower is expected to pay in full and on a timely basis, are typically traded on par documentation which means that the parties evidence their binding oral trade by executing an LSTA Par Confirmation and then settling the trade by completing the form of Assignment Agreement provided in the relevant credit agreement (the term par is used because performing loans historically traded at or near par). Alternatively, where a borrower is in, or is perceived to be in, financial distress or the market is concerned about its ability to make all interest payments and repay the loan in full and on a timely basis, parties may opt to trade the borrower's loans on distressed documentation. In this case, the trade is documented on an LSTA Distressed Confirmation, and the parties settle the transaction by executing the relevant assignment agreement and a supplemental purchase and sale agreement. The LSTA has published a form agreement for this purpose, which has been refined over the years and is generally used by the market. This agreement includes, amongst other provisions, representations and warranties, covenants, and indemnities given by seller and buyer. The adoption of standard documents in this regard, particularly for distressed debt trading, significantly contributed to a more liquid loan market, for market participants, knowing that an asset is being traded repeatedly on standard documents, can then uniformly price the loan and more efficiently settle the trade.

When a loan is traded, the existing lender of record agrees to sell and assign all of its rights and obligations under the credit agreement to the buyer.[8] In turn, the buyer agrees to purchase and assume all of the lender's rights and obligations under the credit agreement. The parties must then submit their executed assignment agreement to the administrative agent which has been appointed by the lenders under the credit agreement. The borrower's and agent's consent is typically required before the assignment can become effective. Once those consents are obtained, the agent updates the register of lenders, and the buyer becomes a new lender of record under the credit agreement and a member of the syndicate of lenders.[9] If, for some reason, the borrower does not consent to the loan transfer to the buyer, the parties' trade is still legally binding under the terms of the LSTA's Confirmation and must be settled as a participation.[10] The LSTA has published standardised par participation agreements and distressed participation agreements which may be used to settle par and distressed trades, respectively, where loan assignments are not permissible. Under this structure, the seller sells a 100% participation interest in the loan to the buyer and retains bare legal title of the loan. Although the seller remains a lender of record under the credit agreement and the borrower will not typically be aware that a participation interest in the loan has been sold, the seller must pass all interest and principal payments to the buyer for so long as the participation is in place. The transfer of a participation interest on LSTA standard documents is typically afforded sale accounting treatment under New York law. Thus, if the seller of the participation becomes a bankrupt entity, the participation is not part of the seller's estate, and the seller's estate will have no claim to the participation or the interest and principal payments related thereto.

The LSTA continues to expand its suite of trading documents and has increasingly played a more active role in the primary market. The LSTA has now published four complete credit agreements – a revolver, a term loan, an agreement that combines both a term loan and revolver, and a multicurrency term loan and revolver. Building on the publication of the second edition of *The LSTA's Complete Credit Agreement Guide*, the LSTA released the first of these credit agreements, the unsecured revolving credit facility, which is designed to be used by investment grade borrowers, in 2017. The other three credit agreements quickly followed, and we have now also published a detailed form of term sheet. Finally, the LSTA continues to expand its suite of documents for making, trading, and settling loans to borrowers domiciled in four jurisdictions in Latin America: Chile; Colombia; Peru; and Mexico.

Leaving LIBOR and Going Green? The Loan Market in 2021

Looking back at 2020, two topics grabbed the attention of market participants despite the pandemic: first, the impending phase-out of LIBOR; and second, the rising importance of environmental, social and governance ("ESG") factors in the loan market. These trends are discussed in detail below.

For most of 2020, loan market participants feverishly worked to prepare for the end of LIBOR – widely seen to be likely at the end of 2021. With the countdown clock ticking away, the Alternative Reference Rates Committee ("ARRC")'s Business Loans Working Group, co-chaired by the LSTA, developed many tools to aid the transition to SOFR: best practices; updated fallback language; and recommended conventions. Following on the heels of these publications, the LSTA also developed a "concept credit agreement", which illustrated how a Daily Simple SOFR-referenced loan could look. In that conception, SOFR is applied daily to outstanding principal – much like today's ABR – subject to a lookback which allows for the interest payment amount to be known in advance of the interest payment date. In June, the ARRC published an updated syndicated loans fallback recommendation which only provided for "hardwired" fallback language – meaning the operative transition terms are agreed at loan origination – and reflected a revised replacement rate waterfall that recognised the requirements of the syndicated loan market in implementing SOFR. Those requirements mean that interest must be accrued daily and, given the flexibility inherent in loans (whether it be intra-period prepayments or regular trading), compounded SOFR, which is favoured by other products, is challenging. Undoubtedly, a forward-looking term version of SOFR continues to be the preference of loan market participants and therefore remained the first step of the replacement rate waterfall set forth in the updated fallback language. Without a term SOFR rate being available for use, however, it was important that the second step of the waterfall be implementable and operationalised. The updated recommendation replaced the earlier compounded average SOFR in arrears with a daily, simple interest version of SOFR, i.e. Daily Simple SOFR. In addition to the updated fallback language, the ARRC also recommended conventions for use with SOFR in arrears. These building blocks helped pave the way for the use of hardwired fallbacks which started in the fall of 2020, and SOFR loan originations which are rumoured to have begun in certain loan market segments.

Despite these developments, however, U.S. market participants learned in December that they are set for an 18-month reprieve. ICE Benchmark Administration, the administrator of LIBOR, announced and launched its consultation setting out the plan for the cessation of LIBOR and that consultation envisions USD LIBOR being available through end-June 2023. It is important to note, however, that US banking regulators issued contemporaneous supervisory guidance making it clear that supervised institutions should be including hardwired fallback language in new deals and should not originate LIBOR-referenced loans after the end of 2021. This unpredicted extension may have caused a reprioritisation of transition-related activities, but the commitment to transitioning away from LIBOR is undaunted.

At the same time as market participants grappled with the end of LIBOR as a benchmark, and quite unrelatedly, ESG considerations became increasingly significant in the minds of investors and asset managers. This trend has manifested itself primarily in two ways in the loan market: the growth of green and sustainability-linked loans and the increased focus on ESG in credit ratings. Interestingly, the pandemic has served as a tailwind to both the growth of sustainable finance, largely through a surge in social bonds addressing the pandemic, and increased focus on ESG considerations as it became clear how vulnerable companies are to workplace and supply chain risks. Companies are recognising that there are links between a company's reputation and the way it addresses ESG risk factors, with a new acknowledgment by companies and investors of the relevance of social considerations. The LSTA's ESG Diligence Questionnaire, which launched in February, just before the COVID-19 pandemic gripped the world, has served as a tool for lenders to solicit important ESG information from borrowers and permit borrowers to communicate their ESG story in a standardised fashion. This questionnaire has already been adopted by a number of loan market participants, been completed by a number of borrowers, and serves as a guidepost to borrowers who are looking to understand the ESG information needs of lenders.

Conclusion

The U.S. corporate loan market continues to evolve and expand, continually adapting to new challenges, including legal, regulatory, and economic challenges, and the COVID-19 pandemic of the past year, of course, presented its own unique challenges. In this environment, the LSTA remains committed to promoting a fair, efficient, and liquid market for loans and maintaining its position as the market's principal advocate. The LSTA will continue to provide leadership for the loan market in all areas impacting its growth and remains committed to promoting a fair, efficient, orderly and liquid market for loans and maintaining its position as the market's principal advocate.

Endnotes

1. Thomson Reuters Loan Pricing Corporation.
2. Thomson Reuters Loan Pricing Corporation. "Leveraged" is normally defined by a bank loan rating by Standard & Poor's of BB+ and below (by Moody's Investor Service, Ba1 and below) or, for non-rated companies, typically an interest rate spread of LIBOR + 125 basis points.
3. For a more detailed description on the loan market sectors, see Peter C. Vaky, Introduction to the Syndicated Loan Market, in *The Handbook Of Loan Syndications & Trading*, 39 (Allison Taylor and Alicia Sansone, eds., 2007); Steve Miller, Players in the Market, in *The Handbook Of Loan Syndications & Trading*, *supra*, 47.
4. Thomson Reuters Loan Pricing Corporation.
5. For a more detailed description of the history of the loan market, see Allison A. Taylor and Ruth Yang, Evolution of the Primary and Secondary Leveraged Loan Markets, in *The Handbook Of Loan Syndications & Trading*, *supra*, 21.

6. Thomson Reuters Loan Pricing Corporation.
7. Thomson Reuters Loan Pricing Corporation.
8. For a detailed comparison of assignments and participations, see Michael Bellucci and Jerome McCluskey, *The LSTA's Complete Credit Agreement Guide*, 2nd ed., at 541–542 (McGraw-Hill 2016).
9. For further information on the structure of assignments, see *id*. at 543–561.
10. For further information on the structure of participations, see *id*. at 561–567.

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Since 1995, the Loan Syndications and Trading Association has been dedicated to improving liquidity and transparency in the floating rate corporate loan market. As the principal advocate for this asset class, we aim to foster fair and consistent market practices to advance the interest of the marketplace as a whole and promote the highest degree of confidence for investors in floating rate corporate loans. The LSTA undertakes a variety of activities to foster the development of policies and market practices designed to promote just and equitable marketplace principles and to encourage coordination with firms facilitating transactions in loans and related claims.

www.lsta.org

Loan Market Association – An Overview

Loan Market Association

Hannah Vanstone

Loan Market Association

Founded in late 1996, the Loan Market Association ("LMA") is the trade body for the syndicated loan market in Europe, the Middle East and Africa ("EMEA").

The LMA's principal objective is to foster liquidity in the primary and secondary loan markets, a goal which it seeks to achieve by promoting efficiency and transparency, by the establishment of widely accepted market practice and by the development of documentation standards. As the authoritative voice of the syndicated loan market in EMEA, the LMA works with lenders, law firms, borrowers and regulators to educate the market about the benefits of the syndicated loan product, and to remove barriers to entry for new participants.

The purpose of this chapter is to give the reader insight into the background and development of the LMA, the scope of its work, and recent and current initiatives.

Background to the LMA

Banks have bought and sold loans for decades but standard market practice is still relatively recent.

Growth in borrowing requirements in the 1970s had seen loan facilities traditionally provided on a bilateral basis increasingly replaced by larger credit lines from a club of lenders, and then by loan facilities syndicated to the wider market. In the US in the 1980s, a more formal secondary market evolved in parallel with demand on banks' balance sheets and into the 1990s with the proliferation of non-bank lenders hungry for assets. Proprietary loan trading began to increase and crossed the Atlantic into Europe initially via London-based units of US banks.

By the mid-'90s, the secondary market in Europe had itself evolved to become of increasing importance to banks looking to manage their loan book more proactively, be it for single client exposure reasons, return on equity, or otherwise. Proprietary trading added to its growing relevance. Despite this, it was evident to practitioners that the market, as it was at the time, lacked any standard codes of practice, and was inefficient and opaque. In response, a group of banks agreed to form a market association tasked with promoting transparency, efficiency and liquidity and, in late 1996, the LMA was formed.

Initial Focus and Development

Within a few years of inception, the LMA had introduced standard form secondary trade documentation for performing loan assets and distressed debt, proposed standard settlement parameters and built out a contributor-based trading volume survey. Based on the success of the LMA's secondary market initiatives, its remit was then broadened to cover primary loan market issues.

Just two years after it was founded, LMA membership had grown from an initial seven founding bank practitioners to over 100 institutions. Steady growth since then has seen the membership base expand to 760 organisations in 2020, including banks, non-bank institutional investors, borrowers, law firms, ratings agencies and service providers from 69 countries.

The evolution of the market from the mid-'90s to today and the requirements of its increasingly diverse membership have seen the LMA's work become broadly subdivided into the following categories:

- Documentation.
- Market practice and guidelines.
- Advocacy and lobbying.
- Education and events.
- Loan operations.

An overview of each category, a brief market overview and outlook summary are given below.

Documentation

From secondary to primary

Following widespread adoption of the LMA's secondary trade documentation as the European market standard, focus was turned to primary documentation. A recommended form of primary documentation was developed by a working party which included LMA representatives and those of the UK-based Association of Corporate Treasurers ("ACT"), the British Bankers' Association ("BBA"), as well as major City law firms, with documents first launched in 1999. Involvement of the ACT and BBA from the outset played a major role in achieving broad acceptance of the LMA recommended forms among borrowers and lenders alike. This success was complemented by the subsequent addition of other forms of primary documentation, including a mandate letter and term sheet.

Following the English law recommended forms in terms of format and style, French law (2002), German law (2007) and Spanish law (2012) versions of investment grade primary documentation were later developed, further broadening general acceptance of LMA standards.

From corporate to leveraged and beyond

The increasing importance of the European leveraged loan market in the early 2000s saw the LMA focus on the development of standardised leveraged loan documentation, with recommended forms agreed in early 2004.

All proposed forms of documentation produced by the LMA are to be regarded as a starting point for negotiations, with the

expectation that the more complex the transaction, the more tailoring will be required. This notwithstanding, the fact that all documents have been developed after extensive consultation with market practitioners has led to the recommended documents being viewed as a robust framework upon which to base subsequent individual negotiations.

As the financial crisis of 2007 began to bite, work commenced on a recommended form of intercreditor agreement, a document generally bespoke to the structure of each transaction. Launched in 2009, the document was met with market-wide acclaim as a robust framework and as the product of comprehensive discussion by market practitioners. As the leveraged market evolved post-crisis, so did the suite of LMA template documents. 2013 saw the launch of an intercreditor agreement and super senior revolving credit facility for use in conjunction with a high yield bond. These were complemented in 2014 with a second super senior intercreditor agreement, for use alongside a super senior RCF, senior secured note and high yield note structure.

Historically, the LMA's principal focus has been on documentation relating to corporate investment grade and leveraged loans, alongside a full suite of secondary loan trading documentation. However, in recent years, and in response to member demand, the LMA has significantly expanded its coverage, both from a product and geographical perspective, the latter particularly with developing markets in mind.

In 2012, a commercial real estate finance document for multi-property investment was launched, as well as a facility agreement for developing markets and a pre-export finance facility agreement. 2013 saw the launch of a single property development finance facility agreement and four further facility agreements intended for use in developing markets transactions. The LMA continued to expand its suite of documentation in these areas in 2014, with the publication of a real estate finance intercreditor agreement, as well as facility agreements for use in South Africa, Kenya, Tanzania, Uganda and Nigeria.

Following positive feedback from members on the *Schuldscheindarlehen* ("*Schuldschein*") project and in response to member demand, work commenced on the production of a standard form private placement document, with documents in both loan and note format launched in January 2015. 2015 also saw the publication of a term sheet for use in pre-export finance transactions, a secured single currency term facility agreement governed by South African law and a real estate finance German law facility agreement. Later that year, the LMA published a recommended form of clause for inclusion in non-EU law-governed facility agreements to the extent required by Article 55 of EU Directive 2014/59, the Bank Recovery and Resolution Directive. This included the production of an EU bail-in legislation schedule, which is referred to in the bail-in clauses of the LMA, LSTA, APLMA and ICMA.

In more recent years, the LMA has continued to expand its suite of primary loan market documentation across key sectors including leverage finance, real estate finance, developing markets, private placement and export finance. Some key developments include the development of German- and English-language *Schuldschein* templates; an intercreditor agreement for leveraged acquisition finance transactions anticipating a combination of senior term debt and a super senior revolving facility; and a facility agreement for use in buyer credit transactions supported by an export credit agency. The LMA also continues to expand and update its suite of secondary documentation, including recent amendments to the LMA Standard Terms and Conditions for Par and Distressed Trade Transactions and the secondary LMA recommended form confidentiality letters to take account of the end of the Brexit transition period.

LIBOR discontinuance and the move to risk-free rates has required the LMA to undertake one of the most, if not the most, substantial documentation projects in its history. To aid the transition to risk-free rates, the LMA published a revised version of the existing "Replacement of Screen Rate Clause" in 2018, and has since published two accompanying notes, *Note on the Revised Replacement of Screen Rate Clause and documentary recommendations published by the Working Group on Sterling Risk-Free Reference Rates* (August 2020) and *Note on the Revised Replacement of Screen Rate Clause and pre-cessation trigger* (October 2020), which set out supplemental language, along with risk-free rate terms that can be used alongside the supplemented Clause.

In 2019, the LMA produced exposure drafts of compounded risk-free rate facility agreements for sterling and US dollars as well as an exposure draft of a reference rate selection agreement for transition of legacy transactions to risk-free rates. Since then, the LMA has also produced two exposure draft multicurrency rate switch facility agreements (one with observation shift and one without observation shift) and two further exposure draft multicurrency term and revolving facilities agreements, incorporating backward-looking compounded rates and forward-looking interbank rates (one with observation shift and one without observation shift), each accompanied by a term sheet and a commentary.

The LMA continues to work hard alongside its members to ensure that the transition to risk-free rates is achieved in the loan market in accordance with the milestones recommended by the various currency working groups. The LMA's risk-free rate exposure drafts mentioned above were developed in conjunction with preliminary input and views provided by a working party consisting of representatives from a wide range of market participants and advisers (including corporate borrowers and the ACT). The rate switch agreements (on which the other risk-free rate facility agreements are based) were open for comments from market participants. The facility agreements were published as exposure drafts to facilitate awareness of the issues involved in structuring syndicated loans referencing compounded SONIA, SOFR or other risk-free rates and the development of an approach to these issues by market participants.

Looking ahead to the rest of 2021, the LMA's documentation projects once again reflect the breadth of the LMA's work across EMEA. The LMA is working to produce an exposure draft for its secondary standard terms and conditions for par and distressed trade transactions, a security agreement for use across common law jurisdictions in Africa, a facility agreement for a post-production commodity borrowing base facility, a credit risk insurance policy and associated user guide, two further real estate finance ancillary documents and a guide to intercreditor agreements. The LMA also continues to work on documentation for LIBOR transition, including the production of a drafting guide for rate switch transactions and starting the process of updating its investment grade documentation suite. The LMA will also launch its document automation platform, LMA.Automate, for syndicated loan templates. Starting as a documentation automation service, the LMA.Automate platform will also have the functionality for negotiation and execution of loan documents to create a comprehensive collaboration tool over time.

Review and Development

In response to member feedback, market developments, legislation and regulation, the LMA's document library is constantly reviewed and updated. Primary and secondary recommended forms have undergone several revisions and seen some significant amendments, a notable example being the combination of secondary par and distressed trading documents in 2010, updated once again in 2012. Continuing the theme, terms &

conditions for secondary loan trading were subject to a full "Plain English" review in 2013 with the goal of making these more navigable, particularly for those whose native language is not English. More recently, the LMA has published revised terms and conditions for secondary loan trading incorporating a bail-in clause (which is based on the LMA recommended form of bail-in clause).

The LMA recommended form primary documents and associated user guides will be updated in 2021 to reflect the changes required as a result of the end of the Brexit transition period on 31 December 2020. In the meantime, the LMA has published *Brexit Destination Tables* and a note, *LMA Brexit documentary implications – Consolidated and Updated Note*, which provide guidance on the Brexit-related amendments, including in respect of EU legislative references and bail-in, that should be made to English law facility agreements entered into from 1 January 2021.

The LMA continues to monitor and update its documentation in response to member comments as well as market and regulatory changes.

Market Practice and Guidelines

LMA guidelines are widely regarded as defining good market practice and typically address those aspects of loan market business not specifically documented between parties.

The first in a series of market guides, *Regulation and the Loan Market*, published late 2012, met with considerable interest from the membership. This publication was subsequently updated to reflect ongoing regulatory developments. Other guides in the series have included *Using English Law in Developing Markets* and a *Glossary of Terms for Transfers of Interests in Loans*. Current guides available on the LMA website include a *Guide to Syndicated Loans and Leveraged Finance Transactions*, a *Guide to Agency Protections*, a *Guide to Secondary Loan Market Transactions*, a *Guide to Improving Liquidity in the Secondary Market*, and *Closing a Primary Syndication – Factors to Consider*.

Recent publications include: *Guide to Claims Trading*; *Best Practice Guide for Term Sheet Completeness*; *a recommended Timeline for Settlement of Primary Syndication Incorporating Delayed Settlement Compensation* (as part of the LMA's efforts to reduce settlement times for primary syndications); and a supplementary note to inform members of market discussions/concerns surrounding the documentary implications of Brexit.

The LMA has also carried out substantial work in the evergrowing field of sustainable finance, producing globally accepted framework principles in collaboration with the APLMA and LSTA. The *Green Loan Principles* (2018) and an accompanying guidance document, and the *Sustainability Linked Loan Principles* (2019) and an accompanying guidance document have been well met across the market and will shortly be joined by the *Social Loan Principles*. In addition, the LMA has produced sector-specific guidance for sustainability issues, including guidance on the application of the *Green Loan Principles* in the real estate finance context.

The LMA has also published a series of desktop reference guides in collaboration with its Loan Servicing Sub-Committee for operations practitioners. These guides are intended to act as operational guides for teams to refer to when carrying out their day-to-day activities. As at the date of this publication, there are 13 publications in the LMA's desktop series.

In relation to the transition to risk-free rates, the LMA has also recently published a number of guidance notes, including a guidance note on €STR publication and changes to EONIA and notes outlining considerations for the LMA's wider suite of documentation to assist members consider the impact of LIBOR transition on the LMA suite of documentation. The LMA has also published a glossary of risk-free rate terms to help members understand the terminology used for LIBOR transition.

Advocacy and Lobbying

The LMA seeks to maintain a dialogue with regulators and government bodies wherever new or revised regulatory proposals may impact the loan market, whilst also proactively promoting the market as a core funding source in the corporate economy. Since the financial crisis of 2007, this area of the LMA's work has grown in importance as the number of regulatory proposals has dramatically increased. Policy decisions underlying the new proposals are largely to be supported, the overarching aim being a more robust financial system better able to shoulder economic shock and withstand periods of stress. The LMA's lobbying focus has been on the potentially negative implications of these proposals for the loan market, both intentional and unintended, and the effects on its members. Responses to regulatory bodies across the globe are too numerous to list.

Notable dialogue over recent years includes submissions *re* the impact of the EU Capital Requirements Directive ("CRD IV") on bank financing, to the OECD consultation *re* Base Erosion and Profit Shifting ("BEPS"), the EC consultation on European Capital Markets Union and submissions to the EC, PRA and FCA *re* the Article 55 bail-in directive. Also to highlight are responses to the Financial Stability Board, EC and EBA consultations on strengthening oversight and regulation of both banking and shadow banking, a response to the HMRC consultation *re* tax deductibility of loan interest payments and lobbying the EU on its framework for simple, transparent and standardised securitisations. The LMA had previously successfully lobbied for lower risk retention requirements for new collateralised loan obligations ("CLOs") in the post-crisis era.

On the subject of the discontinuation of LIBOR, the LMA is on a number of sterling, euro and Swiss franc working groups and is in active dialogue with the Bank of England and the UK Financial Conduct Authority ("FCA") to ensure that the interests of the loan market are represented. The LMA has also been responding to relevant consultations, such as FCA consultations on the proposed policy for exercising benchmark powers under new Article 23A and Article 23D, the Working Group on Euro Risk-Free Rates' consultation on EURIBOR fallbacks, and the US ARRC supplemental consultation on spread adjustment methodology. The LMA has also led the drafting on a number of industry papers to assist the loan market; for example, papers published by the sterling risk-free rate working group on active transition of loans and credit adjustment spread methodologies for active transition. Given the importance of a consistent approach being adopted across the financial markets, the LMA has also brought together relevant trade associations in the financial markets to share knowledge and market developments and discuss a coordinated way forward. The LMA is working in particular with the other loan trade associations (namely the LSTA and APLMA), as well as ICMA, ISDA, AFME and others. The ACT is also involved in this group to ensure borrower input.

Basel III/IV and the related EU Capital Requirements Directives and Regulations will have an ongoing impact on the lending environment, whilst securitisation regulation, ECB leveraged lending guidelines, proposed regulation of NPLs and Brexit will offer further challenges. The LMA will also continue to track changes in accounting principles that could have a material impact on the product, and other issues, such as sanctions and tax regulations.

In response to requests by members to address the issues associated with KYC, the LMA undertook extensive work in the context of AML. This resulted in publication in 2019 of new *JMLSG Guidance*, appointment to the JMLSG board, and increased dialogue with AML supervisors. In 2019, the LMA managed to secure HM Treasury approval for the LMA's

revisions to Sector 17 of the *JMLSG Guidance*. The revised Guidance is intended to provide a clear description of the primary and secondary syndicated loan markets, an assessment of where the risks are most likely to arise when considering money laundering and terrorist financing, and to explain the different types of relationships that exist between the parties to a syndicated loan transaction and the instances where this will translate into a direct customer relationship between those parties. The LMA hopes that its participation in this area will continue to help improve existing market practices whilst ensuring that the product remains low risk from a money laundering perspective.

In recent years, the LMA has also been monitoring evolving market areas, including sustainable lending and financial technology ("FinTech"), as they have become the subject of increased scrutiny by regulators and market stakeholders alike, in order to ensure that the syndicated loan as a product is able to adapt to meet the needs of an increasingly sophisticated market.

Education and Events

As a core objective, the LMA seeks to educate members and others regarding documentation and legislative, regulatory, legal, accounting, tax and operational issues affecting the syndicated loan market in EMEA. As the industry's official trade body, the LMA is the ideal education and training resource for what has become an increasingly technical market. Relationships with the key players in the market afford the LMA access to some of the leading experts in their field and as such the credentials of contributors can be guaranteed.

Prior to COVID-19 restrictions, the LMA held regular evening seminars and documentation training days in the UK. To reflect its multi-jurisdictional membership base, the LMA also regularly held seminars, training days and conferences in many other financial centres, including Frankfurt, Paris, Amsterdam, Brussels, Milan, Madrid, Vienna, Zurich, Stockholm, Istanbul, Moscow, Dubai, Nairobi, Lagos, Johannesburg and New York.

The LMA's 13th annual Syndicated Loans Conference was held virtually in September 2020 with over 3,500 attendees watching the conference worldwide. Additionally, the LMA now also runs a joint LMA/LSTA Conference in both London and New York, an annual Developing Markets Conference in London, an annual Real Estate Conference in London, and conferences in East and South Africa.

The LMA intends to resume its international seminars, training days and conferences once restrictions relating to COVID-19 are lifted.

In 2005, the inaugural LMA Certificate Course was held in London. Consistently oversubscribed, the course is now entering its 15th year and ran virtually four times in 2020. Held over five days, the course covers the syndication process through to secondary trading, including agency, portfolio management, pricing and mathematical conventions, terms sheets and an introduction to documentation.

The Syndicated Loans Course for Lawyers is a two-day programme, designed specifically for those working in the legal profession, providing detailed tuition on all aspects of the primary and secondary loan markets.

Virtual training events and conferences scheduled for 2021 include the Virtual Developing Markets Conference, the Virtual Fintech Conference, real estate finance documentation training, secondary documentation training and the LMA Certificate Course.

In 2011, the LMA published *The Loan Book*, a comprehensive study of the loan market through the financial crisis, with contributions from 43 individual market practitioners. Over 10,000 copies of *The Loan Book* have been distributed to date since publication. In 2013, the LMA published *Developing Loan Markets*, a book dedicated to the analysis of various regional developing markets, both from an economic and loan product perspective. Adding to the series, the *Real Estate Loan Book* was published in May 2015. In recognition of the 20th anniversary of the LMA, the latest book – *20 Years in the Loan Market* – was published in November 2016. Again the result of contributions from leading practitioners from across the market, the publication looked back at the last two decades of the syndicated loan market, analysing its evolution over that period.

In August 2015, the LMA launched a webinar programme, offering members across the globe access to training on demand, with concise and comprehensive tutorials across a range of topics presented by senior industry professionals. The programme has rapidly expanded in terms of its coverage, particularly in response to COVID-19 restrictions. The LMA released 37 webinars in 2020, which were made available to members through the LMA Player page on the LMA's website. A series of spotlight interviews and podcasts have also been launched, providing short updates on key regulatory and topical issues impacting the loan market.

Working in close collaboration with the LMA Operations Committee (see below), in October 2016 the LMA launched its first e-learning programme, *Understanding the Loan Market*. Aimed at practitioners across the market, be it from a legal, financial or operations background, the course seeks to create a knowledge benchmark for the asset class. The course consists of 10 modules in total and is free of charge for LMA members. To date, over 5,000 delegates from 60 jurisdictions have registered on the dedicated e-learning portal.

In 2021, the LMA plans to expand its e-learning offering and release further webinars, podcasts and spotlight interviews.

Loan Operations

Operational issues have long been raised by LMA members as an area of concern, particularly around administrative agency and the potential for significant settlement delays in the secondary market. Syndicate size alone can lead to process overload when waivers and amendments are combined with transfer requests. The LMA has a dedicated Loan Operations Committee focused on identifying roadblocks, communicating issues and promoting best practice solutions. Several administrative "quick-wins" have been implemented across top agency houses since 2014 as a direct result of the Committee's work. Since Q4 2014, the LMA has consolidated and published secondary trade settlement statistics from major European trading desks in order to help benchmark efficiency gains going forward. An LMA-driven escalation matrix, where participants agree to share contact details in case an issue requires escalating internally, has proved to be of significant benefit to reduce query bottlenecks.

In June 2019, the LMA held its 5th Loan Operations Conference to showcase the work of the committee and highlight issues faced by operations teams across the market.

FinTech is high on the agenda at most major financial institutions and the LMA is engaged with banks, lawyers and vendors alike to understand the potential implications of innovative technology such as blockchain, in particular as it may impact operational processes in the medium term.

In recent years, the LMA has actively engaged in various regulatory initiatives, most notably assisting in drafting the revisions to Sector 17 of the *JMLSG Guidance*. In addition, the LMA has produced a number of documents, including: a global administrative details form and agency details form, both of which seek to provide a standard format for communicating key administrative details; *An Agent's Guide to Handling Ancillary Facilities*, which

seeks to provide an introduction to ancillary facilities and their treatment in LMA facility documentation, together with guidance on common operational scenarios; and the new desktop series as previously mentioned.

The LMA continues to work tirelessly to break down communication barriers in the syndicated loan market as a whole, through the promotion of its escalation matrix and via its education forums, including its flagship operations conference, which attracts over 300 operations professionals. Maintaining the spotlight on secondary settlement and operations in general is a core strategic aim for the LMA into 2021 and beyond.

Market Overview

A detailed study of the development of the syndicated loan market in EMEA, particularly post the financial crisis of 2007–2009, is beyond the scope of this chapter. *The Loan Book*, as mentioned above, gives a practitioner's overview and detailed reference guide, as does the LMA's publication *20 Years in the Loan Market*. It goes without saying, however, that the crisis sparked by the US sub-prime mortgage market had a significant impact. Fuelled by an abundance of liquidity, particularly from institutional investors in the leveraged market, primary volumes in EMEA soared in the years building up to the crisis. The liquidity crunch saw primary issuance fall dramatically by 2009 to barely one-third of the record €1,600bn seen in 2007. Volumes recovered some ground through to 2011 but dipped again in 2012 against the backdrop of the Eurozone sovereign debt crisis and the US "fiscal cliff". In contrast, 2013 saw markets rebound and loan issuance increase substantially. Policy intervention and specifically the Outright Monetary Transactions programme announced by the ECB in the second half of 2012 was a significant driver of confidence. In 2015, EMEA total loan market volumes topped €1,200bn for the first time since the crisis. EMEA volumes have levelled off slightly since then and stood at around €1tn in 2020.

Demand for the leveraged loan product in particular has spread across a broader investor base than seen prior to 2007. Credit funds and managed accounts have a larger foothold than previously, though CLOs are now again a major player. A significant driver of demand within leveraged finance pre-crisis, the CLO returned to European markets in 2013 with new vehicle issuance volume of €7.4bn, compared with virtually zero since 2008. European CLO issuance reached a post-crisis high of €29.8bn in 2019.

Institutional investors have also become more visible in other loan asset classes, such as real estate and infrastructure finance. A multitude of funds have also been set up to lend directly to small and medium companies, particularly in the UK. Retrenchment by banks immediately post crisis opened the door to alternative sources of finance across the loan market and many larger institutions are now established participants. Many more managers have raised dedicated loan funds over the last few years and competition for assets is becoming intense, especially as several banks have actively looked to expand activity in the sector.

The Way Forward

Results from a survey of LMA members at the end of 2020 suggest that market participants are cautiously optimistic about prospects into 2021, although the results also recognise the challenges faced in the global environment. Some 47.1% of respondents expect loan market volumes across EMEA to grow at least 10%, whilst 26.4% predicted relatively unchanged volumes in 2021. Global economic and/or other risks (including Brexit and COVID-19) were cited as the biggest potential influence on the market in 2021 by 75% of respondents, with competitive pressure second at 13.1%. Respondents saw restructuring activity as the main volume driver at 36.4% of the vote, with refinancings at 29% and new money requirements in corporate M&A at 19.3%. Asked how much financial regulatory change has impacted their business over the last five years, over 75% have seen a significant or material impact.

Indeed, regulatory issues remain high on the agenda and the LMA's focus on lobbying and advocacy will continue unabated. Whilst 2021 is the key year for LIBOR transition, other trends will also determine the focus of the LMA's work into 2021 and beyond. Environmental, social and governance issues are increasingly front and centre of the agenda for market participants throughout the syndicated loan market. The institutional investor base has continued to grow and non-bank finance has increased in importance across loan asset classes, be it in parallel with banks in syndicated lending, in a bespoke bank/fund partnership, via unitranche or other forms of direct lending. More borrowers from developing markets will require funding from beyond domestic boundaries; the LMA will continue to expand its work in these markets to promote the acceptance of regional standards. The LMA expects the focus on operational efficiency to continue to grow and the LMA is fully engaged with partners and practitioners across the market to identify issues, find solutions and broker change. FinTech will undoubtedly evolve to reshape the financial services industry and it will be increasingly important to trade ideas and knowledge in this area.

The LMA's principal objective some 25 years ago was to promote greater liquidity and efficiency in the loan market, an objective which remains just as, if not more, relevant today.

Hannah Vanstone joined the LMA's legal team in November 2018 and assists with the LMA's documentation projects, education and training events and regulatory and lobbying matters. In particular, Hannah leads the LMA's work in real estate finance and supports the LMA's sustainable finance projects. Prior to joining the LMA, Hannah was a banking and finance solicitor at Osborne Clarke LLP where she acted for numerous domestic and international corporate banks and UK and international borrowers on a variety of syndicated finance transactions, with a particular focus on real estate finance.

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The LMA has as its key objective improving liquidity, efficiency and transparency in the primary and secondary syndicated loan markets in EMEA. By establishing sound, widely accepted market practice, the LMA seeks to promote the syndicated loan as one of the key debt products available to borrowers across the region.

As the authoritative voice of the syndicated loan market in EMEA, the LMA works with lenders, law firms, borrowers and regulators to educate the market about the benefits of the syndicated loan product, and to remove barriers to entry for new participants.

Since the establishment of the LMA in 1996, the LMA's membership has grown steadily and now stands at over 760 organisations covering 69 countries, comprising commercial and investment banks, institutional investors, law firms, service providers and rating agencies.

www.lma.eu.com

LMA | Loan Market Association

Asia Pacific Loan Market Association – An Overview

Andrew Ferguson

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Asia Pacific Loan Market Association

About the APLMA

The APLMA is a professional (not-for-profit) trade association that represents the interests of institutions active in the syndicated loan markets around the Asia Pacific (APAC) region. Its primary objective is to promote growth and liquidity in the syndicated loan markets (both primary and secondary), which it endeavours to do by: advocating best market standards and practices; maintaining a suite of highly professional standard documents; engaging with regulators on key matters affecting the markets; organising conferences and knowledge-sharing events in member countries; and providing a professional networking platform for members across the region.

Standard Documentation

One of the APLMA's key areas of activity has been to create, promote and regularly update standard documents for syndicated loan transactions in the APAC markets, and the APLMA now has an extensive suite of loan documents governed by English, Hong Kong, Australian, Singaporean and Taiwanese law. These documents constitute the market standard in most of the jurisdictions around the APAC region and considerable effort goes into the ongoing review and update process to ensure that the APLMA's documents reflect best market practice and ongoing regulatory changes.

The APLMA has also created (and continues to develop) other related templates to assist market participants in their day-to-day loan market activities. These include term sheets, mandate letters, confidentiality letters, as well as templates for secondary market transactions (including sub-participations) under both English and Hong Kong law. Best practice notes also include guidance on (*inter alia*) agency functions, fee sharing, competition law, FATCA, KYC and electronic communications, and many of the APLMA's documents provide 'wording footnotes' to assist with client negotiations. Increasingly, and given the burgeoning influence of Chinese institutions in the APAC region, key documents have been translated into Chinese. The APLMA has recently launched principles working towards standardisation of project finance loan documentation, an important initiative which has been well received in the market.

All of these standard loan agreements and other related documents are available free of charge to members of the Association on the APLMA website (http://www.aplma.com).

APAC Loan-related Cross-border Marketing

In January 2020, the APLMA published an Outline on Loan-Related Cross-border Marketing Considerations for certain Asia Pacific Jurisdictions. This set out for each jurisdiction in an executive summary and more detailed outline, to be read together, some of the considerations of which a bank should be aware before sending a representative into another jurisdiction to market certain loan products of the bank to local corporate customers. The outline covers the following jurisdictions: Australia; PRC; Hong Kong; Indonesia; Malaysia; the Philippines; Singapore; Taiwan; and Vietnam.

This guide serves as a useful reference and can be found on the APLMA website.

Conferences, Seminars and Knowledge-Sharing Events

In a normal year, the APLMA would be hosting more than 100 physical, in-person events, including conferences, seminars, training courses and networking events for the purposes of enhancing industry education, encouraging debate, and providing a vibrant professional network for members across the APAC region. COVID-19 has of course changed all that, but from 1Q20 onwards we quickly and successfully adopted virtual communication through live and recorded webinars, many of which are still available for viewing on the APLMA website. Notable among them were the AGM in June, the Annual Conference in September 2020 and the Certificate Course in November. As 2021 progresses, we all look forward to the resumption of 'service as normal'.

Sustainable Finance

The APLMA is deeply committed to promoting and advancing green and sustainable lending to its members in the APAC region. In 2020, the APLMA organised a number of Asia-wide dedicated webinars on this important topic, with expert speakers in this field from both borrowers and lenders, invariably providing a platform at other conferences for education and debate on green and sustainable finance. Both the CEO and Head of Legal have spoken at a number of high-profile virtual conferences, including those organised by the Hong Kong Monetary Authority and the Hong Kong Quality Assurance Agency.

In 2020, the APLMA, working with the LMA and LSTA, produced two Guidance Documents to give market participants more clarity on their benchmark Green Loan Principles (GLPs) and Sustainability Linked Loan Principles (SLLPs). The GLPs and SLLPs aim to create a high-level framework of market standards and guidelines which facilitate a consistent methodology across the wholesale green and sustainability linked loan market. In early 2021, the APLMA also plans to publish Social Loan Principles recognising how social and green and sustainable issues are interlinked and of particular relevance in the current COVID-19 pandemic.

Along with a number of leading banks and other financial institutions, the APLMA is represented on the ICMA Working Group on Climate Transition Finance.

LIBOR Transition

The pace of transition from LIBOR to risk-free benchmark rates picked up considerably in 2020 and the building blocks are now in place to move smoothly during the course of 2021 towards a world without LIBOR. During the year 2020, the APLMA played an active part in discussions with regulators, market participants and other trade associations and became engaged in numerous awareness and educational events. Additionally, the APLMA produced several new template 'discussion' documents, which we believe have considerably assisted the syndicated loan market in APAC to move forwards more quickly than it would otherwise have done. These included two new 'day-one SOFR' documents (one based on compounded calculation methodology and the other based on 'Daily Simple SOFR' methodology) and our two 'Rate Switch Documents' (again with different versions to accommodate the two calculation methodologies). These documents were well received in the market and applauded by several regional regulators.

Going forward, we will continue our mission (particularly in some of the less developed APAC countries) to educate and raise awareness regarding the complex issues involved in the LIBOR transition debate, with a particular emphasis on transitioning the legacy books of lenders in the region and dealing with tough legacy contracts that do not provide for amendment to facilitate alternative benchmarks.

Looking Ahead

With the regulatory landscape constantly changing, the APLMA will continue to monitor fiscal and regulatory developments in the APAC region and publish market guidance notes to assist members in assessing the extent of the potential impact on the loan markets. It will also be engaging actively with regulators in the region and, as part of its commitment to enhance industry skills and education and provide members with a vibrant professional network, it will continue to host regular seminars and conferences online and, eventually, in various cities and financial centres across Asia Pacific.

Specific projects already in motion include:

- setting up working groups in Indonesia and Malaysia to develop facility agreements for use in those markets (and in the latter case, making them *Shariah*-compliant);
- attracting more non-bank investors into the loan asset class and improving secondary market liquidity;
- maintaining momentum on the further development of green and sustainable finance as the GLPs and SLLPs continue to shape the market; and
- developing and improving the APLMA's training and knowledge-sharing offering and making it more accessible in less developed frontier countries in APAC.

Andrew Ferguson, a veteran of the banking industry (with a career spanning 39 years with Lloyds, Bank of America, BNP Paribas, HSBC and ANZ), established a successful consulting business in Hong Kong in 2012, as a result of which he delivered the APLMA Certificate Course in Hong Kong, Singapore and Sydney in 2016 and 2017 and then undertook an intensive research project for the APLMA in 2017. He was appointed as Advisor to the Board of the APLMA in February 2018 and appointed as Chief Executive Officer in November 2018.
Andrew was educated at the University of Southampton in England, is an Associate of the Chartered Institute of Banking and a Fellow of the Hong Kong Institute of Directors, and twice served as the Chairman of the Capital Markets Association in Hong Kong.

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Rosamund Barker is a commercially minded finance lawyer and currently Head of Legal at the Asia Pacific Loan Market Association based in Hong Kong. She has spent much of her career working in the Banking and Finance and Capital Markets teams at Linklaters in London and Hong Kong, most recently as Counsel Professional Support Lawyer. She was also Director of Knowledge Management for Asia Pacific at Baker McKenzie. She has been active in raising awareness of the APLMA's Green Loan Principles and Sustainability Linked Loan Principles to Borrowers and Lenders and has spoken at a number of high-profile conferences in the region.
Rosamund read law at Churchill College, the University of Cambridge and is a qualified solicitor both in Hong Kong and England and Wales.

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The APLMA was founded in August 1998 by 15 major international banks. As of the end of 2020, it had 335 members made up of banks, non-bank financial institutions, law firms, insurance companies, ratings agencies, multilateral agencies, financial information service providers and other financial intermediaries. It is headquartered in Hong Kong with full legal branches in Australia and Singapore, as well as offshore committees in China, India, Indonesia, Malaysia, New Zealand and Taiwan.
The APLMA cooperates closely with its sister associations in Europe and North America (respectively the LMA and LSTA) and with other trade organisations around the globe. Several regulators in APAC (notably HKMA and MAS) are Honorary Members.

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An Introduction to Legal Risk and Structuring Cross-Border Lending Transactions

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1 Introduction: The Rise of Cross-Border Lending

Increase in Cross-Border Lending. Notwithstanding recent trends that signal a shift away from globalization and free trade in certain contexts (including, of course, the impact of the ongoing pandemic), cross-border lending has increased dramatically over the last couple of decades in terms of volume of loans, number of transactions and number of market participants. According to the Bank for International Settlements, the amount of outstanding cross-border loans held by banks worldwide has increased from approximately $1.7 trillion in 1995 to over $7 trillion today. There are many reasons for this increase: the (continued) globalization of business and development of information technology; the rise of emerging economies that have a thirst for capital; and the development of global lending markets, especially in the US, which has led to a dramatic rise in the number of market participants searching for the right mix of yield and risk in the loan markets, a search that often leads to cross-border lending opportunities.

Challenges of Cross-Border Lending. In addition to understanding the creditworthiness of a potential borrower, the additional exposure of a lender to a foreign jurisdiction entails analysis of a number of additional factors, the weighting of which will vary from country to country. This mix of political, economic and legal risks, bundled together, is referred to collectively as *country risk*. Understanding country risk is imperative for lenders and investors to be able to compare debt instruments of similarly situated companies located in different countries.

Examination of Legal Risk. This first overview chapter of the *Guide* provides some observations on an element of country risk that is closest to the hearts of lawyers: *legal risk*. Together with tax considerations, understanding legal risk is important for structuring cross-border loan transactions. But what exactly is legal risk? Can legal risk be measured? What tools do lenders traditionally use to mitigate legal risk? Do these tools work? Finally, we complete this chapter with some observations on how conventional notions of legal risk are being challenged.

2 Legal Risk in the Cross-Border Lending Context

What is Legal Risk? Young lending lawyers are taught that when a loan transaction closes, "the borrower walks away with a pile of the lender's money and the lender walks away with a pile of paper *and the legal risk*." If the borrower refuses to pay the money back, then the lender must rely on the *pile of paper and the legal process*, in order for the money to be returned. This notion helps drive the point home that legal risk is primarily something that keeps lenders (rather than borrowers) awake at night. While there is no settled description of legal risk, it can be thought of as having a number of components, starting with *documentation risk*, which is mitigated by having competent counsel ensure that legal documentation correctly reflects the business arrangement and is in the proper form. In a cross-border lending context, it is useful to think of legal risk as having two additional related and sometimes overlapping components: (1) *enforcement risk*; and (2) *the risk of law reform.*

Enforcement Risk. Lenders prefer to enter a lending transaction knowing that a number of "enforcement components" are in place to allow for enforcement of loan documentation (that *pile of paper*) and to resolve disputes and insolvency in a predictable way. These components include a well-developed body of commercial law, an independent judiciary and an expedient legal process. In a cross-border lending context, especially if a borrower's primary assets are located in a foreign jurisdiction, there is typically some reliance by a lender on the laws, legal institutions and legal process of that jurisdiction.

For example, a US lender seeking to enforce a loan agreement against a non-US borrower could do so in one of two ways. Assuming the borrower has submitted to the jurisdiction of New York courts, the lender could file suit in New York against the borrower, obtain a judgment from a New York court, and then seek to have that judgment enforced against the assets of the borrower in the borrower's home country. In the alternative, the lender could seek to enforce the loan agreement directly in the courts of the non-US jurisdiction. In either case, there is reliance on the laws, institutions and legal process in the borrower's home jurisdiction.

If the non-US jurisdiction's local law is not consistent with international norms, or its legal institutions are weak, corrupt or subject to undue political influence, then *enforcement risk* may be considered high. It should be noted that enforcement risk may be high even in a jurisdiction that has modernized its commercial laws if legal institutions have not also matured (the latter taking more time to achieve).

Law Reform Risk. Lenders also want to know that the laws they are exposed to in connection with a loan to a borrower will not arbitrarily change to the lender's detriment. This aspect of legal risk is closely associated with political risk. Law reform risk detrimental to lenders is at its highest when a country is undergoing some sort of systemic crisis. For example, in 2002 during the Argentine financial crisis, the government of Argentina passed a law that converted all obligations of Argentine banks in US dollars to Argentine pesos. Given that pesos were only exchangeable at a fixed rate that did not accurately reflect a true market rate, this change in law had the effect of immediately reducing the value of the lenders' loans.

Why Legal Risk Matters. If enforcement risk is high, this weakens a lender's negotiating position in the case of a workout of a loan (as compared to a similarly situated borrower in a country where enforcement risk is low). If law reform risk is high, lenders risk a multitude of unsettling possibilities, some examples of which are described below. In each case, this increased risk should be reflected in increased pricing. In cases where the risk and/or pricing of a loan is considered too high, then a loan transaction may be structured in order to attempt to mitigate the legal risk and/or reduce pricing. Lenders have a number of tools at their disposal in order to mitigate legal risk. In this way, loan transactions that might otherwise not get done, do get done.

3 Can Legal Risk be Measured?

Before examining ways to mitigate legal risk, it is interesting to examine the extent to which legal risk can be measured. Measuring legal risk is not an exact science, but it can be a useful exercise to consider yardsticks that provide a sense of one country's legal risk relative to another's. A threshold challenge is that while there are many tools available to measure *country risk*, *legal risk* is only one component of country risk. Nevertheless, there are some tools that may be helpful. In terms of measuring legal risk, the conventional wisdom is that developed economies have stronger legal institutions and less legal risk when compared to emerging market jurisdictions.

The Usefulness and Limitations of Sovereign Ratings. Sovereign ratings measure the risk of default on a sovereign's debt. These ratings are useful to get a "systemic" view of how a country is doing economically. A country that has a high sovereign debt rating is likely to be financially stable. A country that is financially stable is less likely to undergo systemic stress, at least in the short term, and therefore less likely to undergo *law reform* adverse to lenders (remember the link between systemic stress and law reform noted above).

But does it follow that there is a correlation between a sovereign's rating and *enforcement risk* against private borrowers in the sovereign's jurisdiction? A sovereign's risk of default on its debt instruments may be low because the country has extensive state-owned oil production that fills the country's coffers. This would not necessarily indicate that a country's legal institutions would fairly and efficiently enforce a pile of loan documents against a borrower in that jurisdiction – the legal institutions in such a country might be corrupt and/or inefficient. While a quick review of sovereign ratings suggests that there is at least some correlation between ratings and enforcement risk, there are also some outliers (for example, at the time of writing, Bermuda and China have similar long-term sovereign ratings from Standard & Poor's, though international lenders probably consider enforcement risk to be more significant in China than in Bermuda).

Sovereign Rate Spreads and Sovereign Credit Default Swap Prices. One of the simplest and most widely used methods to measure *country risk* is to examine the yields on bonds issued by the country in question compared to a "risk free" bond yield (still usually considered the US). A comparison of sovereign debt credit default swap prices provides a similar measure. As with sovereign ratings, this tool is useful to obtain a measure of potential systemic stress and *law reform risk* but seems less useful in terms of measuring *enforcement risk* of a borrower in that jurisdiction for the same reasons provided above.

Recovery after Default Analysis. A type of analysis performed by ratings agencies that might be considered useful for measuring legal risk from country to country is corporate default and recovery analysis. A reasonable hypothesis might be that the average recovery for creditors after a borrower default would be higher in countries with low legal risk: stronger institutions means higher recoveries for creditors. But a review of the data suggests there is little or no such correlation. Why is this? There are a few possible explanations: recovery rates depend on a variety of factors other than legal risk, including the severity of default and the makeup of the individual borrowers subject to the analysis. It also is probable that lenders in a country with strong legal institutions (and low risk) may be more willing to make "riskier" loans (based on a portfolio theory of investment) given they have confidence in the jurisdiction's strong legal institutions to resolve defaults and insolvency in a predictable manner.

World Bank "Doing Business" Rankings. The World Bank publishes an interesting study each year titled the *Ease of Doing Business Rankings*. These rankings rate all economies in the world from 1 to 190 on the "ease of doing business" in that country, with 1st being the best score and 190th the worst (see http://doingbusiness.org/rankings). Each country is rated across 11 categories, including an "enforcing contracts," "resolving insolvency" and "protecting investors" category. The rankings provide a helpful tool for comparing one country to one another. While there is not space to detail the methodologies of the rankings in this chapter, the methodologies can produce some unexpected results. For instance, in the 2020 rankings, each of China, Kazakhstan, the Russian Federation and Rwanda have a better "enforcing contracts" score than the United Kingdom. Nevertheless, these rankings can be a useful benchmark and are worth mentioning.

Subjectivity. Ultimately, in addition to the data described above, a lender's perception of the legal risk of lending into a particular country will be driven by a number of geographic, historical, political, cultural and commercial factors peculiar to the lender and the country in question. For example, French lenders seem more comfortable than US lenders when lending to borrowers in certain jurisdictions in Africa, while US lenders seem more comfortable than French lenders when lending to borrowers in in certain jurisdictions in Latin America. (UK lenders seem comfortable lending anywhere!) Lenders will measure legal risk differently based on their institution's experience and tools at hand to work out a loan should it go bad.

4 Tools Used to Mitigate Legal Risk

The fact that a borrower is located in a jurisdiction with a high level of legal risk does not mean that a loan transaction cannot be closed. Lenders have been closing deals with borrowers in far-off lands since the Venetians. Today, lenders use a number of tools to help mitigate legal risk, both in terms of structuring a transaction and otherwise. These concepts are used in all sorts of financings, from simple bilateral unsecured corporate loans to large, complicated syndicated project financings with a variety of financing parties. Which of these tools will be available to a lender will depend on a variety of factors, especially the relative negotiating positions of the borrower and lender for a particular type of transaction.

Governing Law. As a starting point, the choice of governing law of a loan agreement is important because it will determine

whether a contract is valid and how to interpret the words of the contract should a dispute arise. The governing law of most loan agreements in international transactions has historically been either New York or English law. This is primarily because these laws are considered sophisticated, stable and predictable, which lenders like. Also, lenders generally prefer not to have a contract governed by the law of a foreign borrower's jurisdiction, since lawmakers friendly to the borrower could change the law in a way detrimental to the lender (law reform risk). As part of any cross-border transaction, lending lawyers spend time ensuring that the choice of governing law will be enforceable in the borrower's jurisdiction, often obtaining coverage of this in a legal opinion delivered at closing.

It should be noted that that while a loan agreement may be governed by New York or English law, the collateral documentation (the documentation whereby the borrower pledges assets as collateral to secure the obligations under the loan agreement) is almost always governed by the law where the assets are located – often that of the borrower's home jurisdiction. As a general matter, courts generally have the power to adjudicate issues relating to property located in their jurisdiction. Sometimes local laws require that the collateral documentation be under local law, though in any event local courts are more efficient when interpreting and enforcing collateral agreements that are governed by their own law.

Recourse to Guarantors in a Risk-Free Jurisdiction. A lender to a borrower in a jurisdiction with high legal risk may require a parent, subsidiary or other affiliate of the borrower in a "risk-free" jurisdiction to guarantee the loan. In this type of situation, the lender would want to ensure that the guarantee is one of "payment" and not of "collection," since the latter requires a lender to exhaust all remedies against a borrower before obligating the guarantor to pay. In a cross-border context, this could result in a lender being stuck for years in the quagmire of costly enforcement activity in a foreign and hostile court. While almost all New York and English law guarantees are stated to be guarantees of payment, it is nevertheless always wise to confirm this is the case, and especially important if the guarantee happens to be governed by the laws of another jurisdiction.

Collateral in a Risk-Free Jurisdiction. With secured loans, if the legal risk of a borrower's home country is high, lenders will often structure an "exit strategy" that can be enforced without reliance on the legal institutions of the borrower's jurisdiction. This has been a classic tool of project finance lenders for decades and has contributed to the financing of projects in a variety of countries that have high legal risk.

a. *Offshore Share Pledge*. For example, a lender often requires a share pledge of a holding company that ultimately owns the borrower. This type of share pledge may be structured to allow for an entity organized in a risk-free jurisdiction to pledge the shares of the holding company, also organized in a risk-free jurisdiction, under a pledge document governed by the laws of a risk-free jurisdiction. Such a pledge, properly structured and vetted with local counsel, is a powerful tool for a lender, allowing a lender to enforce the pledge and either sell the borrower as a going concern to repay the loan or to force a replacement of management. In the case of such a pledge, it is important to ensure that the borrower's jurisdiction will recognize the change in ownership resulting from enforcement of such a pledge under its foreign ownership rules. When preparing such a pledge, it is important to carefully examine the enforcement procedures to ensure that the pledge can, to the maximum extent possible, be enforced without reliance on any cooperation or activity on the part of the borrower, its shareholders or directors.

b. *Offshore Collateral Account*. Another classic tool is to require a borrower to maintain an "offshore collateral account" in a risk-free jurisdiction into which the borrower's revenues are paid by its customers. In project finance structures, lenders will often enter into agreements with the borrower's primary customers requiring that revenues be paid into such an account so long as the loans are outstanding. It is important to point out that these accounts will only be as valuable as the willingness of customers to pay revenues into them. Creditworthy, offshore customers from jurisdictions where the rule of law is respected are likely to provide more valuable credit enhancement than customers affiliated with the borrower and located in the same jurisdiction.

c. *Playing Defense and Offense*. It should be noted that, in the case of a secured transaction, offshore collateral should not be viewed as a substitute for the pledge of the borrower's local assets. In such a case, a pledge of local assets is also vitally important since, at least theoretically, it preserves the value of the lender's claim against those assets against third party creditors. To use a football analogy, collateral can be thought of as having an "offensive" component and a "defensive" component: the pledge of local assets to the lender is a "defensive" move because this keeps other creditors from obtaining prior liens in these assets, while an equity pledge might be considered an "offensive" tool, allowing the lender to foreclose and sell a borrower quickly and efficiently in order to repay a loan with the proceeds.

Partnering with Multilateral Lenders or Export Credit Agencies. A multilateral development bank is an institution (like the World Bank) created by a group of countries that provides *financing* and advisory services for the purpose of *development*. An export credit agency (ECA) is typically a quasi-governmental institution that acts as an intermediary between national governments and *exporters* to provide export financing. Private lenders to borrowers in risky jurisdictions are often comforted when these government lenders provide loans or other financing alongside the private lenders to the same borrower, the theory being that the "governmental" nature of these institutions provides additional leverage to the lenders as a whole, given these entities are considered to be more shielded from possible capriciousness of a host country's legal and political institutions.

Reputation in the Capital Markets. A borrower or its shareholders may be concerned with their *reputations* in the capital markets in connection with a long and contentious loan restructuring exercise. This may be particularly true in the case of family-owned conglomerates in emerging markets, especially if other parts of the business need to access international financing. If access to the capital markets is not considered to be important, they may be willing to weather the storm. In sovereign or quasi-sovereign situations, a government *seeking foreign investment* or striving to *maintain good relations with the international capital markets* may be less likely to be heavy-handed in a dispute with international investors.

Personal Relationships. The value of personal relationships should not be overlooked in mitigating legal risk. While personal relationships are important in both the developed and emerging markets, personal relationships play a particularly special role in those countries that do not have well-developed institutions and processes to resolve disputes. Some institutions, when working out problem loans in emerging markets, often turn the loan over to different personnel than those who originated the loan. In certain cases, it may be helpful to keep those with the key personal relationships with the borrower involved in these negotiations.

Political Risk Insurance and Credit Default Swaps. A lender may purchase "insurance" on a risky loan, in the form of political risk insurance or a credit default swap. Rather than mitigating risk, this instead shifts the risk to another party. In any event, this is a good tool to have in the lender's toolbox.

Why Good Local Counsel is Important. Finally, the value of high-quality local counsel in a cross-border loan in a high-risk jurisdiction cannot be overstated. This value comes in three forms: knowledge of local law and which legal instruments provide the most leverage to lenders in an enforcement situation; providing local intelligence on where other "leverage points" may be; and finally, by being well connected to the local corridors of power and thereby being able to predict or "deflect" law reform in a manner helpful to clients. When choosing local counsel in a high-risk jurisdiction, spending more for the best counsel is usually worth the investment.

5 Recent Developments and Anecdotes that Both Support and Challenge the "Conventional Wisdom"

Legal Reform Risk in Developed Economies? As mentioned above, the conventional wisdom suggests that legal risk is higher in the emerging markets compared to the developed economies. But consider what happened to creditors in Ireland and Greece a few years ago. In both cases, lawmakers in these countries *changed the law* in a manner that materially and adversely impacted the rights of creditors. In Ireland, Irish lawmakers changed the bank resolution rules *to favor equity over debt*. In Greece, lawmakers changed Greek law in a way that allowed for collective active mechanics in a form that did not exist previously, effectively forcing minority shareholders to be bound by a majority vote. *See* T. DeSieno & K. Dobson, *Necessity Trumps Law: Lessons from Emerging Markets for Stressed Developed Markets?* (Int'l Ass'n of Restructuring, Insolvency and Bankruptcy Professionals, International Technical Series Issue No. 25, 2013). These and other examples make clear that even in the so-called developed economies, law reform can be a risk to creditors, especially when economies are under systemic stress.

Why New York or English Law is Still a Good Choice. In the Greek situation mentioned above, the majority of Greek bonds were issued under Greek law and some bonds were issued under English law. Bondholders holding English law-governed bonds did not suffer the same consequence of the change in Greek law (since Greek lawmakers could not change English law). In this instance at least, the conventional wisdom held true.

Why Local Law May Sometimes be a Better Choice. In a recent transaction in the emerging markets, lenders were provided with a choice to have a guarantee governed by either New York law or local law. Conventional wisdom would suggest the lenders should opt for New York law. However, on the advice of a top local law firm, the lenders opted for the guarantee to be governed by local law. Why? Because after considerable weighing of risks and benefits (including the law reform risk associated with the choice of local law), it was determined the local law guarantee would provide considerably more leverage against the guarantor in the event of enforcement. It could be enforced more quickly and efficiently in local courts than a New York law guarantee (used by other creditors under other facilities), thus potentially providing an advantage to its beneficiaries. This notion of local law being better is probably more often going to be the exception rather than the rule.

Are Offshore Share Pledges Really Risk-Free? Even in cases of offshore pledge agreements that are perfectly documented as described above, lenders who have tried to enforce these pledges have sometimes run into difficulties. In jurisdictions with high legal risk, borrowers and their shareholders can prevent lenders from being able to practically realise on the value of their collateral in a number of ways: they may use the local legal system to their advantage by making baseless arguments that the change of ownership should not be legally recognized; they may transfer assets to other affiliated companies in violation of contractual obligations; or engage in countless other activities unimaginable to lenders when the loan was closed. This "hold-up" value effectively gives the borrower and its shareholders leverage not available in risk-free jurisdictions, even when the equity is "out of the money."

Does Teaming Up With Government Lenders Help or Hurt Private Lenders? As mentioned above, private lenders are often comforted when government lenders co-lend to a borrower. Is this comfort warranted? Government lenders may have motivations during a workout that extend beyond debt recovery to other goals. These goals may be maintaining good relationships with the foreign country in question, maintaining employment at home (in the case of ECAs), or instituting environmental, anti-terrorism or other policy goals. Experience with government lenders in restructuring exercises suggests that government lenders may be less willing to engage in difficult negotiations with foreign borrowers and, in the eyes of at least some private investors in certain restructuring exercises, their inclusion in a transaction has led to decreased recoveries. While government lenders can certainly be helpful to a workout process under the right circumstances, private lenders should be clear-sighted on the benefits government lenders provide.

Challenges to New York and English Law? As transaction and insolvency laws in emerging markets are modernized and become more uniform, and as legal and political institutions develop and mature, many local borrowers may push harder for local law to govern their loan agreements. At a recent syndicated lending conference focused on Latin America, local lenders in the region made clear they thought they had a competitive advantage over international lenders because they had an ability to make loans under local law, something local corporate borrowers seemed to value. The extent to which the market would soon see syndicated loans governed by local law was much discussed. While this phenomenon likely may not occur on a significant scale in the near term, it does seem that the choice of governing law may be one consideration that is increasingly in play when lenders are competing for lending mandates.

6 Final Thoughts

With emerging markets developing and lenders searching for yield, more lenders will seek opportunities in cross-border lending. As a result, the question of legal risk will be one of increasing relevance, and local knowledge will be of increasing importance.

Lenders have a number of useful tools available to help mitigate legal risk. Ultimately, it may not be possible to reduce risk to that of a "risk free" jurisdiction. Lenders should be careful to not overestimate the comfort certain structural tools will ultimately provide. A borrower and its shareholders in a jurisdiction where the rule of law is weak typically enjoy a significant advantage over a foreign lender in a debt restructuring exercise.

Focus on structural tools should not overshadow perhaps the most important mitigant of all: the best protection against legal risk is to make a good loan to a responsible borrower with "sound commercial fundamentals." In the case of a cross-border loan to a borrower in a high-risk jurisdiction, "sound commercial fundamentals" goes beyond looking at a borrower's financial statements, projections and understanding its strategies. The most forward-thinking lenders will strive at the outset of a transaction to understand the full array of leverage points it may have against a borrower and its shareholders, including the need for future financing and/or access to the capital markets, and of the consequences of default for a borrower and its shareholders.

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Global Trends in Leveraged Lending

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The significant global trends in leveraged lending in 2020 were driven by loose monetary policy and fiscal stimulus, coupled with a surprisingly brief loan market crash during the height of the COVID-19 pandemic. The strong rebound in loan prices following the March crash was a surprise to even the most hardened special situations investors. On March 20, when loan prices were in free-fall and collateral calls were rolling out through the credit markets, a grim pall had fallen over the leveraged lending market. Government stimulus saved the day. A quarter later, the sun was once again shining on all financial assets (whether debt or equity). The Klieg lights of government stimulus had arrived and deal activity had rebounded. Risk on, risk very much off, and then risk on, in a very short space of time. While loan defaults, work-outs and bankruptcies all increased, especially in the hardest hit industries, it was noteworthy that 2020 was not significantly worse in all these metrics. The relative change in GDP to business cycle peak was unprecedented when compared to all recent recessions, job losses profound and deep, and certain sectors of the economy effectively shuttered. Notwithstanding additional election turbulence in the United States and Brexit, the end of 2020 ended with a roar, with leveraged loan volumes strong and new issuances rolling into January 2021.

Overall, the COVID-19 pandemic did cause the total leveraged loan volume in Europe and the U.S. to drop by 20% compared to 2019, according to LCD.

Jurisdiction	Volume YTD 20	YTD 19	Change in Volume (%)
U.S. (*US$bn*)	393.11	491.32	- 20%
European (*€bn*)	64.95	81.15	- 20%
Global (*US$bn*)	466.63	582.10	- 20%

Source: LCD Global Loan Stats, S&P Global Market Intelligence

We discuss below specific trends in leveraged lending from 2020.

1 Pre-pandemic

January and February were the quiet before the storm. The longest economic expansion in U.S. history was ongoing and the loan market was chugging along at a steady clip. Repricings, new deals and incrementals were being closed at a strong pace and competitive terms for sponsor deals were being pushed successfully. Much like the summer of 2008, the first few months of 2020 can now be consigned to loan market history as a period when the credit cycle had peaked, albeit for very different reasons. While certain significant credit investors and chief investment officers were calling top of the market and bubble territory, it was not because of the impending pandemic, rather elevated asset prices had become disconnected from economic fundamentals. For those wise enough to short the credit markets on a fundamental basis, an enormous windfall gain was to arrive.

2 March 17–23: Now We Panic

All hell broke loose in asset markets. The party was over, the nightclub lights came on, it was 3am and no one looked good. Cash was king, and a panic-driven flight to quality was draining the markets for riskier assets. Volatility (for rolling 30-day periods) went through prior record highs for loan assets. Loan bids crashed through 80, and ended the month only slightly above. While not hitting the absolute lows reached during the global financial crisis (GFC), the speed of loan price declines was unprecedented. Spreads on *performing* loans in the secondary market went to highs not seen since the worst of 2009. Every single sector of the loan market was in the red for Q1. Oil & gas was crushed, retail, leisure and lodging, and casinos were not far behind. The supply of loans dwarfed demand, and the market for new issuances was on tilt. Collateralised loan obligation (CLO) formation slowed dramatically. Retail investors pulled cash from all asset classes, including from retail funds supporting the loan market. Panic and forced selling were rife. Even investment grade debt saw significant losses. Investors sought security in the form of treasuries and other ultra-safe asset classes.

The interconnectedness of the U.S. credit markets was apparent and the SEC October 2020 report identified several noteworthy factors: (1) short-term funding stresses rippled through the market as risk aversion spiked; (2) intermediation structural weaknesses became apparent (especially in dealer-intermediated markets, including those for muni bonds, corporate bonds and short term funding); and (3) the long-term impact of COVID-19 on the issuers and purchasers of long-term credit was expected to manifest itself in issuer- and sector-specific credit issues.

3 Government Intervention

Notwithstanding the ghost of Ayn Rand and other absolutist free market ideologies, the government yet again stepped into the free-falling market and saved the economy. The loan market was one of many beneficiaries. The playbook from the GFC was cracked open and governments flooded the markets with liquidity and fiscal stimulus (including government-backed loans, employee furlough and tax deferral schemes), and extraordinary public health measures were rolled out. While the government decisionmakers were different, the fundamental policy recognition that the U.S. federal government was the lender of last resort was the same. Investors who had lived through the GFC and caught the updraft of governmental stimulus in 2010 saw the same winds were blowing and quickly re-entered the market to seize the opportunity. Seeking to slow a recession and prevent a depression, governments rolled out the big guns of massive fiscal stimulus and direct monetary interventions. By the end of summer, the markets were back in robust health, looking beyond the horizon of the pandemic and the "shock" recession. The perception that the pandemic and its shocks would be temporary came to settle into investor behaviour and expectations. A retracing of assets prices occurred at a truly remarkable speed including for loans. Loan market participants were able to resume business as usual, and conditions became favourable once more for new issuances. The high yield market saw a boom in new issuances, while the loan market also experienced a robust upsurge.

As a result of the widespread borrower support action taken by governments, central banks, lenders and sponsors alike, default rates reduced by the end of the year with fewer restructurings taking place as was originally anticipated in March.

Quarter Date	U.S. Distress Ratio (% of performing loans in S&P/LSTA Leveraged Loan Index trading below 80)	Europe Distress Ratio (% of performing loans in S&P European Leveraged Loan Index trading below 80)
Q4 2019	3.4%	3.75%
Q1 2020	24.24%	39.77%
Q2 2020	8.26%	11.21%
Q3 2020	5.07%	6.83%
Q4 2020	2.17%	3.42%

Source: LCD, an offering of S&P Global Market Intelligence

4 CLO Market

CLO structures support over half of the US$1.2 trillion of leveraged loans outstanding. As opposed to 2008–2009, CLOs now have stronger features to match funding and better absorb risks, e.g., diversification, assets and liabilities with similar maturity, floating rates and liabilities that are not redeemable. While monthly cash flow and collateral tests may cut off distributions to lower-tier security holders in the CLO, post-GFC CLOs (so-called "2.0 CLOs") do not generally have "mark-to-market" loan value performance tests. When loan prices plummeted during 2020 and CCC ratings began to proliferate, these CLOs concentrated risks (and losses) with junior note holders and equity tranches; these events did not, however, force CLOs to be sellers into a market already suffering over-supply. 2020 saw new CLO issuance hit an all-time high before the COVID-19 economic shock, a three-month dramatic fall-off, followed by a solid rebound thereafter. While credit spreads widened for AAA tranches (when comparing September to February), the gap was relatively modest (50bps or so); a remarkable recovery in a short space of time.

5 Sector-specific Impacts

With plunging oil and gas prices during the COVID-19 crisis, the oil & gas sector suffered leveraged loan defaults in excess of 25%. In contrast, the broader market was under 5%. The combination of low oil prices and over-levered balance sheets pushed producers into restructurings and bankruptcies. While premier investment grade issuers were able to access the capital markets and battle-harden their balance sheets, non-investment grade issuers were effectively locked out of the leveraged loan and high yield market. Reserve base lending facilities were subject to renegotiations and restructurings when redeterminations of borrowing bases revealed fundamental weaknesses.

In other severely adversely affected sectors, e.g. travel, hospitality and retail, spikes in defaults were also noteworthy and strong companies rushed to secure cash and liquidity to bunkerise their balance sheets. By the end of 2020, a little less than 12% of syndicated loans were deemed "classified" or "special mention" by the Federal Reserve, FDIC and Office of the Comptroller of the Currency, a near doubling compared to one year earlier. Loans labelled classified are substandard, doubtful or losing money, while those in the special mention category are considered to have potential weaknesses "that could result in further deterioration of the repayment prospects or in the institution's credit position in the future", according to regulators' definitions.

In contrast, certain industries were seen to be resilient to the effects of COVID-19, and according to LCD, the most active sectors in Europe were Computers & Electronics (with a 22% share of the deals), Healthcare (14%), and Professional & Business Services (12%).

Sector	Approximate Share of Deals
Computers & Electronics	22%
Healthcare	14%
Professional & Business Services	12%
Insurance	6%
Telecommunications	6%
Educational services	6%
Automotive	5%
Others (made up of over 11 sectors)	29%

Source: LCD, an offering of S&P Global Market Intelligence (LCD tracked 130 direct lending deals in the European mid-market)

These sectors were leading investment areas in 2020, bolstered by their innate resistance to lockdown measures and strong growth potential. In a market where lenders are increasingly selective about credit quality and sector, the chase for higher-rated credits in these preferred industries (which was already evident prior to COVID-19) has become even more pronounced during the disruption caused by the pandemic. The increased attention placed on these markets will likely translate to an unbalanced supply and demand dynamic; inevitably, lenders and sponsors will be chasing the same deals, leading to potentially more aggressive terms and looser documentation in the year ahead.

6 Brexit

The UK voted to leave the European Union in June 2016 and, after complex negotiations that wrapped up on Christmas Eve 2020, finalised an exit deal on New Year's Eve 2020 (the end of

the 11-month transition period after the notional exit at the end of January). The thorny area of financial services and "equivalence" was barely dealt with directly in the deal, with the most important elements arguably being included in a side Declaration (the main document is a "Trade and Cooperation Agreement"). There was no transition period, nor formal pass-porting. Power to grant equivalence (e.g., recognition and access) resides with each party, which, of course, leaves the EU with the upper hand given London's dependence on access to the EU in order to maintain its status as a leading financial centre. A noteworthy trend for 2020 was that the loan market was largely unaffected by these significant political and regulatory developments. The LMA has assisted market participants in modifying standard loan documentation to address complexities arising from implementing legislation, regulatory divergence and technical challenges, including with respect to the "on-shoring" of retained EU laws in the UK post-December 31. While financial services firms in the UK prepared for deploying their contingency plans for hard Brexit (or a "Canada-style" Brexit described above), the loan market was most directly affected by the trends discussed above (e.g., the COVID-19 pandemic, and monetary and fiscal policy). A post-Brexit trend for the foreseeable future is a trade and regulatory battle over the EU's reliance on London for capital, including bank finance.

7 Direct Lending

The rise of direct lending continued in 2020. While certain platforms were put under heavy pressure during the worst of the pandemic crisis, the industry as a whole performed well and continued to push for origination market share. The continued flight of human capital from the regulated sector continued, with the divergence of compensation remaining dramatic. The fund-raising environment as a general matter remained strong, albeit not during the period when the market was in shock mode, and special situations platforms were able to raise significant new funds.

The Deloitte Alternative Lender Deal Tracker reported a decrease of 29% in the number of direct lending deals in Europe in the first half of 2020, attributing the dramatic slowdown to the impact of the pandemic rather than as a result of a reduction in the appetite for funding from direct lenders. Notwithstanding the overall reduction in deal volume in 2020, direct lenders continue to be a major force in the European market with alternative lenders continuing to dominate the mid-market space in 2020.

Quarter	Alternative Lenders	Banks
Q1 2020	70%	30%
Q2 2020	64%	36%
Q3 2020	64%	36%
Q4 2020	90%	10%

Source: LCD – European mid-market deals by lender type

2020 saw a rise of "jumbo" unitranches, highlighted by the Ardonagh Group's refinancing transaction involving the largest-ever unitranche seen globally, at approximately £1.575 billion. The deal was provided through a club made up of Ares, CDPQ, HPS and KKR and was the first of its type in Europe to feature several lenders. Similarly, stretching for the large cap space, 2020 saw alternative asset manager Apollo and UAE sovereign wealth fund Mubadala team up to launch a US$12 billion direct lending platform that will invest in deals of up to US$1 billion in size, with Mubadala also launching a similar initiative with Barings. Market participants are increasingly seeing direct lenders aim to muscle in on the large cap space, so as to make use of their mountains of dry powder, which may make these "jumbo" private deals a more common occurrence.

COVID-19 has added fuel to the trend away from local bank club deals to financings from direct lenders, particularly as many banks were focused on disbursing government-backed COVID-19 rescue loans and did not necessarily have the bandwidth to both chase origination and manage their existing portfolios in the turmoil. This shift, coupled with a direct lender's ability to deliver deals quickly and with less red tape, makes them an attractive financing option for borrowers, and places the alternative lending market in a strong position to continue its growth in 2021.

8 Adjustments

With the widespread proliferation of covenant-lite (or "cov-lite") loans with borrower-friendly EBITDA add-backs and *pro forma* adjustments being able to be made in many deals, arguably much of the existing loan documentation already protected borrowers against financial covenant defaults as a result of the effects of COVID-19. For example, a reasonable case could be made that additional costs borne by borrowers in relation to the pandemic qualify as "one-off, non-recurring, extraordinary or exceptional" items, which can often be added back to reported EBITDA. Reorg reported seeing these COVID-19-related EBITDA adjustments being made in companies' financial reports in Q2 2020, including two Blackstone-owned companies, Schenck Process and Cirsa, which both adjusted EBITDA upwards for losses suffered as a result of the pandemic, and CVC-owned entity Douglas, which made a COVID-19 adjustment to EBITDA of €15 million for costs incurred in connection with closed stores. Similarly, "proceeds of business interruption insurance" are often included as an EBITDA add-back (often calculated at the point of claim rather than in terms of actual cash receipts) and, as the pandemic forced many businesses to significantly reduce or temporarily halt their operations, such policies came into their own where the scope of the protection was sufficiently framed to capture the impact of COVID-19. Both of these provisions are prime examples of the tools that were already available to borrowers in order to remain compliant with their financial covenants.

Notwithstanding the foregoing existing flexibilities, in order to help businesses stay out of a default occasioned by the pandemic, a wave of express COVID-19-related adjustments were made to facility agreements in Q2 and Q3 2020. Set out below is a brief precis of some of these COVID-19-related documentary innovations seen across the market:

- the birth of "EBITDAC", providing for an express EBITDA adjustment for COVID-19-related costs, as the market recognised the potential long-term nature of the pandemic. This adjustment was typically seen made subject to a cap (often at or around 25% of EBITDA) as lenders fought to ensure that this loosening of terms did not otherwise mask the general underperformance of a business;
- an outright suspension of financial covenant testing until Q1 or Q2 2021 (or later), or amendments to covenants to loosen the required covenant ratios or the calculation methodologies themselves (as opposed to a full suspension of covenant testing). In this latter category, the market saw some deals going far beyond merely including an add-back for COVID-19-related costs, for example by calculating LTM EBITDA using annualised figures from financial quarters unaffected by the pandemic, or by using historic 2019 EBITDA (or another pre-agreed metric) for affected quarters;

- COVID-19-specific carve-outs were generally accepted against certain events of default including audit qualification, cessation of business and "material adverse change", with Reorg reporting seeing these expressly included in 5% of the deals it analysed in 2020. These changes were designed to enshrine in the documentation the mantra adopted by governments and regulators worldwide, in that lenders should not use the disruption caused by the pandemic to enforce against borrowers; and
- additional innovative carve-outs were seen in certain credits, enabling businesses to ride out the economic storm while optimising value protection for the business and its secured creditors, including affording flexibility to businesses to default on payments to unsecured creditors, in particular landlords, without automatically tripping cross default and litigation events of default.

Lenders did, however, seek some changes of their own in exchange for these documentary adjustments. Minimum liquidity covenants, a mainstay of the restructuring arena, were imposed on many deals as a *quid pro quo* for additional flexibility on leverage covenant testing, usually coupled with increased reporting requirements to give lenders more visibility over businesses' performance. Additionally, whilst covenant testing was often switched off during 2020 and beyond, lenders focused on further restricting their borrowers' ability to incur new *pari passu* (or super senior) debt, move cash and assets out of the restricted group, and reduce pricing on their facilities through the operation of the margin ratchet.

As the world continues to grapple with the spread of COVID-19, with many European countries entering into new government-enforced lockdowns at the start of 2021, the foregoing COVID-19 era amendments to loan documents are likely to remain pertinent and to be re-visited in the coming months. As government subsidies run-off, deferred taxes become due and other deferred payments bite, a delayed distress wave may yet hit the loan market.

9 Environment, Social and Governance (ESG) Investing

The pandemic has accelerated investors' focus on indications of long-term business sustainability, as well as financial performance. As such, certain leading investors (including pension funds and certain sovereigns) are now actively seeking ESG indicators as part of their investments and incorporating ESG investment analysis as part of diligence. The European loan market is at the forefront of these developments when compared to the U.S. loan market. ESG loans that require a borrower to meet defined sustainability targets to earn discounted pricing are an emerging trend, and continued interest in developing standardised, measurable and accountable ESG criteria (on an industry-by-industry basis) is also noteworthy. While regulation in this area is non-existent, the LSTA, LMA and AMPLA have promulgated certain voluntary principles in the area of green loans and ESG-linked loans. As criteria for earning ESG-based favourable treatment are refined, there will be continued focus on borrower reporting and accountability. Without adequate controls, the market remains concerned that ESG-based pricing reductions are merely a trend towards windfall-engineered discounted pricing for favoured companies (and sponsors).

10 Continued Aggressive Sponsor Terms

Despite certain additional restrictions described above finding their way into facility agreements as a result of increased COVID-19-related concessions, these were largely a temporary feature, with any permanent changes being an exception rather than the rule.

Cov-lite loans continue to be a common feature of the European loan market, accounting for over 86% of institutional loans in 2020 according to Reorg (with the remaining 14% being covenant-loose) and the watering down of documentary protections, in favour of borrowers, is now an embedded feature of the market.

Half Year Date	Covenant-lite Share of Institutional Loans in Europe
2H 2018	84%
1H 2019	88%
2H 2019	97%
1H 2020	83%

Source: Debtwire Par

Towards the end of 2020, borrowers (particularly those operating in high-demand sectors) were able to secure financing with relative ease as the markets returned to close to pre-pandemic levels, and overwhelmingly continue to do so on terms in line with, and sometimes even more aggressive than, what was available in the borrower-friendly pre-COVID-19 market. The year 2020, although ending with a reduced volume of European leveraged loans when compared to 2019, continued the long-term convergence between loan and high yield bond terms, with sponsors in some cases cherry-picking the more borrower-friendly technologies from both and combining them.

Headline examples include:

- the number of so-called "high yield bonds in disguise" continue to hover around the 45% mark based on the number of deals analysed by Xtract in 2020. Such European leveraged loans adopt a high yield bond covenant package wholesale, through schedules often governed by New York law, in an otherwise English law-governed facility agreement. Sponsors are attempting, with increasing frequency, to import this style of aggressive documentation seen on large-cap deals into terms for much smaller credits that would not otherwise be able to access the high yield bond market and its loose terms;
- Reorg reported that 36% of the deals it analysed in 2020 included both a high yield-style "builder basket" (permitting dividends to be paid up to an amount equal to a specified proportion of Consolidated Net Income (CNI) over the life of the deal) and a loan-style "available amount" basket, as exceptions to the covenant limiting restricted payments, with both baskets including a substantial starter amount (sometimes as high as 40–50% EBITDA for the CNI basket according to Xtract), thereby creating more capacity for value leakage to equity investors;

Half Year Date	Presence of CNI Builder Basket and Available Amount (% of European deals reviewed by Reorg)
1H 2019	6%
2H 2019	21%
1H 2020	30%

Source: EMEA Covenants by Reorg

- increasing flexibility in the time at which financial ratios can be calculated (for example, in relation to the incurrence of additional debt under a ratio-based basket), including as at the most recent date for which the borrower has "sufficient available information" to make the relevant

calculation (which may be made by reference to latest internal management accounting rather than against the quarterly and annual financial statements that are prepared in accordance with applicable accounting standards and accompany compliance certificates). Xtract have also reported seeing the calculation date for ratio-based debt incurrence tests being loosened from the date of entry into a legally binding commitment to incur the debt, or the date of incurrence itself, to any date as determined by the borrower in good faith, thereby giving further power to borrowers to cherry-pick the most favourable time to test the compliance of a transaction with its covenant terms;

- an increase in the use of "no worse" tests in complying with a debt covenant. This flexibility was sometimes afforded to borrowers where debt was being incurred in connection with an acquisition only, permitting the debt to be incurred where leverage post-acquisition was no worse than immediately prior thereto. However, this flexibility has increasingly been extended to include a broader range of transactions, or even to any transaction involving the incurrence of new debt;
- a further expansion of the scope of forward-looking *pro forma* adjustments to EBITDA, allowing expected synergies and cost savings as a result of acquisitions, disposals, restructurings, cost-cutting measures and similar actions to be given up-front effect in covenant calculations. Typically such adjustments were subject to caps of 20–25% of EBITDA with independent verification required above a certain threshold (generally 10–15% EBITDA). However, the requirement for independent third-party certification has increasingly fallen away throughout 2020; and
- an increase in the use of so-called "super-grower" baskets, whereby the relevant baskets grow in line with EBITDA growth, but conversely do not fall proportionately with any reduction in EBITDA. Reorg reported having seen this feature in only 2% of deals in 2019, but on 17% of deals in 2020. Accordingly, if the performance of the borrower's business was to decline after an initial period of EBITDA growth, the capacity of the baskets will be kept at their "high water mark" – the consequence of which is brought into stark light by the impact of COVID-19 and the recasting of many businesses' prospects in a post-pandemic landscape.

11 Leverage and Pricing Amidst a Pandemic

Initial market reactions to COVID-19 saw pricing rocket in March in the leveraged loan market; however, as markets stabilised and investor appetite remained strong, pricing quickly tightened to almost pre-pandemic levels by the end of the year. The European pricing data below is illustrative:

Quarter Date	Weighted Margin (bps) (European *Pro Rata* Loan Pricing)	Weighted Margin (bps) (European Institutional Loan Pricing)
Q4 2019	334	353
Q1 2020	257	346
Q2 2020	279	531
Q3 2020	442	461
Q4 2020	439	401

Source: Debtwire Par

According to Debtwire Par, leverage on European LBOs averaged 5.8× in 2020, marginally below the 5.9× recorded in 2019, again providing evidence of the robustness of the European leveraged loan market in the face of the pandemic. The share of deals levered 6× or more increased to 46% in 2020 from 35% in 2019, though there was a decrease in deals at the upper end, with 8% of deals levered 7× or more in 2020, down from 12% in the prior year.

Year	Average Total Debt/EBITDA (x:1)
2020	5.8
2019	5.9
2018	6.0
2017	5.9

Source: Debtwire Par

However, according to LCD, sponsors' equity contributions for a European LBO remained high by comparison, at 57.4% for 2020 against approximately 48% in 2019.

12 Incremental Debt, Most Favoured Nation (MFN) and Maturity Exceptions

U.S. and European leveraged loan terms continue to offer numerous avenues to borrowers seeking to incur additional debt, both under and outside the facility agreement on a super senior, *pari passu*, and/or subordinated basis. Sponsors have continued to seek to hard-wire such additional debt capabilities into facility agreements from the outset in order to reduce (or otherwise make flexible) the number of conditions that must be met in order to do so. In European leveraged loans, additional secured debt incurrence (ranking *pari passu* with the existing senior debt and secured on the same collateral package) is generally permitted subject to compliance with a leverage-based ratio test. In addition to this, loan terms have increasingly featured a "freebie basket" (an entirely separate basket, permitting additional *pari passu* debt incurrence up to a fixed quantum, regardless of leverage). Reorg reports seeing this "freebie basket", in addition to the ratio-based basket, in around 68% of facility agreements in 2020 (and 43% of 2019 deals), illustrating that this is now an established feature at all levels of the European market. As noted earlier, Xtract has also pointed out the growing prevalence of "no worse" leverage baskets in this context, further establishing the loosening of terms restricting additional debt incurrence.

MFN protection (which limits the amount by which the pricing on certain types of additional debt exceeds the pricing of the original debt) was an area that took a real beating in 2020 from a lender perspective, with a multitude of carve-outs to traditional MFN protection being seen.

2020 saw an increased push from sponsors to determine MFN protection by reference to the margin on the additional debt, rather than a yield-based cap, with Reorg reporting that only 37.5% of deals in 2020 included a yield cap (with the remaining 62.5% including margin caps), compared to 73% in the first half of 2019. By linking MFN protection to margin rather than yield, interest rate floors, original issue discount and upfront fees are generally not taken into account, which would potentially allow borrowers to give preferential economic terms to lenders of additional debt, to the detriment of the existing lenders.

The MFN sunset period (after which the MFN construct no longer applies) was also successfully reduced to six months from the typical 12-month period in approximately 62% of the deals Reorg reviewed in 2020, compared to 30% in the previous year – a trend which and can now be viewed as a general market shift in Europe as opposed to being reserved for the hottest of credits on the market.

The year also saw an increase in the number of carve-outs from MFN protection. For example, 71% of deals analysed by

Reorg in 2020 gave no MFN protection to existing lenders if an incremental facility matured a certain length of time after the original debt, compared to 47% of deals in 2019. The most common maturity requirement in this context was 12 months after the original debt (in 53% of relevant deals). This MFN carve-out was also accepted for an incremental facility maturing six months after the original debt in 18% of 2020 deals reviewed by Reorg, up from the 2% seen in 2019.

Another valuable (at least from a borrower's perspective) and increasingly popular carve-out from MFN protection was with respect to debt incurred to fund acquisitions, investments, JVs and/or capex. This carve-out was seen in 31% of deals reviewed by Reorg (up from 12% in 2019), and is useful for sponsors operating a "buy and build" strategy, enabling them to fund bolt-on acquisitions using add-on facilities without triggering MFN protection provisions.

Similarly, Xtract reported that 2020 increasingly saw debt incurred outside of the framework of a facility agreement (i.e. side car debt) not being subject to the same MFN, amortisation and maturity protections as debt incurred under the facility agreement. Increasingly, no MFN protection applied in respect of that additional side car debt, and it was free to mature ahead of the term debt under the existing facility agreement, with Reorg reporting an increase in the inclusion of these "inside maturity" baskets in 22% of European leveraged loans in 2020, compared to only 7% of 2019 loans.

13 Investor Pushback on Aggressive Covenant Terms

Borrowers did not have it all their own way in 2020. Investor pushback during the syndication process on leveraged loans remained a feature of the market, as the fight against top-of-market terms trickling down into small to mid-market credits continued. The erosion of certain pricing protections was at the forefront of this battle, with Xtract reporting successful pushback on several occasions against triple margin step-downs (albeit Reorg reported seeing only a quarter of a turn of de-leveraging being required for each step down on the more aggressive deals it analysed, compared to the usual half a turn). In a similar manner, investors showed resistance to a *de minimis* threshold applying to MFN protection on additional debt incurrence, with Reorg reporting that only 9% of deals in 2020 included this carve-out (a similar figure to 2019), which illustrates a push from debt investors to limit acceptance of such feature to the most desirable of credits only.

The "dividend-to-debt toggles" seen in 2019, which allow a borrower to sacrifice restricted payment capacity in exchange for an increase in the amount of additional debt that it can incur, featured in around 16% of credit agreements analysed by Xtract in 2020, a similar proportion to 2019 deals. This ability to convert restricted payment capacity to debt capacity is particularly useful for a borrower that has restricted payment capacity but no cash available to make such a payment, or for a distressed borrower that could benefit from the additional liquidity afforded by additional debt incurrence. Unsurprisingly, this is another sponsor-driven term that lenders are keen to limit to an anomaly, being accepted only on a handful of top-tier sponsor financings.

Another area of understandable focus for market participants in the current climate has been transfer provisions, with lenders and sponsors alike pushing for a shift in terms in their favour. 2020 saw some wins for debt investors, including reductions in the minimum hold and transfer amounts, the inclusion of deemed consent periods and the removal or reduction of prior notification or notice periods to transfer provisions. Reorg reported nearly 10% of the deals it analysed in 2020 had all or some of these changes made to the transfer provisions in favour of the lenders during the syndication process. It should be noted, however, that this area saw less investor focus than pricing and debt capacity in 2020, and the overall trend for more restrictive transfer regimes continued in general, as discussed further below.

Given the period of unprecedented uncertainty occasioned by the pandemic, increased scrutiny was seen in relation to financial reporting requirements in syndication, as debt investors sought greater visibility over the borrower's financial performance. According to Xtract, reporting periods were successfully shortened, with several Q4 2020 deals containing a requirement to deliver quarterly financial statements within 45–60 days of the end of each quarter (against a more borrower-friendly allowance of 90 days). Similarly, annual financial statements were often being required for the financial year ending 2020 rather than from 2021 onwards (on new transactions completed during 2020, where often annual financials are only required after one full financial year following completion) and annual management presentations to lenders were made an automatic requirement (rather than following a majority lender request only).

14 Asset Sales

Many European leveraged loans have imported a high yield bond-style asset sales covenant in recent years (a provision fairly typical in the U.S. leveraged loan market), giving borrowers broad discretion to undertake asset sales provided certain conditions are met. These conditions generally include a requirement to ensure that such disposals are for fair market value, with at least 75% of the consideration received in cash and cash equivalent investments, and a requirement to use the disposal proceeds in excess of a set threshold to prepay existing debt or to reinvest those proceeds in the borrower's business within a set period (typically up to 365 days + 180 days (if committed)). This construct already represents significant erosion to the traditional lender-friendly covenant from English law leveraged loans in years gone by, where asset disposals were tightly controlled and the proceeds were generally required to be used to pay down the existing lenders.

However, in 2020 borrowers found additional ways to weaken the asset sales covenant, including by removing the cash consideration requirement in the covenant, and the addition of a *de minimis* threshold to the fair market value and cash consideration requirements, which allow disposals valued below such a threshold to be made for less than fair market value and to be paid in kind. Further weakening of this covenant was seen through expansion of the permitted uses of such asset sale proceeds, including to fund restricted payments and make permitted investments.

Trends in Asset Sales Covenant	2019	2020
Fair market value with no cash consideration requirement	4%	14%
De minimis carve-out for 75% cash consideration requirement	22%	30%
De minimis carve-out for fair market value requirement	8%	9%
Restricted payments permitted to be made from disposal proceeds	4%	20%
Excess proceeds subject to a leverage reduction test	11%	19%

Source: EMEA Covenants by Reorg

15 Transfers

The tightening of the transfer regime has been an ongoing focus for sponsors and borrowers seeking greater control and visibility over the composition of their lender group. Sponsors have chipped away at these provisions for a number of years, with some of these watered-down terms being seen in the overwhelming majority of deals such that they have become accepted as the market standard. In Europe, examples include the fact that the borrower's consent right over transfers to non-whitelisted entities now generally falls away only on the occurrence of a non-payment or insolvency event of default (rather than any event of default) and the same limited fall away applying to borrower consent on transfers to distressed debt funds and loan-to-own investors, with Reorg reporting these weakened terms featuring in 89% and 72% of deals, respectively.

One notable development in the leveraged loan market, which originally gained traction in 2019, was the inclusion by sponsors of "anti-net short" provisions in the transfer regimes set out in credit agreements. These provisions are designed to provide sponsors with greater control over the identity of their portfolio companies' debt investors, and to curtail net short debt activism by restricting the extent to which lenders with a net short position in the underlying credit can trade into the borrower's debt. A net short lender is a lender that would stand to benefit economically from a default under the loan documentation or the insolvency of a borrower, by holding a short position created by purchasing a credit default swap or a similar derivative instrument (which would pay out in such circumstances). This of course creates a divergence in the aims of such a net short investor and the goals of par lenders and sponsors, which can produce serious difficulties for borrowers and sponsors in trying to agree consensual transactions with their lenders.

Albeit initially gaining momentum in the U.S. leveraged loan market, there have been increasing attempts (seen in 8% of deals reviewed by Reorg up from 3% in 2019) by borrowers and sponsors to import anti-net short provisions into European loans this year, which were seen in the following forms:

- an absolute block on transfers to net short lenders or the power to withhold borrower consent at any time to lenders who incorrectly represent their net short status;
- requiring borrower consent (in its absolute discretion) for any transfer to an anti-net short lender; and/or
- disenfranchising any net short lenders from lender consent thresholds and any other lender instruction to the agent to take any action under the loan documentation (including the issuance of enforcement instructions).

16 The Rise of "Auto-cures"

Reorg reported that "auto-cures" were seen for the first time in the market on highly aggressive deals (approximately 17% of all 2020 deals in Europe analysed by Reorg), which would allow a financial covenant default to be cured at any time (rather than only in the typical 20-business-day period after delivery of a compliance certificate showing a covenant breach), even after the relevant cure period has ended and without necessarily requiring the injection of additional sponsor equity, by simply retesting the covenant with more up-to-date figures such as monthly management accounts.

Importantly, this provision effectively creates an open-ended cure period and accordingly increases the level of risk on lenders seeking to accelerate their debt, who may not know, at the point at which an acceleration notice is issued, whether the borrower has any more up to date financial information showing that it is back in compliance with its financial covenant. Furthermore, it provides a trump card to sponsors, in allowing them to open restructuring discussions with lenders, safe in the knowledge that they can inject funds to cure a historic covenant breach should those negotiations fail at any time, whilst remaining in control of their equity.

17 Rise in Restructuring

2020 was the year that broke the decade-long growth cycle in the U.S. and European leveraged market; however, the level of disruption to date has not impacted whole economies but rather specific sectors that were profoundly affected by the pandemic, such as retail, transport, automotive and oil & gas. Market participants saw a rise in restructurings but not nearly at the levels that were expected in March, which is reflected in the distress ratio (the ratio of loans trading below 80 in the secondary market), which tightened to 2.6% in December, having hit a historical peak of 35.6% in March, according to LCD.

The unparalleled government and central bank intervention, action from sponsors and investors to avoid COVID-19-induced defaults, and an abundance of liquidity in the market combined with weak credit documentation over the past few years has helped to curtail high levels of insolvencies and to keep defaults in check. The corporate casualties to insolvency seen in the year, such as some of the retail and leisure industry giants, were largely businesses which were already on the brink of a collapse, with COVID-19 merely providing the final push over the edge. Fitch Ratings reported that the default rate in 2020 was just 3.7% for loans, up only 0.9% from the end of 2019, and a strong final quarter in 2020 would suggest that the level of defaults will remain low during the first half of 2021. However, there is a growing feeling among some market participants that once the temporary life support provided by government and central bank stimulus measures is withdrawn, a wave of defaults and restructurings will be triggered.

18 Security

The guarantor coverage requirement in European leveraged loans typically requires group companies who together generate at least 80% of the group's consolidated EBITDA to grant guarantees and security over their assets in favour of the lenders, with an associated requirement for all "Material Subsidiaries" (being those contributing 5% or more of the group's total EBITDA) to do the same, except in each case where certain "agreed security principles" provide otherwise. A guarantor coverage test has long been a standard feature in the European market – according to Reorg, 2020 saw 95% of European leveraged loans contain such a requirement, up from the 90% seen in 2019.

2020 saw further attempts by sponsors to narrow the security package offered to lenders, including by limiting the scope of the security package to just shares, material bank accounts and intra-group receivables and expanding the list of jurisdictions where no guarantees and security can be required beyond the usual few jurisdictions where taking security is known to be incredibly difficult or costly. In some cases, the 80% guarantor coverage test and 5% "Material Subsidiary" requirement was tested only by reference to the "restricted group" of entities which are subject to the credit agreement's covenants, or to a sub-set of group companies that are incorporated in a pre-agreed list of security jurisdictions, thereby limiting the "true" level of credit support received by lenders (Reorg noted this feature was seen in 53% of 2020 deals, compared with 42% in 2019). Certain aggressive deals also gave credit for the EBITDA generated by any subsidiary whose shares are subject to security (regardless of whether that subsidiary is in fact a guarantor itself) – as seen in 8% of transactions analysed by Reorg in 2020, up from 4% in 2019.

However, Xtract reported seeing greater lender scrutiny on guarantor coverage levels at the syndication stage in the deals they viewed in the later part of 2020, with the concept of pre-agreed security jurisdictions being successfully removed, or at least expanded to cover more jurisdictions than initially proposed.

19 LIBOR Transition

December 31, 2021 is fast approaching, being the date on which the LIBOR interest rate benchmark will cease to be published (subject to extension). LIBOR has of course been embedded in loan documentation across the globe for many years, and will be replaced by alternative, risk-free rates (RFRs). This leaves just under one year for firms to phase out and to remove their reliance on the benchmark in both new and legacy loans.

The following RFRs have developed as the preferred rates in each of the key currencies impacted by LIBOR's cessation:

Currency	Preferred RFR	Description	Working Group
GBP	Reformed SONIA (Sterling Overnight Index Average)	Unsecured overnight sterling transactions negotiated bilaterally	Working Group on Sterling Risk-Free Reference Rates
USD	SOFR (Secured Overnight Financing Rate)	Secured, based on transactions in the U.S. Treasury repo market	Alternative Reference Rates Committee
JPY	TONAR (Tokyo Overnight Average Rate)	Unsecured rate based on uncollateralised overnight call rate market transactions	Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks
CHF	SARON (Swiss Average Rate Overnight)	Secured rate based on data from the Swiss repo market	Swiss National Working Group on Swiss Franc Reference Rates
Euro	€STR (European Short-Term Euro Rate)	Unsecured rate to reflect wholesale euro unsecured overnight borrowing transactions with financial counterparties	Working Group on Euro Risk-Free Reference Rates

Currency-specific working groups have issued milestones for the transition, including for LIBOR to no longer be used from the end of March 2021 in new transactions. Whilst the adoption of RFRs and progress has been noticeable in the derivatives and LIBOR-linked securities markets in 2020, the pace has been slower in the leveraged market, with most new loans still being LIBOR linked.

The bottleneck in the European loan market for the replacement of LIBOR can largely be attributed to the lack of coherent market practice on the matter. Reorg recently reported that, following analysis of 100 syndicated loan agreements from January 2019 to December 2020, the majority had adopted a "wait and see" approach, incorporating only the UK Loan Market Association's (LMA) amendment mechanics whereby the discontinuance of LIBOR serves as the trigger for amendments to the facility documentation (requiring majority lender and borrower consent). Notably, only a minority of deals contained specified RFRs or a switch mechanism to move from LIBOR to a set RFR at the relevant time. Reorg noted that their research highlighted many market participants are deliberately waiting for a market consensus to develop before transitioning loans, particularly as a number of key concerns and uncertainties have emerged:

- a lack of consensus as to which replacement benchmark(s) to adopt and how different benchmark replacements for different currencies are to be rolled into one credit;
- a lack of clarity as to the effect a particular replacement benchmark will have on pricing (particularly given the desire that the amendments should leave lenders and borrowers in the same economic position as they are currently); and
- internal back office systems and third-party IT systems are still being changed and adapted to accommodate any future replacement benchmarks that are adopted.

The regulators do have a possible safety net on the horizon in the UK following the introduction of the Financial Services Bill in October 2020, which would give the FCA new powers to address "tough legacy contracts" and allow it to designate LIBOR as a "critical benchmark" to continue to publish it in certain circumstances and under a new methodology (known as "synthetic LIBOR"). The safety net remains under discussion including the definition of "tough legacy contracts" and will very much be a last resort (and not an easy fallback) where there is genuinely no realistic ability to renegotiate or amend a contract to reference an alternative benchmark before the 31 December deadline.

Deals in 2021 will soon therefore have no choice but to move to RFRs and a wave of "re-papering" will need to be implemented to transition legacy loans with each contract to be re-negotiated separately. Data from the UK Loan Market Association (LMA) released in December showed that 27 new loan agreements had been signed and made public in LIBOR jurisdictions that make reference to RFRs, illustrating that the transition is taking place, albeit slowly. The LMA has further published guides and drafting forms, including in January 2021 when exposure drafts of two multicurrency term and revolving facilities agreements which incorporate backward-looking compounded RFRs were released. However, the LMA recognises that there is no established market consensus on the implementation of RFRs in leveraged loan agreements as yet. It is now up to market participants to push ahead in lending based on RFRs and therefore facilitate the development of a unified market approach.

In the U.S., U.S. dollar LIBOR loans continue to be underwritten, with SOFR replacement mechanics. The market for SOFR leveraged loans in U.S. dollars is non-existent. How the transition, as a practical matter, is to be effected remains unclear. The effective date for transition was previously set for December 31, 2021, but it was extended in 2020 through June 2023, due to lack of market readiness and the complexity of the process. The risk of a disorderly USD benchmark transition weighs heavily on the shoulders of regulators. The ARCC paced transition plan, and related efforts, is a continued valiant attempt to induce voluntary (or quasi-voluntary) transition. The transition is, of course, complex, expensive and multi-year. Whether the extra transition time is used productively is an open question. Regulators and legislators will likely have to take a heavier hand to effect transition in the remaining time.

With the de-dollarisation of London (with the FCA effectively abandoning its unique (and somewhat anomalous) position to regulate the Eurodollar market via USD LIBOR) and the post-Brexit risk of the EU white-anting London's role in Euro-based transactions, a noteworthy trend for 2020 was a structural degradation of London as a financial centre for non-sterling based transactions. As a corollary, the transition of regulatory authority over U.S. dollar benchmarks to U.S. regulators is a work in progress as an uptick in SOFR-based deals slowly gains traction. Market participants have adopted a "wait and see" approach to USD LIBOR transition, including with respect to how SOFR's lack of both a credit spread (i.e., the gap arising between the secured risk-free overnight swap rate and the unsecured interbank rate that imbeds the credit risk between banks) and term structure will be resolved. The "encouragement" of U.S. regulators (i.e., the Fed, Office of the Comptroller of the Currency and the FDIC) to banks to stop using LIBOR in new contracts as soon as possible (and no later than the 2023 deadline) is a relatively light touch approach that may not continue as we approach the deadline.

In March 2021, the FCA announced that LIBOR settings either will cease to be provided by any administrator or will no longer be representative (i) after June 30, 2023, in the case of the principal U.S. dollar LIBOR tenors (overnight and one, three, six and 12 months), or (ii) after December 31, 2021, in all other cases (e.g., sterling, euro, Swiss franc and Japanese yen settings and one week and two-month U.S. dollar settings). On the same day, the IBA made a related announcement. The FCA and other regulators have emphasised that, despite any continued publication of U.S. dollar LIBOR through June 30, 2023, no new contracts using U.S. dollar LIBOR should be entered into after December 31, 2021. In short, it currently appears highly probable that LIBOR will be discontinued or modified by December 31, 2021 or June 30, 2023, depending on the currency and tenor. In the case of "tough legacy" contracts, the FCA indicated that it is taking steps to "reduce disruption in these cases" and is pursuing the publication of certain LIBOR settings on a synthetic basis; the precise nature of this synthetic arrangement is still to be determined. Bank of England Governor Andrew Bailey said "[w]ith limited time remaining, my message to firms is clear – act now and complete your transition by the end of 2021".

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The Rise of the SPAC

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One of the most notable trends in corporate investment and finance in the United States over the past several years has been the rapid growth in the use of special purpose acquisition companies (known as "SPACs", and sometimes referred to as "blank check companies") as an alternative to the more traditional initial public offering ("IPO") process that has for years been the primary means used to change a private company into a publicly listed company. There are a number of metrics that can be used to measure the increase in the number of SPACs, but the two most commonly cited are the number of IPOs of SPACs and the number of completed business combinations between SPACs and target companies (each explained further below). As the table below shows, there was a steady increase in both SPAC IPOs and completed SPAC business combinations in the US in 2017, 2018 and 2019, and then a dramatic increase in both SPAC IPOs (over 300% from 2019) and SPAC business combinations (over 125% from 2019) in 2020.

	2017	2018	2019	2020	2021 (as of 01/29/2021)
SPAC IPOs	34	46	59	248	91
SPAC Business Combinations Completed	13	23	28	64	8

At the time of writing, 2021 is on track to far surpass the 2020 numbers if current trends continue through the end of the first half of the year, which seems likely. Also, as of January 29, 2021, there were a further 91 SPAC IPOs and 60 SPAC business combinations pending.[1]

Brief History

The first SPAC was created by David Nussbaum, Roger Gladstone and Robert Gladstone of GKN Securities in 1993. The product achieved some success in the 1990s, though it later fell out of favor due to a number of factors, including the dot-com bust and the legal travails of GKN Securities in the late 1990s. David Nussbaum then went on to co-found EarlyBirdCapital, Inc., which in 2003 began acting as a fairly prolific lead manager or co-manager underwriting SPAC IPOs as SPACs began their resurgence as a vehicle for smaller companies to go public at a time when the market had a limited appetite for small-cap and micro-cap IPOs. At that time, SPACs were able to benefit from a certain amount of "regulator arbitrage" regarding the level of disclosure required at the time the SPAC completed its business combinations with a target operating company, since the post-business combinations SPAC was only required to file a current report on Form 8-K, and not the more onerous Form S-1 registration statement required for an IPO. In 2011, the United States Securities and Exchange Commission ("SEC") began requiring SPACs to file a so-called "Super 8-K" disclosure report within four business days following its business combination. The Super 8-K, unlike a regular Form 8-K report, required substantially the same information required in a Form-10 registration statement, including three years of audited financial statements of the target business, prepared in compliance with Public Company Accounting Oversight Board rules. In spite of this change, SPAC IPOs continued to be deployed over the following few years, with 9, 10, 12, 20 and 13 occurring in 2012, 2013, 2014, 2015 and 2016, respectively, before beginning their more rapid climb in 2017.[2]

Formation & Structure

In the US, the modern SPAC is generally a Delaware corporation or Cayman Islands company (or occasionally a British Virgin Islands company) that is formed by a financial investor or manager, or a team of such persons or entities ("Sponsor"), as a "shell" company for the specific purpose of raising equity capital through an IPO, and then deploying that capital through a business combination with a targeted private company (the "Business Combination" and "Target," respectively). The SPAC's charter documents require that the SPAC effect a Business Combination within a certain period of time (typically within two years of the SPAC's IPO). The deadline may vary somewhat, and it may also be possible to extend the deadline with the consent of the SPAC's shareholders or upon certain triggering events (like the entry into definitive documentation for a Business Combination).

If the SPAC does not consummate a Business Combination within the allotted time, then it will be liquidated in accordance with its charter documents. The consummation of the Business Combination, after which the SPAC ceases to be a shell company, is also referred to as the "de-SPAC." In addition, the specific requirements for companies imposed by the relevant stock exchange where the SPAC is to be listed will dictate features like minimum number of issued shares, minimum share price at IPO and minimum market value upon initial listing.

Sponsor

The Sponsor is the driving force behind the SPAC – it forms the SPAC; provides management and guidance; conducts the Target search; and pays most of the SPAC's non-deferrable costs and expenses until the completion of the Business Combination. Most Sponsors are experienced participants in the public and/or private equity capital markets, including private equity sponsors, hedge funds, growth equity funds and individual investors. In some cases, the Sponsor may be a collaboration between or

among financial investor(s) and experienced corporate leaders or operators with relevant business sector experience. According to a recent analysis from McKinsey & Company, "SPACs that are led or co-led by operators rather than solely by investors tend to outperform throughout the deal cycle. One year after taking a target public, operator-led SPACs traded about 10 percent higher than their sector index and much better than other SPACs."[3] Additionally, a successful Sponsor will have the infrastructure to identify the right Target, and the right contacts to negotiate the Business Combination without a prolonged and costly auction or bid process.

As compensation for providing the leadership and operating capital, the Sponsor is allocated founders' shares in a separate class of stock for a nominal purchase price (also called the "promote"). The promote will usually equal 20% of the SPAC's total post-IPO shares. The Sponsor will also have the ability to purchase warrants, redeemable at a premium above the IPO share price. The aggregate costs of these warrants will usually be approximately 2.5% of the IPO price, and the proceeds of that sale will be used to pay IPO expenses (including a 2% initial underwriting fee) and other pre-Business Combination costs (and the Sponsor will have no right to retrieve that money if the SPAC is liquidated). The founders' shares will also include anti-dilution protection, providing for conversion into public stock equal to 20% of the total amount of outstanding shares following the de-SPAC process, although in some cases the Sponsor will ultimately waive part of that dilution protection as an accommodation to other investors and shareholders. Also, until the de-SPAC occurs, only the holders of the promote shares will be able to vote for the SPAC's board of directors, and the Sponsor will not receive management fees.

The IPO and the Trust

Since a SPAC has no history of operations, liabilities or assets (other than some cash), the IPO process is relatively quick and inexpensive, and the underwriter of the IPO will defer part of its underwriting fee until the de-SPAC is completed to preserve the SPAC's initial capital. Investors in the IPO will purchase "units" in the SPAC (usually for a nominal price of $10 per unit), each of which consists of one common share in the SPAC and one fractional warrant to purchase additional shares (typically between 1/5 and 1/2 of a share) at a share price 15% above the IPO price, which warrants will become detachable from the shares not long after the IPO.

The cash proceeds of the IPO are then placed into an inviolable trust account and invested in low-risk assets like short-dated treasuries. Until the SPAC undertakes a Business Combination, the funds in the trust may only be released for certain specific purposes (like paying taxes), and may not be used to pay for the SPAC's search for a Target. Each share sold in the IPO has a right to a ratable share of the funds in the trust account upon a redemption of that share, which redemption will occur if the SPAC is unable to consummate a Business Combination within the allotted time period, or at the election of the individual shareholder at the time of a Business Combination, or at the time of a shareholder vote to extend the deadline to consummate a Business Combination. Because the redemption right is a right to a ratable share of assets, any fluctuations in the SPAC's share price during the period between the IPO and the de-SPAC will not affect the redemption value of the share. Interestingly, because of the strong redemption right, certain hedge funds and other investors that wish to accumulate warrants for later sale or exercise, but do not desire to hold common shares, may buy SPAC units at the time of the IPO, then detach the warrants and sell the shares – and if the shares are trading at or above the IPO price, they will essentially receive the warrants for free. Other investors may do the converse – selling the warrants when they detach and retaining the common shares.[4]

Alternative Structures

The structure described above is generally representative of the vast majority of SPACs that have been brought to market in the last few years. In 2020, certain Sponsors resolved to innovate and launched SPACs with some notable differences. The most discussed was Pershing Square Tontine Holdings, Ltd. ("PST"), sponsored by funds managed by Bill Ackman's Pershing Square Capital Management ("Pershing"), which had its IPO in June of 2020. With gross proceeds of $4.0 billion, it is the largest SPAC IPO to date, eclipsing the $1.8 billion of gross proceeds from the next largest SPAC IPO, Churchill Capital Corp. IV.[5] In addition, Pershing has committed to purchase up to $3.0 billion worth of additional units at the time of a Business Combination under a forward purchase agreement with PST. PST sold its units for $20 each in the IPO (instead of the usual $10 per unit) and each unit included a 1/3 share warrant, but only 1/3 of that warrant (or a warrant for 1/9 of a share) is actually detachable and able to be traded separately, while the remaining 2/9 warrant is to remain attached until a de-SPAC. But the reason for including "Tontine"[6] in the name of the SPAC is that if a share is redeemed at the time of a Business Combination, then the accompanying non-detachable warrants will be ratably redistributed among the shareholders who do not redeem their shares. Additionally, Pershing has not taken the typical 20% Sponsor promote, but instead spent $65 million to purchase warrants to buy 5.95% of the common shares of SPAC outstanding immediately following a Business Combination, on a fully diluted basis.[7]

Another modified SPAC structure that appeared in 2020 is the "Stakeholder Aligned Initial Listing" (or "SAIL"), developed by Morgan Stanley & Co. LLC, and featured in the Health Assurance Acquisition Corp. SPAC which had its IPO in November of 2020. The SAIL structure is designed to link the ultimate percentage of the post-Business Combination common shares received by the Sponsor to the post-Business Combination share price performance, with dilution of the other shareholders by the Sponsor shares to occur more gradually over time.[8]

Both of these alternative structures appear to be designed at least in part as a response to criticism in the press regarding the size and dilutive effect of the Sponsor promote.[9]

Business Combination and de-SPAC

Target Search

Once the IPO is concluded, the SPAC must begin searching for a Target with all due speed, as the countdown to the SPAC's liquidation deadline has begun. With the limited funds available for business and legal advisors, and for due diligence investigation, the SPAC will want to avoid a protracted auction process and will try to gain "exclusivity" with the Target before commencing detailed negotiations. The ideal Target will have a strong management team (ideally with some public company experience), and well-developed internal financial reporting and control structures. Likely candidates include (a) private equity portfolio companies nearing the end of their "turn around" cycle (e.g. Vivint),[10] (b) subsidiaries or business units of larger public companies that are suitable for a carve-out (e.g. Ardagh Metal

Packaging),[11] and (c) companies that have grown organically to the point that they are seriously considering (and preparing for) an IPO (e.g. DraftKings).[12]

From the perspective of a potential Target (including investors in the Target considering an exit), a Business Combination with a SPAC *in lieu* of an IPO has a number of potential advantages, including, among others: (a) a means to avoid volatility in the equity market (especially with the ongoing pandemic and its effects on public markets); (b) avoiding some of the time, cost and distraction of preparing for an IPO in an uncertain environment; (c) the ability to directly negotiate a valuation of the Target; (d) the ability to include financial projections in disclosure materials (where they would not normally be included in an underwritten IPO filed on a Form S-1); (e) access to the Sponsor's personnel, expertise and experience; and (f) a motivated buyer with a ticking clock. Balanced against those are some disadvantages, including (1) no reverse-breakup fee or other meaningful remedy for buyer breach (because the SPAC cannot use funds in the trust account to pay such a fee), (2) trading in the shares of the post-Business Combination entity may be thin if shareholder redemptions have been substantial, and (3) uncertainty as to the amount of cash that will actually be available at the closing of the Business Combination because of the shareholders' right to redeem their shares. This last concern can be addressed, or at least ameliorated, by the inclusion of a "minimum cash" or "available cash" condition precedent in the business combination agreement (so that if there is insufficient cash payment by the SPAC, the Business Combination will not occur), and/or by raising additional committed financing, usually through an agreement to sell shares to sophisticated investors in a private issuance of public equity (a "PIPE") that funds contemporaneously with the closing of the Business Combination. In addition, the Target's shareholders can expect to retain more post-Business Combination rollover equity (which may be subject to certain restrictions on an immediate sale), and receive significantly less cash than they would in an acquisition by a private equity fund.

Business Combination Process

Where a SPAC is acquiring an entity domiciled in in the United States, the Business Combination may occur between the Target and a wholly owned merger subsidiary of the SPAC, with the SPAC becoming a passive holding company and the Target being the survivor of the Business Combination and a wholly owned operating company or intermediate holding company; however, if there is concern about triggering a change of control or similar provision under one or more of the Target's material agreements (including debt financing facilities), or a concern about material tax consequences, then other Business Combination structures may be used. The actual documentation is generally similar to that used for other public company-style mergers and acquisition transactions, but with a few significant differences, including the frequent incorporation of a "minimum cash" provision and the absence of a reverse-breakup fee, as noted above, and usually the absence of provisions relating to a committed debt financing. Also, except in cases where the Sponsor and its affiliates hold sufficient voting shares to approve the Business Combination, or a vote is not otherwise triggered because of the structure of the Business Combination, the SPAC's entry into the Business Combination will require the approval of a majority of the SPAC's public shareholders. It should also be noted that shareholders are permitted to vote in favor of a Business Combination while also electing to redeem shares. Generally, the Sponsor is required to vote in favor of the Business Combination.

Unlike a leveraged private equity acquisition where there is usually an incurrence of significant term loans and/or bonds at the time of the acquisition, a SPAC transaction is much more likely to include an injection of significant additional equity financing at closing, via a PIPE. Advantages of PIPEs include allowing equity investors to evaluate the SPAC on the basis of the Target and its business, rather than just as a "blank check" company. This also has the benefit of demonstrating investor confidence in the *pro forma* valuation of the post-Business Combination entity. Using a PIPE investment also avoids burdening the newly public company with excessive debt. An analysis done by SPAC Research in September of 2020 revealed that, for the period reviewed (from the start of 2019 through September 9, 2020), equity capital raised from PIPEs accounted for 38.3% of the aggregate equity capital used in SPAC Business Combinations, with IPO proceeds held in the trust account making up 48.3%.[13]

Upon the completion of the Business Combination: (a) the Sponsors' promote shares will convert into the public shares (except in the cases of PST, SAIL or other alternate structures), though they will usually remain subject to a lockup until the earlier of one year after the de-SPAC or the achievement of an agreed price increase and maintenance target; (b) the SPAC shareholder who elected to redeem their shares will receive their ratable share of the amount in the trust account immediately prior to the Business Combination; (c) any PIPE investors will receive their public shares; and (d) the post-Business Combination company trades as a publicly listed company. Because SPACs will typically merge with Targets at least three times their own size, even after accounting for any PIPEs investment and the dilutive effect of the Sponsor promote, it is likely that the Target's original shareholders will hold a majority of the public shares following the de-SPAC. That may seem counterintuitive if one thinks in terms of typical acquisitions, but ultimately makes sense when one remembers that the de-SPAC is an alternative to an IPO.

Debt in SPAC Business Combinations

Unlike private equity-led leveraged acquisitions, and many strategic acquisitions, most Business Combinations involving SPACs do not include a requirement to prepay the Target's existing credit facilities. In many cases, the business combination agreement will either not refer to the Target's credit facilities, or will contain just a general "conduct of business" covenant requiring the Target to comply with the terms of its credit facilities and maintain the credit facilities in effect. This is feasible because in most cases the Business Combination can be structured so that it does not violate the "change of control" or "change in control" event of default in the Target's credit facilities. In some cases, a Target's credit facilities will also include a "no fundamental change" (or similar) negative covenant that would be triggered by the Business Combination, but in such cases that provision may be waived by lenders holding a bare majority of the loans and/or commitments under the relevant credit facilities.

There are exceptions, however, where the business combination agreement will mandate or permit transactions with respect to the Target's credit facilities, including: (a) permitting the Target to incur a specific amount of additional indebtedness to fund a dividend recapitalization (e.g. CCC Information Services);[14] (b) in the case of a split-off or carve-out Business Combination, requiring a partial prepayment of the Target's parent's term loan facility and the release of any liens on the Target and its assets that were securing such term loan facility (e.g. Fertitta Entertainment);[15] or (c) requiring a prepayment of the Target's revolving credit loans, but not a termination or reduction of the revolving credit commitments (e.g. LiveVox).[16]

In a limited number of cases, the SPAC will obtain financing commitments, and the business combination agreement will include representations, warranties and covenants from the SPAC with respect to the committed financing, covenants of the Target to cooperate with the implementation and syndication of the committed financing, and customary "Xerox" protections for the "financing sources" (e.g. OneSpaWorld),[17] all in a form similar to that used in a leveraged acquisition. In such cases, the resulting credit facilities tend to closely resemble those used in private equity sponsor-led leveraged finance acquisitions, with a similar set of limited conditions precedent to closing and initial funding.

The Future

2020 was a banner year for SPACs, and thus far 2021 is looking like it will surpass it and drive SPACs to even greater heights. With SPACs becoming increasingly popular and accepted in both the equity capital markets, and the wider financial culture, the more traditional Sponsors are being joined by new entrants like former Disney executives Kevin Meyer and Tom Scraggs, whose Forest Road Acquisition Corp. recently entered into an agreement and plan of merger for a concurrent acquisition of The Beachbody Company Group, LLC and Myx Fitness Holdings, LLC.[18] Meyer and Scraggs are now collaborating with basketball legend Shaquille O'Neal to launch Forest Road Acquisition Corp. II, which is intended to focus on potential targets in the entertainment sector.[19] Further, activist investor Paul Singer's Elliott Management is reportedly also preparing to sponsor a SPAC in the $1 billion range;[20] in what might feel like an echo from past financial booms, a SPAC named "Just Another SPAC" filed its initial draft Registration Statement on Form S-1 on February 16, 2021;[21] and Pershing Square's Bill Ackman recently tweeted a link to a music video entitled "Spac Dream."[22]

Endnotes

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22. On February 8, 2021, Pershing Square's Bill Ackman tweeted a link to "Spac Dream" by Cassius Cuvée with the simple instruction: "Watch this." The respect appears to be mutual, because Cuvée name-checks "Bill SPACman" in the video; https://www.youtube.com/watch?v=9rHkXfaIRTM.

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Intellectual Property and Personal Data in Drop-Down Financings

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Introduction

An increasingly common form of liability management transaction in the leveraged finance market is a "drop-down financing", in which a borrower and a group of lenders create new financing that is structurally senior to an existing capital structure with respect to an asset or group of assets owned by a subsidiary that is not party to the pre-existing financing. A drop-down financing is fundamentally the sum of two related transactions. **First**, assets are transferred – typically, contributed – by a parent to a subsidiary that is not an obligor of the main pre-existing parent debt (the "drop-down" step); **second**, the subsidiary incurs or guarantees structurally senior debt secured by the contributed assets. There has been intense focus in the loan market on drop-down financings recently, as these transactions result in the creation of debt that is structurally senior to an existing secured financing using assets that may have been collateral to support that existing financing. The backdrop against which these transactions typically occur – a borrower in financial distress or at least anticipating and trying to avoid distress – can make the exercises challenging for all parties involved.

In several recent high-profile drop-down financings, the contributed assets, and, therefore, the collateral for the new financing, consist entirely or predominantly of intellectual property ("IP") and personal data, sometimes including the company's core brands and/or consumer and client data. This chapter explores the rationale for and benefits (to both borrowers and lenders to a subsidiary) of utilising IP and data as the underlying asset for these financings.

Brand Intellectual Property

There have been several drop-down financings in which brand IP has been contributed to the subsidiary and serves as the foundational collateral securing the financing. From a property or legal standpoint, the core brand usually consists of the trademarks epitomising a company's business. Generally speaking, in order to use a trademark without infringement, an entity either needs to own or have a licence to use the trademark. This principle also applies within a group of affiliated entities: if a trademark is owned by a parent's subsidiary (including after giving effect to a "drop-down"), the parent needs a licence from the subsidiary to use the trademark. The risk that a parent loses its licence to its core brand can be ignored or managed while the parent maintains sole control of the subsidiary, but that risk can suddenly become manifest and significant when third parties gain the power to interfere with that shareholder control, including as a result of lenders implementing customary secured creditor covenants or exercising remedies against the subsidiary. If, in such case, the parent loses its licence to use its core brand, whether as a result of the termination of the licence agreement with its subsidiary or the suspension of the licence, the results could be dire for the parent. Even if rebranding were possible – and in some cases, depending on the significance of the brand identity, it is not – a termination or suspension may not afford the parent an orderly transition period to continue its business operations with its core brand until rebranding takes place.

This leverage afforded to the subsidiary and the ability to concentrate the value of the enterprise in the subsidiary may not be as significant when other types of assets are contributed to a subsidiary, and it is one important reason why creditors value core brand assets as a basis for a drop-down financing. But there are others. For the same reasons that a core brand has value to the parent, it also has value to a third-party purchaser. Where the core brand is the "crown jewel" of the business, that value can be significant and concentrated in one trademark or a suite of related trademarks (as opposed to other asset categories – e.g., equipment, inventory or vehicles – where value may be spread out over a large number of assets or categories of assets that could be easily replaced). In a downside scenario, this concentration facilitates the purchase of the core brand by licensing companies whose goal is to monetise the brand through further licensing arrangements, without the need to purchase any "hard" assets from the company (which may not be owned by the subsidiaries).

In addition, trademarks can often be transferred among related legal entities and pledged to creditors quickly and efficiently and without third-party approvals. The transfer is typically effectuated through a relatively straightforward contribution agreement and related filings with the United States Patent and Trademark Office ("USPTO"), and the security interest in favour of the lenders to the subsidiary is documented in traditional pledge and security documentation, a "short form" version of which is filed with the USPTO along with other filings as necessary to perfect the security interest. Other asset classes such as real estate or vehicles can be substantially more difficult to transfer and encumber.

It is interesting to note that while patents and copyrights can also be transferred quickly and efficiently, patent and copyright assets have not been utilised as frequently as trademarks in recent drop-down financings.[1] A possible basis for this may be the comparative flexibility of that portion of IP law: depending on the particular property rights, the parent may be able to redesign its products or revise its software code such that it no longer infringes the transferred patent or copyright even if the parent's licence were terminated, reducing the value of the asset and the leverage of a creditor secured by it.

To be clear, there is no general structural reason that asset categories other than trademarks cannot be the basis of drop-down financings. The total mix of attributes described above,

however, explains why trademarks, and therefore a company's core brand, have been a preferred asset category to secure drop-down financings. The prevalence of IP in drop-down financings is certainly not a secret to loan market participants, and arrangers and creditors in recent years have been increasingly focused on including limitations in loan agreements on transfers of material IP. These limitations, which often focus on transfers of material IP to unrestricted subsidiaries or other non-loan parties (but many examples of which do not create special limitations on distributing material IP to shareholders), are intended to address the fact that "investments" and other baskets utilised under existing credit agreements to facilitate drop-down financings are typically available equally to IP and other asset categories. Having transfer limitations that focus solely on IP is not necessarily an approach that is too narrowly focused on historic transactions, since IP will likely continue to be a preferred asset category to secure drop-down financings. But market participants should strive to remember that IP-specific transfer limitations do not in any way limit drop-down financings secured by other asset categories, and those types of financings may be facilitated through the use of obvious, and potentially large but capped, "investments" baskets; through the use of less obvious and potentially uncapped baskets; or through the use of a combination of baskets.

Personal Data

To date, personal data has not played nearly the same role in drop-down financings as trademarks have, but there are recent examples of personal data being contributed along with core brands and/or other assets to form the collateral package for the financing. Personal data is information that can be used to identify individuals, which may include not only the names, physical and e-mail addresses, social security numbers and/or other identifying information of individuals, but also information relating to health, financial position and consumer/personal preferences. For many companies that sell goods or provide services to consumers, personal data is vital to their sales and services operations. As with trademarks, if personal data is contributed to a subsidiary, the parent must obtain rights from the subsidiary to continue to use the personal data, which rights could be terminated or suspended by the subsidiary in certain circumstances. The ability to terminate or suspend these rights, of course, can buttress the leverage that subsidiary lenders in a drop-down financing have over the parent (and its lenders). In addition, personal data may be valuable in its own right, independent of the core brand, as an asset that could potentially be sold to certain third parties either as a stand-alone asset or as a necessary or desirable component of a business line (whether of the parent or subsidiary) being acquired by a third party.

A key difference between trademarks and personal data in the context of drop-down financings is that the transferability of personal data to third parties or even to controlled subsidiaries is more complex and, as a result, the circumstances under which personal data can form the bedrock, or even a component, of the collateral package for a drop-down financing are more limited. The ability to transfer and/or pledge personal data is impacted not only by contract and privacy policies, but also by data privacy laws. If the parent acquired the personal data directly from an individual, the parent's privacy policy and notices provided to the individual will govern – and potentially limit – the parent's ability to use, transfer and/or pledge that personal data. On the other hand, if the parent acquired the personal data from a third party, any such use, transfer and/or pledge will be subject to the terms of the contract with the third party and the third party's own privacy policies and notices. In all cases, data privacy laws also need to be considered, as these laws may further limit the ability of the parent to transfer and/or pledge personal data. Depending on the jurisdictional expanse of the business and the proposed personal data to be transferred and/or pledged, multiple data privacy laws could apply (e.g., the General Data Protection Regulation ("GDPR") and the California Consumer Privacy Act). The full scope of these laws, and the myriad ways in which they apply to transfers and pledges of personal data, is beyond the scope of this chapter, but certain key considerations for drop-down financings are set forth in Annex I (see below). It is important to note that the complexity of and risks related to violations of data privacy laws are increasing, especially as the regulatory and legislative landscape continues to evolve rapidly, which demands due consideration in connection with the use of personal data in drop-down financings.[2]

Licence Agreements and Key Licence Terms

As discussed above, any IP or personal data contributed to a subsidiary in a drop-down financing must be licensed back to the parent in order for the parent to have continuing use of those assets. While a short-form licence agreement could generally address any IP or personal data concerns raised by the contribution, the subsidiary's rights under the licence agreement usually serve as a material component of the collateral package for the drop-down financing and provide meaningful collateral value to the subsidiary's lenders. During the term of the licence agreement, the parent will usually have exclusive rights to use the IP and personal data. These exclusive rights would encumber the IP and certain rights in the personal data in the event of a sale of the IP and/or personal data to a third party (as a result of a foreclosure or otherwise), which could severely limit the ability of the subsidiary lenders to monetise the IP and/or personal data following a default, unless the licence is terminated. To enhance the value of the collateral and the flexibility of the drop-down lenders' rights and remedies with respect to licensed collateral, there is often significant focus on, and negotiation of, the licence agreement's terms. While a comprehensive treatment of the terms of these licence agreements is beyond the scope of this chapter, there are certain key provisions to consider:

- **Ongoing Royalty Payments to the Subsidiary and Continued Use**. Lenders to a subsidiary often look to the licence agreement itself to generate meaningful cash flows for the subsidiary through ongoing royalty payments by the parent. This feature is of critical importance as such payments may be the primary (or sole) source of liquidity for the subsidiary and, therefore, the primary (or sole) source of cash available to make ongoing interest and other payments to the lenders. These royalty payments can be structured in a number of ways, including as "fixed" payments or as "percentage-based" payments tied to either the gross or net revenues of the parent or, alternatively, to some measure of the revenue attributable to the use of the IP itself. If the royalty payments are based on the use of the licensed IP, the subsidiary and its lenders may seek to protect the royalty payments by including covenants in the licence agreement obligating the parent to continue to use and invest in the IP by, for example, maintaining minimum advertising spending to support the brand and/or by not rebranding or launching potentially dilutive competing brands. To add to the complexity of these negotiations, royalty payments can be relatively large – in some cases, in excess of $50 million per year – and percentage-based royalty payments are sometimes coupled with minimum payment requirements. From the standpoint of creditors of the parent, the treatment of royalty payments under the

parent's debt facilities will depend on the corporate structure and the specific covenant package, but these arrangements may implicate both the investments and affiliate transactions covenants. Lenders to the parent may view these royalty payments as added leakage from their credit group, above and beyond the leakage resulting from the initial contribution of the IP to the subsidiary.

- **Exclusivity**. Absent a termination or suspension of the licence agreement, the parent will seek to retain exclusive rights to the IP so that competitors or other third parties cannot exploit the IP for their own benefit. Of course, in a non-distressed scenario in which the IP is owned by a controlled subsidiary, this is a non-issue. However, exclusivity becomes an issue for the parent in a distressed scenario in which the subsidiary's lenders seek to sell the IP to a third party. Unless the licence is already terminated, these third parties would purchase the IP subject to the exclusive licence to the parent, meaning that the third parties would effectively be purchasing a stream of cash flows from the parent and, if – and only if – the licence agreement is eventually terminated or suspended, the right to exploit the IP themselves or through licensing. While subsidiary lenders may view this type of exclusivity as an acceptable part of the overall drop-down financing structure, it puts greater importance on the financial terms of the licence and the termination and suspension triggers.
- **Termination and Suspension Events**. As noted above, termination and suspension events are critical for a number of reasons. From the parent's standpoint (and from the standpoint of its lenders), terminating or suspending the licence agreement could have existential consequences. From the standpoint of the subsidiary's lenders, the ability to terminate the licence agreement not only affords them negotiating leverage, but also provides them an avenue to sell the IP to a third party free and clear of the licence, permitting full realisation of the value of the asset through sale to a purchaser with the immediate ability to exploit the IP itself. Of course, termination of the licence agreement would also result in the subsidiary's loss of the related royalty stream. As a result of these high stakes, the range of termination events is often a key negotiation point, with some licence agreements containing only very narrowly tailored termination events (e.g., for failure to pay the ongoing royalty). The suspension of a licence agreement can also pose a meaningful threat to the ongoing operations of a parent, but may also provide the parent with a meaningful ability to cure the event that resulted in the suspension and, thereafter, resume use of the IP and personal data.
- **Treatment on the Parent's Bankruptcy**. If the parent files for bankruptcy protection under the United States Bankruptcy Code, the parent would have the ability to assume or reject its executory contracts (often including IP licences). In drop-down financings, the parties are often heavily invested in ensuring that the parent assumes the licence agreement. This is because, on the one hand, the parent will often need to have continued access to its core brand and personal data in connection with a reorganisation and, on the other, the royalty payments under the licence agreement will continue to support the subsidiary's debt expense. As a result, the licence agreements often include language specifically contemplating reorganisations and insolvencies, permitting assumption and providing for significant – and perhaps prohibitive – financial costs to the rejecting party.

These provisions are often collectively designed to provide leverage to the subsidiary lenders in a downside scenario as against the parent and, just as important, the parent's lenders. In many bankruptcy proceedings, a successful reorganisation of the parent depends on the reorganised parent having continued access to its core brand. Because of this, the pre-petition parent lenders who, upon the debtor's emergence from bankruptcy, may become equity owners of (or creditors to) the reorganised parent are often incentivised to agree to the relatively favourable treatment afforded to the subsidiary lenders in order to obtain continuing access to the core brand through a licence agreement.

Endnotes

1. Though patents and copyrights have been prominently used in some pharmaceutical and entertainment industry financings.
2. As an example, the GDPR includes fines for certain violations thereof in an amount up to 4% of a violating company's annual revenue.

Annex I

Key questions to consider in structuring drop-down financings secured by personal data include:

- Does the initial transfer of personal data to the subsidiary require updates to privacy policies or new consents? Depending on the nature of the personal information, the California Consumer Privacy Act ("CCPA") requirements around "sales" of personal information could require an updated notice, with the relevant consumers being given the right to opt out of the transfer. This could apply to both the initial transfer to the drop-down subsidiary as well as later transfers in connection with an exercise of remedies.
- Does the transfer of personal data to the subsidiary introduce new privacy law compliance burdens? If the subsidiary is incorporated in a new jurisdiction, that jurisdiction's data privacy laws may apply to all of the personal information held by the subsidiary regardless of its source. For instance, if the subsidiary is organised in Europe, the GDPR could extend to apply to all of the personal data held by it, even if the parent had historically kept its non-European data separate in order to limit the reach of the GDPR. This could introduce both operational and risk burdens as the company would now need to implement a programme to respond to data subject requests from a larger population and subject a broader set of data to the controls and potential fines under the GDPR.
- How should the transfer of personal data be structured from a "data controller" perspective? Companies will need to carefully consider whether the subsidiary should be treated as a data processor or data controller under the GDPR (and similar regimes) to ensure that responsibility for the data is maintained and that the relationships are appropriately documented. For instance, the GDPR requires that data controllers and data processors enter into contracts with, at least, a specific set of data privacy-driven terms and, depending on the arrangement between the data controllers, they could be jointly liable for any violations of the GDPR.
- Would the personal data be transferable in connection with an exercise of remedies if it is not transferred together with other assets? The CCPA includes exceptions to the concept of "sales" to the extent that the acquirer of the personal data assumes control of all or part of the associated business. Transfers of just the data may not fall within this exception and so could trigger the notice/opt-out mechanism described above. Additionally, attempts to sell personal data as a stand-alone asset out of bankruptcy have been challenged, with some resulting sales forcing the personal data to be sold to a buyer of at least some of the buyer's other assets.

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The Pandemic: A Regulatory Perspective

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The Pandemic

Last year's edition of this chapter, written just before the full extent of the pandemic's likely effect in the U.S. and globally became apparent, noted a substantial measure of uncertainty around the emergence of the novel coronavirus ("**COVID-19**"). In retrospect, 2020 and 2021 will long be remembered as a time that brought revolutionary changes in the shape of work and a level of dislocation unprecedented during the post-WWII period. In contrast to the OECD's earlier projection of decline in economic growth to 2.4%, the OECD estimates that global gross domestic product as a result of the pandemic has contracted by more than 4%, although China, with estimated growth of 1.8%, entered its recovery earlier than most other global market participants. The OECD projects that China will account for over one-third of world economic growth in 2021, while the contribution of Europe and North America "will remain smaller than their weight in the world economy."

The Response of the Federal Reserve

In the U.S., the Federal Reserve reported to Congress in February 2021 that:

> GDP is currently estimated to have declined 2.5 percent over the four quarters of last year [2020] and payroll employment in January [2021] was almost 10 million jobs below pre-pandemic levels, while the unemployment rate remained elevated at 6.3 percent and the labor force participation rate was severely depressed.[1,2]

The Federal Reserve Board ("**FRB**") responded aggressively to the pandemic, which Chair Jerome Powell has characterized as "the most severe [economic downturn] of our lifetimes." Early in the emergence of the pandemic in the U.S., the FRB confronted serious strains in short-term funding markets and among institutions engaged in liquidity transformation. In March 2020, there was a significant pullback from commercial paper, or "**CP**," markets. Data from the Federal Reserve reflects that CP borrowing rates for financial issuers, as measured in spreads for CP borrowing rates over Treasuries, spiked by about 200 basis points in March 2020, as investors grew reluctant to buy new CP.[3]

To add liquidity and foster credit provision in the CP market, the Federal Reserve intervened on March 17, 2020, establishing the Commercial Paper Funding Facility ("**CPFF**") to support the flow of credit to households and businesses with a credit facility designed to contain risk in an abruptly slowing economy.[4] The CPFF operated by providing a liquidity backstop to U.S. issuers of CP through a special purpose vehicle ("**SPV**") to purchase unsecured and asset-backed CP rated A1/P1 (as of March 17, 2020) directly from eligible companies. The CPFF program was established under the authority of Section 13(3) of the Federal Reserve Act, with approval of the Treasury Secretary, and supported by $10 billion of credit protection to the Federal Reserve in connection with the CPFF from the Treasury's Exchange Stabilization Fund ("**ESF**").

At the same time, some prime and tax-exempt money market funds experienced large redemptions, resulting in large outflows at corporate bond funds and exchange-traded funds, forcing the sale of assets, further depressing net asset values. Corporate bond funds play an important market function by providing daily liquidity. Significant asset sales can lead to runs, aggravating market stresses and threatening market stability.[5] The FRB responded to these challenges on two fronts: establishing the Primary Market Corporate Credit Facility ("**PMCCF**");[6] and the Secondary Market Corporate Credit Facility ("**SMCCF**")[7] on March 23, 2020.[8]

The PMCCF provides companies access to credit so that they are better able to maintain business operations and capacity during the period of dislocations related to the pandemic. The facility was open to investment grade companies, as well as certain companies that were investment grade as of March 22, 2020. The FRB established an SPV through which the PMCCF could make loans and purchase bonds.[9] The SMCCF was designed to support credit to employers by providing liquidity to the market for outstanding corporate bonds by purchasing in the secondary market corporate bonds issued by investment grade U.S. companies or certain U.S. companies that were investment grade as of March 22, 2020, as well as U.S.-listed exchange-traded funds whose investment objective is to provide broad exposure to the market for U.S. corporate bonds, with the intention of creating a portfolio that tracks a broad, diversified market index of U.S. corporate bonds. The Treasury, using funds appropriated to the ESF through the CARES Act,[10] made an equity investment in the SPV established by the Federal Reserve for the PMCCF and the SMCCF.

A fourth area of liquidity strain was in the U.S. Treasury market – one of the largest and deepest financial markets in the world. Treasury market conditions deteriorated rapidly in the second week of March, when a wide range of investors sought to sell Treasuries to raise cash. Foreign official and private investors, certain hedge funds, and other leveraged investors were among the big sellers. During this dash for cash, Treasury prices fell and yields increased, a surprising development since – in the usual race to value – Treasury prices typically rise when investors try to shed risk in the face of bad news or financial stress, reflecting their status as the ultimate safe asset. Although trading volumes remained robust, bid-ask spreads widened dramatically for less recently issued Treasuries, but this soon spilled over into

the more liquid recently issued segment of the market, as well as the futures markets, overwhelming the capacity or willingness of dealers to intermediate the Treasury market. The FRB responded by increasing the scope of its repurchase agreement (repo) operations,[11] bringing greater stability to the market and driving down the Secured Overnight Financing Rate, which had drifted up to more than 1.5%, to somewhere in the range of 0.01% to 0.1%.[12]

Bank Supervisory Relief

It is a testament to the post-financial crisis reforms that banks faced the COVID crisis with stronger balance sheets and more and higher-quality capital, more liquid assets, and less reliance on fragile funding. Nonetheless, the ensuing market dislocation challenged the banking sector. Many businesses, locked out of CP and corporate bond markets, drew down on their existing credit lines with banks in order to raise cash; bank commercial and industrial ("**C&I**") loans increased by nearly $480 billion in March – by far the largest monthly increase ever.[13] Nonetheless, the FRB and the Office of the Comptroller of the Currency ("**OCC**")[14] and the Federal Deposit Insurance Corporation ("**FDIC**,"[15] and together with the FRB and the OCC, the "**Agencies**"), which exercise federal authority over the most significant part of the U.S. banking sector, responded to the stresses on lending and liquidity resulting from the pandemic by relaxing some of the constraints on bank activities. These included:

- **Accommodative measures**:
  - On April 7, 2020, in the wake of the adoption of the CARES Act, the Agencies, the National Credit Union Administration ("**NCUA**") and the Consumer Financial Protection Bureau ("**CFPB**") issued an Interagency Statement encouraging financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations because of the effects of the pandemic. In particular, the Agencies recognized that loan modification programs might mitigate adverse effects on borrowers due to COVID-19 and announced that they would not criticize institutions for working with borrowers in a safe and sound manner. They also announced that supervised institutions would not be required automatically to categorize all COVID-19-related loan modifications as troubled debt restructurings.[16]
  - On August 3, 2020, the FRB and the other Federal Financial Institutions Examination Council ("**FFIEC**") members issued a joint statement discussing risk management principles as loans near the end of initial loan accommodation periods related to COVID-19. The statement includes principles for affected institutions considering accommodation options and for restructuring safe and sound credit extensions going forward. The Agencies encouraged financial institutions to consider prudent accommodation options that can ease cash flow pressures on affected borrowers, improve their capacity to service debt, and facilitate a financial institution's ability to collect on its loans.[17]
- **Discount window**: On March 16, 2020, the Agencies released an Interagency Statement encouraging banks to use the Federal Reserve's discount window.[18]
- **Intraday credit**: On March 15, 2020, the FRB issued a statement encouraging depository institutions to utilize intraday credit extended by Reserve Banks, on both a collateralized and uncollateralized basis.[19]
- **Capital**:
  - On March 17, 2020, the Agencies issued a statement on the use of capital and liquidity buffers stating that:

    > The agencies support banking organizations that choose to use their capital and liquidity buffers to lend and undertake other supportive actions in a safe and sound manner. The agencies expect banking organizations to continue to manage their capital actions and liquidity risk prudently.[20]

  - On March 17, 2020, the Agencies adopted an interim final rule that revised the definition of eligible retained income to make automatic limitations on capital distributions that could apply under the Agencies' capital rules more gradual.[21]
  - On May 15, 2020, the Agencies announced temporary changes to the supplementary leverage ratio to increase banking organizations' ability to support credit to households and businesses in light of the coronavirus response.[22]
- **Liquidity**:
  - On March 15, 2020, the FRB encouraged banks to use their capital and liquidity buffers as they lend to households and businesses who are affected by the coronavirus and for banks to use their capital and liquidity buffers to lend and undertake supportive actions in a safe and sound manner.[23]
  - On March 19, 2020, to support the flow of credit to households and businesses, the Agencies adopted an interim final rule to ensure that financial institutions will be able to effectively use the Money Market Mutual Fund Liquidity Facility ("**MMLF**") to enhance the liquidity and functioning of money markets and to support the economy. The interim final rule modifies the Agencies' capital rules so that financial institutions would receive credit for the low risk of their MMLF activities, reflecting the fact that institutions would be taking no credit or market risk in association with such activities. The change only applies to activities with the MMLF.[24]
  - On May 5, 2020, to support the flow of credit to households and businesses, the Agencies announced an interim final rule that modified the Agencies' Liquidity Coverage Ratio rule to support banking organizations' participation in the Federal Reserve's MMLF and the Paycheck Protection Program Liquidity Facility.[25]
- **Reserve requirements**:
  - On March 15, 2020, the FRB reduced deposit reserve requirement ratios to 0%, effective on March 26, the beginning of the next reserve maintenance period. This action eliminates reserve requirements for thousands of depository institutions and will help to support lending to households and businesses.[26]
  - On April 24, 2020, the FRB announced an interim final rule to amend Regulation D (Reserve Requirements of Depository Institutions) to delete the six-per-month limit on convenient transfers from the "savings deposit" definition.[27]
- **Appraisals**: On April 14, 2020, the Agencies (including the CFPB and the NCUA) issued an interim final rule temporarily to defer real estate-related appraisals and evaluations under the Agencies' interagency appraisal regulations.[28]

Some of the foregoing measures have been the subject of criticism by progressive lawmakers.[29] Although not framed directly as a defense of these measures or response to any criticisms, the FRB has observed:

> Banks entered this crisis with much stronger balance sheets than the last one—with more and higher-quality capital, more liquid assets, and less reliance on fragile funding. This is a testament to reforms implemented by the Fed and other agencies in the aftermath of the [Great Financial Crisis] GFC.[30]

However, the pandemic has not resulted in a simple reprise of the distress suffered by banks during the GFC. In contrast, the real challenges have been in the non-banking sector:

> While the continued ability of banks to lend to creditworthy borrowers has been good news, a lot of credit in the United States is provided by nonbank financial institutions and markets. Indeed, almost two-thirds of business and household debt in the United States is held by nonbanks, though much of the origination of the debt held by nonbank investors is done or facilitated by banks. And in March, this lending by non-banks dried up. In addition to the strains in short-term funding markets, some vital long-term lending markets were virtually closed. As the extent of the economic disruptions became clear, the cost of borrowing rose sharply for businesses issuing corporate bonds, for state and local governments issuing longer-term municipal debt, and for issuers of asset-backed securities (ABS), such as originators of auto and student loans. Spreads in some cases widened to post-crisis highs. Exacerbated by the problems in short-term funding markets and at bond funds, market functioning and liquidity deteriorated, and issuance of new debt in long-term markets slowed markedly or stopped altogether. Effectively, the ability of creditworthy households, businesses, and state and local governments to borrow, even at elevated interest rates, was threatened.[31]

Thus, the COVID event has made it harder for many borrowers – businesses as well as households – to repay their debt or find credit. Encouraged by supervisors, banks have been working actively with their customers and have agreed to grant forbearance to millions of borrowers. At the same time, banks have recognized that the credit quality of many loans has deteriorated considerably, and they have made sizable provisions to prepare for expected loan losses.

The FRB has also noted that recent research shows how COVID-related increases in the cost of borrowing U.S. dollars through foreign exchange ("**FX**") swap markets resulted in higher borrowing costs for U.S. corporations in the leveraged loan market.[32]

The Federal Reserve System has had standing U.S. dollar liquidity swap lines in place since October 31, 2013, with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank ("**ECB**"), and the Swiss National Bank.[33] The cost of borrowing U.S. dollars through FX swap markets increased significantly in the beginning of the pandemic in February 2020, indicated by larger deviations from Covered Interest Rate Parity ("**CIP**").[34] On March 19, 2020, the New York Fed entered into temporary U.S. dollar liquidity arrangements (swap lines) with the Reserve Bank of Australia, the Banco Central do Brasil, the Danmarks Nationalbank (Denmark), the Bank of Korea, the Banco de Mexico, the Norges Bank (Norway), the Reserve Bank of New Zealand, the Monetary Authority of Singapore, and the Sveriges Riksbank (Sweden). An analysis published by the European Central Bank described the COVID-related effects on the FX swap markets:

> In the context of high market volatility and risk aversion due to the coronavirus (COVID-19) pandemic, the EUR/USD FX swap basis spread – an important indicator of US dollar funding costs for European banks – rose significantly. The FX swap basis spread is the difference between the average implied interest rate on borrowing US dollars in the EUR/USD FX swap market and the US dollar risk-free rate, which is represented by the US dollar overnight index swap (OIS) rate. Under normal market conditions, the FX swap basis spread is small and only reflects temporary market frictions, such as those related to balance sheet reporting dates. However, from the end of February, European banks increased the premium that they were willing to pay in order to secure US dollar funding in the EUR/USD FX swap market, which resulted in a wider FX swap basis spread. This reflected a large increase in the demand for US dollars as market participants hoarded cash in anticipation of potential liquidity outflows to the real economy. European banks and corporates that generally have significant business exposure to the US dollar were also affected. On 28 February the overnight FX swap basis spread reached 25 basis points, doubling in only three days. At the same time, the FX swap basis spread in the three-month maturity widened to 49 basis points on 3 March, which was 30 basis points above the average level recorded in February 2020….[35]

The FEDS Note paper notes that with the growth in funding of leveraged loans primarily from non-bank investors, and specifically Collateralized Loan Obligations ("**CLOs**"), foreign bank participation in those instruments directly transmitted FX swap pricing in to the leveraged loan market. It observes that, while foreign banks only hold a small portion of leveraged loans directly, foreign bank and foreign non-bank investors are significant participants in this market through holdings of CLOs and mutual funds. While comprehensive data is lacking, it is estimated that foreign investors hold about 20% of U.S. CLOs.

Thus, the FEDS Note paper asserts that the Federal Reserve System's initiatives to provide global U.S. dollar liquidity contributed to easier financial conditions for U.S. corporate borrowers., indicated by larger deviations from CIP. CIP deviations narrowed again when the Federal Reserve System expanded its swap lines to support U.S. dollar liquidity globally – by enhancing and extending its swap facility with foreign central banks and introducing the new temporary Foreign and International Monetary Authorities (FIMA) repurchase agreement facility.

The Monetary and Other Tools Available to the Federal Reserve

On August 27, 2020, the Federal Open Market Committee ("**FOMC**")[36] unanimously approved a revised Statement on Longer-Run Goals and Monetary Policy Strategy[37] that represents a significant change to the Federal Reserve's monetary policy framework.[38] The new framework has important implications for the conduct of monetary policy going forward. At the September 16, 2020 FOMC meeting, the Committee made material changes to its forward guidance for the future path of the federal funds rate to bring the guidance into line with the new policy framework and, in so doing, provided transparent outcome-based guidance linked to the macroeconomic conditions that must prevail before the Committee expects to lift off from the effective lower bound ("**ELB**").[39] As is recognized in the Statement on Longer-Run Goals and Monetary Policy Strategy, this leaves the Federal Reserve more reliant on unconventional strategies, such as longer-term asset purchases, interventions to directly target longer-term yields (similar to the Bank of Japan's yield curve control approach), and negative nominal interest rates.

Because the FRB had already exhausted its ability to respond to the financial crises through its management of rates – having hit the "effective lower bound" of its traditional central bank monetary powers, as evidenced by the programs described above and others adopted separately by the FRB following its powers under 13(3) of the Federal Reserve Act – the FRB reversed course on its reduction of its balance sheets assets. Total assets of the FRB increased from $870 billion in August 2007, to $4.5 trillion in early 2015. Between October 2017 and August 2019, reflecting the "normalization policy," total assets declined to under $3.8 trillion. Beginning in September 2019, and steeply accelerating in late February 2020, assets began to increase, and are now nearly $7.6 trillion.[40]

FRB Chair Jerome Powell has commented on these issues:

> The Fed's response to this crisis has been guided by our mandate to promote maximum employment and stable prices for the American people, along with our responsibilities to promote the stability of the financial system. As noted in our Statement on Longer-Run Goals and Monetary Policy Strategy, we view maximum employment as a broad-based and inclusive goal. Our ability to achieve maximum employment in the years ahead depends importantly on having longer-term inflation expectations well anchored at 2 percent. As we reiterated in today's statement, with inflation running persistently below 2 percent, we will aim to achieve inflation moderately above 2 percent for some time so that inflation averages 2 percent over time and longer-term inflation expectations remain well anchored at 2 percent. We expect to maintain an accommodative stance of monetary policy until these employment and inflation outcomes are achieved. With regard to interest rates, we continue to expect it will be appropriate to maintain the current 0 to ¼ percent target range for the federal funds rate until labor market conditions have reached levels consistent with the Committee's assessment of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time.
>
> In addition, as we noted in today's policy statement, we will continue to increase our holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward our maximum-employment and price-stability goals. We believe the increase in our balance sheet this year has materially eased financial conditions and is providing substantial support to the economy.
>
> * * * *
>
> Many of our programs rely on emergency lending powers that require the support of the Treasury Department and are available only in very unusual circumstances, such as those we find ourselves in today. These programs serve as a backstop to key credit markets and have helped to restore the flow of credit from private lenders through normal channels. We have deployed these lending powers to an unprecedented extent, enabled in large part by financial backing and support from Congress and the Treasury.
>
> Although funds from the CARES Act will not be available to support new loans or new purchases after—of assets after December 31, the Treasury could authorize support for emerging lending facilities, if needed, through the Exchange Stabilization Fund. When the time comes, after the crisis has passed, we will put these emergency tools back in the box.[41]

While asset purchases support the economy broadly, Chair Powell specifically adverts to the slowness of decisionmakers to deploy fiscal tools necessary to meaningfully reinflate the economy, reflecting that we "are all Keynesians now:"[42]

> As I have emphasized before, these are lending powers, not spending powers. The Fed cannot grant money to particular beneficiaries. We can only create programs or facilities with broad-based eligibility to make loans to solvent entities with the expectation that the loans will be repaid. Many borrowers are benefiting from these programs, as is the overall economy. But for many others, getting a loan that may be difficult to repay may not be the answer. In these cases, direct fiscal support may be needed. Elected officials have the power to tax and spend and to make decisions about where we, as a society, should direct our collective resources. The fiscal policy actions that have been taken thus far have made a critical difference to families, businesses, and communities across the country. Even so, the current economic downturn is the most severe of our lifetimes. It will take a while to get back to the levels of economic activity and employment that prevailed at the beginning of this year, and it may take continued support from both monetary and fiscal policy to achieve that.[43]

Fiscal Relief

The Biden Administration has strongly supported the Consolidated Appropriations Act, 2021,[44] a $2.3 trillion spending bill that combines $900 billion in stimulus relief for the pandemic with a $1.4 trillion omnibus spending bill for the 2021 federal fiscal year (combining 12 separate annual appropriations bills). The Act has passed the House and passed the Senate, with some revisions, at the time of writing pending final approval in the House and submission to the President.

Bank Lending

While banks have continued to lend, there has been a tightening of bank lending standards over 2020. In the January 2021 FRB survey of senior loan officers,[45] banks reported having tightened standards for C&I loans to firms of all sizes, with notable differences in reported changes across bank sizes. On net, modest shares of large banks reported having eased standards to large and middle-market firms, while modest shares of large banks reported having tightened standards to small firms. In contrast, some small banks reported having tightened their C&I lending standards to firms of all sizes. Banks cited the uncertain economic outlook and industry-specific problems as the main reasons for tighter lending, not capital or liquidity pressures. Although the overall contraction in credit availability is less severe than during the GFC, tighter lending standards may make it difficult for some businesses and households to borrow during the pandemic.

Shared National Credit Program

The Agencies annually publish a Shared National Credit ("**SNC**") report reflecting an interagency review and assessment of risk in the largest and most complex credits shared by multiple regulated financial institutions. In their most recent report,[46] the Agencies observe that SNC risk is high and increased over 2020 as a result of COVID, which negatively affected the economic environment, and the magnitude and unknown duration of the pandemic have created significant operating challenges and uncertainty for many borrowers, with a substantial increase in defaults and downgrades.

Special mention[47] and classified[48] SNC commitments rose significantly during 2020, from 6.9% in 2019 to 12.4% in 2020. The Agencies report that FDIC-insured institutions substantially increased their loan loss reserves from March 31 to September 30 of 2020, a component of tier 1 capital, and the aggregate tier 1 risk-based capital ratio reported on the FDIC Quarterly Banking Profile rose by nearly a percentage point.

The volume of SNC commitments with the lowest supervisory ratings (special mention and classified) continue to be concentrated in transactions that agent banks identified and reported as "leveraged loans." The increase in non-pass commitments was largely because of borrowers in industries heavily affected by COVID, such as entertainment and recreation, oil and gas, real estate, retail, and transportation services. Although U.S. and foreign banks own the largest share of SNC commitments, including the majority of SNC commitments to borrowers in the COVID-impacted industries, non-banks continue to hold a disproportionate share of all loan commitments rated below a supervisory pass. The gap is narrowing as banks' share of special mention and classified credits have increased from 35% in 2019 to 45% in 2020, largely due to downgrades in oil and gas and other COVID-impacted obligors that tend to be held more widely by banks.

Agent bank-identified leveraged loan commitments represent 48% of total SNC commitments, 66% of special mention commitments, and 78% of classified commitments. Total agent bank-identified leveraged loan commitments saw a nominal increase during the past year. Agent bank-identified leveraged lending remains a primary focus of SNC review samples given the volume, asset quality, and layered underwriting risk within the segment. The 2020 SNC samples covered 35% of agent bank-identified leveraged borrowers and 43% of agent bank-identified leveraged lending commitments. Banks hold $1.5 trillion or 63% of agent bank-identified leveraged loans, most of which consists of higher rated and investment grade equivalent revolvers. Non-banks primarily hold non-investment grade equivalent term loans. Economic stresses brought on by COVID-19 had a significant impact on obligors within the SNC population. While the pandemic impacted many obligors, the level of risk was magnified in leveraged lending transactions when the obligor was operating in a COVID-19-impacted industry. The special mention and classified rate in this segment rose from 13.5% to 29.2% between third quarter 2019 and third quarter 2020. Total commitments to borrowers in industries significantly affected by COVID-19 totaled $1.1 trillion or 21.6% of total SNC commitments.

Leveraged Loans

As has been the case in past years, the SNC Review 2020 casts a disapproving eye on leveraged loans, focusing on the fact that many leveraged loans exhibit "layered risks" that inhibit the ability of lenders to manage the underlying credit. These "layered risks" include:

- high leverage;
- aggressive repayment assumptions;
- weakened covenants; and
- permissive borrowing terms that allow borrowers to increase debt, including draws on incremental facilities.[49]

The Agencies observe that:

> Credit risk associated with leveraged lending is high and increasing. While leveraged loans comprise nearly half the SNC population, they represent a disproportionately high level of the total special mention and classified exposures. The previous SNC reviews found that many loans possess weak structures….
>
> The volume of leveraged transactions exhibiting these layered risks increased significantly over the past several years as strong investor demand for loans enabled borrowers to obtain less restrictive terms. The accumulated risks in these transactions and the economic impact of COVID-19 have contributed to a significant increase in special mention and classified exposures. Borrowers with elevated leverage are especially vulnerable as they often have reduced financial flexibility to absorb or respond to external challenges such as the COVID-19 pandemic.[50]

The Agencies caution that the current credit environment may have complicated effective risk management processes by changing the premises on which repayment capacity assessments were made, the uncertainty around assumptions of economic recovery and the need to incorporate appropriately the consequences of new debt that many borrowers added to build liquidity as a result of pandemic-related economic stress. As a result of these concerns, the Agencies threaten that stress testing procedures should reflect the possibility that loss and recovery rates may differ from historical experience and identified risks exert a greater negative impact on capital and earnings.

It is undoubtedly comforting to the Agencies that "nonbank entities hold a significant portion of non-pass leveraged commitments and non-investment[51] grade equivalent leveraged term loans, while the SNC leveraged exposure held at banks is primarily comprised of investment grade equivalent revolving facilities."[52] Although, the resulting comfort is tempered by the fact that some banks seek higher yields (and greater risk) in the current low rate environment.

ECB Concerns Regarding the Pandemic Reponse

Unsurprisingly, the pandemic is not a supervisory concern only in the U.S. In a January speech,[53] Andrea Enria, currently Chair of the ECB's Supervisory Board, noted that the ECB perceives significant credit risk concerns among European banks. Almost all significant banks (80%) exhibited loan quality that was addressed with credit risk recommendations, with an increase in the number of findings concerning credit risk of 79%.

While the credit provisioning by European banks in the second quarter of 2020 was anticipated to absorb most of the risk associated with the pandemic, the ECB's expectation is that the social restriction policies that became necessary during the last quarter of 2020 – and that are still in force – will demand additional provisioning by the banks.

This conclusion is shared by the central bank side of the ECB, who share the supervisory view that European bank credit provisions are below the levels observed in other jurisdictions (such as the United States), below the levels reached in response to the financial crisis and, more generally, below the levels predicted by historical elasticities to macroeconomic developments. In particular, Chair Enria noted that bank optimism might be swamping their credit judgment, noting that in November 2020, the ECB identified that some models on probabilities of default used by European banks had become less sensitive to changes in GDP. He observed that this might indicate that the banks have implemented model changes aimed at artificially reducing the measurement of credit risk.

ECB Concerns Regarding Leveraged Loans

Chair Enria also expressed concerns about the exposure of European banks to the leveraged loan market, acknowledging that the ECB has been focused on the risks in the leveraged loan

markets for a while. He observed that, in their search for yield, European banks have ventured into the leveraged loan market in quite a significant way. In 2017, the ECB issued guidance for European banks cautioning them only exceptionally to engage in highly leveraged transactions,[54] and to limit the exposures to so-called covenant-lite transactions. Despite that guidance, Chair Enria reports that the exposures to highly leveraged transactions represent around 60% of leveraged loan exposures. The exposure to covenant-lite transactions is also quite high.

Consequently, the ECB is increasing its pressure on European banks, including using its stress testing tools, to assess and apply supervisory oversight with respect to these exposures. Chair Enria clearly signals the ECB's intention to use strong measures – including incremental capital charges – with respect to European banks that are not adequately responsive to the ECB's supervisory pressure.

The U.S. Debate over Leveraged Loans

GAO

In December 2020, the U.S. Governmental Accountability Office ("**GAO**")[55] reported its assessment of the potential risks to financial stability posed by leveraged loans and CLO securities.[56] The GAO's Report takes notice of the negative impact on the leveraged loan and CLO markets of the pandemic, particularly in credits to consumer-facing industries like airlines, non-essential retail, and hotels. While this resulted in generally depressed asset valuations, increased volatility, and impaired market functioning across the economy, and particularly for riskier assets such as leveraged loans and riskier CLO securities, the GAO concluded that the regulators have not been able to conclude that leveraged lending activities contributes significantly to widespread financial instability. While risks remain and the pandemic has increased the probability of default for leveraged loans and reduced expected recoveries on defaulted loans, as of September 30, 2020, senior CLO securities had generally retained their ratings, and the leveraged loan and CLO markets appeared to be recovering.

The GAO report is particularly valuable as a source of data concerning the structure of the leveraged loan and CLO securities markets. Based on available data from multiple sources, the GAO estimates the size of the leveraged lending market as of year-end 2018 at approximately $2.6 trillion. This consist of the following components:

- $548 billion in leveraged loans issued outside of the broadly syndicated loan market by private debt funds and business development companies, which generally hold their loans to maturity, according to the Office of Financial Research ("**OFR**");[57]
- $871 billion in debt held by banks to support the syndication of leveraged loans or the securitization of loans into CLO securities; and
- $1.147 trillion in institutional leveraged loans (generally held by institutional investors other than banks).

The GAO specifically mentions a number of factors that render the CLO market more stable:

- Diversification and transparency. CLOs are backed by simpler, more diversified pools of collateral than crisis-era collateralized debt obligations ("**CDOs**"). CLO portfolios are generally diversified across firms and sectors, and information on the individual corporate loans held in CLO portfolios is available to investors and credit rating agencies.[58]
- Funding stability. Present-day CLOs have less liquidity risk than crisis-era CDOs. According to the Federal Reserve and OFR, CLOs have more stable funding than crisis-era CDOs because they issue securities with maturities similar to the loans in which they invest, whereas some crisis-era CDOs relied on funding from short-term debt. In addition, present-day CLOs are generally insulated from market value swings, and CLO managers generally are not forced to sell assets during periods of stress.[59]
- Higher levels of subordination. Present-day CLOs have higher levels of subordination, providing greater protection or credit enhancement to securities in the senior CLO tranches. Thus, CLOs today are better able to absorb defaults in the underlying collateral loans before the AAA-rated CLO securities face losses. The GAO observes that all three large credit rating agencies stated that after the COVID-19 shock, subordination had provided a satisfactory buffer to risks for the senior CLO securities as of September 30, 2020.[60]

Based on its observation that the risks associated with leveraged lending are associated less with complex entities that might warrant designation as being systemically significant, the GAO's focus shifts to the sufficiency of the mandate and powers of the Financial Stability Oversight Council ("**FSOC**"), revisiting an earlier GAO Report on this subject.[61] The GAO repeats its recommendation that the structure of FSOC be revised to enhance its ability to address systemic risk more directly:

> FSOC's designation authorities may not allow it to comprehensively address systemic risks arising from financial activities like leveraged lending, in which multiple types of financial entities participate…. [T]here may be risks that arise from widely conducted financial activities, such as leveraged lending activities, that FSOC cannot address through its [payment, clearing, and settlement (PCS) designation authority] and for which entity-by-entity designation may not be effective or feasible. In those cases, FSOC can recommend regulatory action, but it cannot act or compel action even with a broad consensus among FSOC members. In the event that regulators do not or cannot act to mitigate systemic threats, FSOC's authorities to respond are limited. As a result, FSOC may lack the tools needed to comprehensively address systemic risks that may emerge. In addition, without requisite authorities, it is difficult for Congress to hold FSOC accountable for addressing threats to financial stability.
>
> [W]e recommended that Congress consider whether legislative changes were necessary to align FSOC's authorities with its mission to respond to systemic risks. As of September 30, 2020, Congress had not amended FSOC's authorities in this regard. Accordingly, we reiterate our 2016 recommendation that Congress [make changes to FSOC's mission, its authorities, or both, or to the missions and authorities of one or more of the FSOC member agencies to support a stronger link between the responsibility and capacity to respond to systemic risks].[62]

House Hearing

A U.S. House of Representatives hearing on the systemic risks of leveraged loans in mid-2019 highlighted challenges to addressing coherently the risks identified by the GAO.[63] Not only is there little political consensus around the risks of leverage lending, but there is not a clear framework for assessing the possibility of resulting financial stability risks.

Exit from the Pandemic: Possible Cliff Effects

While the emergence of effective vaccines permits policymakers to contemplate the eclipse of the pandemic, the end of eviction and other moratoria, the expiration of regulatory relief, as well as the inevitable cessation of fiscal and central bank support threaten an economic cliff in which the practical consequences of the pandemic may come crashing down. Such measures will not only impair liquidity support to firms and households when phased out, but may also trigger the reimbursement of temporary relief or payment of deferred obligations. Not only may the recovery be less robust than hoped, the cliff effects could be substantially larger. In a January 2021 speech, ECB Chair Enria also shares what might be important insights on the possible cliff effects of moratoria and other support measures that have provided banks and borrowers with vital breathing space as the social restrictions were implemented. In Chair Enria's view, banks should act early to avoid these measures generating damaging cliff effects when they simultaneously expire.[64] The simultaneous termination of policy measures could trigger a protracted downward shift in the recovery path.[65]

The ECB warns that in Europe, countries relying on moratoria, direct support and tax deferrals may be more exposed to cliff effects in policy support for 2021. Across the largest euro area countries, simulations suggest that such effects would be most pronounced in the Netherlands, mainly owing to the phasing-out of a large part of the direct support coupled with the ending of tax deferrals and short-time working schemes. Likewise in Italy, the broadly simultaneous expiration of the majority of loan moratoria, exit from short-time working schemes and ending of direct support would indicate a substantial drop in the support to the recovery in 2021. In Germany, the extension of short-time working schemes until the end of 2021 would only partially cushion the exit from quite generous direct support measures and tax deferrals. By contrast, the strong reliance in France and Spain on guarantee schemes mitigates the cliff effects in 2021, while the impact could be further alleviated by the extension of short-time working schemes in these countries. Along with the reduction in support to the real economy, the phasing-out of policy measures could adversely affect banks' balance sheets and capitalization. Phasing out the various measures could have an adverse impact on credit risk and banks' ability to lend to the real economy, as well as the potential default of assets and related adverse changes to reserves for credit loss.

It will be important for prudential authorities to take account of assessments of potential cliff effects on the financial system and the broader economy from the phasing-out of support measures. This will be pertinent for the speed and timing of the tightening of supervisory requirements and the replenishment of macroprudential buffers.

Overall, there are substantial short-term risks associated with the withdrawal of policy support, while medium-term risks of protracted policy support should also not be ignored. The enacted policies have been instrumental in preserving financial stability and reducing the impact of the pandemic on the real economy. Looking ahead, exiting from the extraordinary support should be timed carefully, given the very sizeable cliff effects for the economy and the banking sector, and the interactions between the monetary, fiscal and prudential policies.

Endnotes

1. Board of Governors of the Federal Reserve System ("**FRB**"), Monetary Policy Report (February 19, 2021), avail. at https://www.federalreserve.gov/monetarypolicy/files/20210219_mprfullreport.pdf. The Federal Reserve System is the central bank of the United States and comprises the FRB, which governs the Federal Reserve System, and the 12 regional Federal Reserve Banks, through which the Federal Reserve System engages in its banking and open market operations. The FRB also has supervisory and regulatory oversight of bank holding companies, their non-bank subsidiaries, state banks that are members of the Federal Reserve System, state regulated branches and agencies of foreign banks, and foreign banking organizations that are treated as bank holding companies as a result of having a U.S. branch, agency or commercial lending subsidiary.
2. The FRB reports that the level of labor force participation is down nearly 2 percentage points, from approximately 64% to approximately 62%. *Id.*, at 6. According to the U.S. Bureau of Labor Statistics, this is up from a low of approximately 60% in April 2020. *See* Civilian labor force participation rate, avail. at https://www.bls.gov/charts/employment-situation/civilian-labor-force-participation-rate.htm. This suggests that unemployment is even more acute than the figures suggest.
3. Congressional Reseach Services, COVID-19: Commercial Paper Market Strains and Federal Government Support, at 2 (April 13, 2020), avail. at https://crsreports.congress.gov/product/pdf/IN/IN11332.
4. https://www.federalreserve.gov/newsevents/pressreleases/monetary20200317a.htm.
5. J. Liang, Hutchins Center Working Paper #69, Corporate Bond Market Dysfunction During COVID-19 and Lessons from the Fed's Response (October 1, 2020), avail. at https://www.brookings.edu/wp-content/uploads/2020/10/WP69-Liang_1.pdf ("**Corporate Bond Market Disfunction**").
   There is an expectation that the systemic role of such vehicles, including similar funds outside the U.S., will be the subject of further study – and possibly regulation – in the aftermath of the Pandemic.
6. https://www.federalreserve.gov/monetarypolicy/pmccf.htm.
7. https://www.federalreserve.gov/monetarypolicy/smccf.htm.
8. In *Corporate Bond Market Disfunction*, *supra*, n.5, observing the increasing role of bond funds and stress unlike that occurring with respect to corporate bonds during the financial crisis, the authors note:

   > The corporate bond market has grown rapidly in the past decade, reaching about $9.6 trillion in 2019, up from $5.5 trillion in 2008. The investment-grade (IG) bond sector is about six times the size of the high-yield (HY) sector (Ohara and Zhou, 2020). Corporate bonds provide well over half of the debt financing for domestic nonfinancial corporate businesses, similar to the share in the UK and much higher than elsewhere in Europe.
   >
   > As the corporate bond market has grown, ownership has changed dramatically. While insurance companies remain the largest holder, mutual funds increased their holdings more quickly and exceeded $2.2 trillion in 2020 Q1…. Net assets of long-term

> mutual funds that invest primarily in corporate bonds have risen substantially since 2008: investment-grade corporate bond mutual funds rose to $2.159 billion in 2019 from $738 billion in 2008, and net assets of high-yield corporate bond mutual funds rose to $337 billion in 2019 from $116 billion in 2008 (Investment Company Institute).

Id., at 3. The commencement of the Pandemic had a profound effect on the market:

> Corporate bond spreads began rising sharply in early March as concerns about the virus began to escalate. The Fed's announcement on March 13 to purchase Treasuries and to repo Treasuries did little to halt the rise in spreads; neither did the announcement of the PDCF on March 17 and its implementation on March 20. In the days before the PMCCF/SMCCF announcement on March 23, spreads of IG bonds were up by 3.5 percentage points from the beginning of the year, and spreads on HY bonds were up 6.5 percentage points. The ratio of the IG-to-HY spread was 25 percent higher, a highly unusual occurrence, suggesting some significant dislocations in investment-grade bond market pricing that were not related to rising credit risk.

Id., at 4.

9. The Coronavirus Aid, Relief, and Economic Security Act ("**CARES Act**"), Pub. L. 116–136, 134 STAT. 281 (03/27/2020), avail. at https://www.congress.gov/116/plaws/publ136/PLAW-116publ136.pdf.
10. *Id.*
11. *See* Federal Reserve Bank of New York, Statement Regarding Treasury Reserve Management Purchases and Repurchase Operations (March 12, 2020), avail. at https://www.newyorkfed.org/markets/opolicy/operating_policy_200312a.
12. *See* Federal Reserve Bank of New York, Secured Overnight Financing Rate Data, avail. at https://apps.newyorkfed.org/markets/autorates/SOFR.
13. *See* Federal Reserve Bank of Richmond, Economic Brief No. 21-05, Bank Lending in the Time of COVID (February 2021), avail. at https://www.richmondfed.org/publications/research/economic_brief/2021/eb_21-05.
14. The OCC, an independent division of the Department of the Treasury, has supervisory and regulatory oversight of national banks, which includes many of the nation's largest banks, and federal branches and agencies of foreign banks. All national banks are members of the Federal Reserve System.
15. The FDIC insures the deposits of all FDIC member banks (all U.S. depository institutions) and has supervisory and regulatory oversight with respect to state banks that are not members of the Federal Reserve System.
16. Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised) (April 7, 2020), avail. at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200407a1.pdf.
17. FFIEC, Joint Statement on Additional Loan Accommodations Related to COVID-19 (August 3, 2020), avail. at https://www.ffiec.gov/press/PDF/Statement_for_Loans_Nearing_the_End_of_Relief_Period.pdf.
18. FDIC, FRB, OCC, Federal banking agencies encourage banks to use Federal Reserve discount window (March 16, 2020), avail. at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200316a.htm.
19. FRB, Federal Reserve Actions to Support the Flow of Credit to Households and Businesses (March 15, 2020), avail. at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200315b.htm.
20. FDIC, FRB, OCC, Statement on the Use of Capital and Liquidity Buffers (March 17, 2020), avail. at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200317a1.pdf.
21. FDIC, FRB, OCC, Federal banking agencies provide banks additional flexibility to support households and businesses (March 17, 2020), avail. at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200317a.htm.
22. FDIC, FRB, OCC, Regulators temporarily change the supplementary leverage ratio to increase banking organizations' ability to support credit to households and businesses in light of the coronavirus response (May 15, 2020), avail. at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200515a.htm.
23. FRB, Federal Reserve Actions to Support the Flow of Credit to Households and Businesses (March 15, 2020), avail. at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200315b.htm.
24. FDIC, FRB, OCC, Federal bank regulatory agencies issue interim final rule for Money Market Liquidity Facility (March 19, 2020), avail. at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200319a.htm.
25. FDIC, FRB, OCC, Federal bank regulatory agencies modify liquidity coverage ratio for banks participating in Money Market Mutual Fund Liquidity Facility and Paycheck Protection Program Liquidity Facility (May 5, 2020), avail. at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200505a.htm.
26. FRB, Reserve Requirements, avail. at https://www.federalreserve.gov/monetarypolicy/reservereq.htm.
27. FRB, Federal Reserve Board announces interim final rule to delete the six-per-month limit on convenient transfers from the "savings deposit" definition in Regulation D (April 24, 2020), avail. at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200424a.htm.
28. CFPB, FDIC, FRB, NCUA, OCC, Federal banking agencies to defer appraisals and evaluations for real estate transactions affected by COVID-19 (April 14, 2020), avail. at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200414a.htm.
29. *See* Maxine Waters, Chairwoman, House Committee on Financial Services, Letter to President Elect Biden (December 4, 2020), avail. at https://financialservices.house.gov/uploadedfiles/120420_cmw_ltr_to_biden.pdf; Senators Elizabeth Warrant and Sherrod Brown, Letter to Agencies (June 19, 2020), avail. at https://www.warren.senate.gov/imo/media/doc/2020.06.19%20Letter%20to%20Financial%20Regulators%20on%20Bank%20Capital.docx.pdf.
30. FRB, Speech Vice Governor Quarles, What Happened? What Have We Learned From It? Lessons from COVID-19 Stress on the Financial System (October 15, 2020), avail. at https://www.federalreserve.gov/newsevents/speech/quarles20201015a.htm.
31. *Id.*
32. FEDS Notes, How the Federal Reserve's central bank swap lines have supported U.S. corporate borrowers in the leveraged loan market (November 12, 2020), avail. at https://www.federalreserve.gov/econres/notes/feds-notes/how-the-federal-reserves-central-bank-swap-lines-have-supported-uscb-in-the-llm-20201112.htm.

33. ECB. US dollar funding tensions and central bank swap lines during the COVID-19 crisis (May 2020) ("**ECB US Dollar Funding**"), avail. at https://www.ecb.europa.eu/pub/economic-bulletin/focus/2020/html/ecb.ebbox-202005_01~4a2c044d31.en.html.
34. FEDS Notes, *supra*, n.32.
35. ECB US Dollar Funding, *supra*, n.33.
36. The Federal Reserve Act of 1913 gave the Federal Reserve System responsibility for setting monetary policy. The Federal Reserve controls the three tools of monetary policy – open market operations, the discount rate, and reserve requirements. The FRB is responsible for the discount rate and reserve requirements, and the Federal Open Market Committee is responsible for open market operations. Using the three tools, the Federal Reserve influences the demand for, and supply of, balances that depository institutions hold at Federal Reserve Banks and in this way alters the federal funds rate. The federal funds rate is the interest rate at which depository institutions lend balances at the Federal Reserve to other depository institutions overnight.

    The Federal Open Market Committee (FOMC) consists of 12 members: the seven members of the FRB; the president of the Federal Reserve Bank of New York; and four of the remaining 11 Reserve Bank presidents, who serve one-year terms on a rotating basis. The rotating seats are filled from the following four groups of Banks, one Bank president from each group: Boston, Philadelphia, and Richmond; Cleveland and Chicago; Atlanta, St. Louis, and Dallas; and Minneapolis, Kansas City, and San Francisco. Non-voting Reserve Bank presidents attend the meetings of the Committee, participate in the discussions, and contribute to the Committee's assessment of the economy and policy options.
37. FOMC, Federal Open Market Committee announces approval of updates to its Statement on Longer-Run Goals and Monetary Policy Strategy (August 27, 2020), avail. at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200827a.htm.
38. *See* Guide to changes in the Statement on Longer-Run Goals and Monetary Policy Strategy, avail. at https://www.federalreserve.gov/monetarypolicy/guide-to-changes-in-statement-on-longer-run-goals-monetary-policy-strategy.htm.
39. Speech, FRB Vice-Chair Clarida, The Federal Reserve's New Framework: Context and Consequences (November 11, 2020), avail. at https://www.federalreserve.gov/newsevents/speech/clarida20201116a.htm.

    The ELB is an effective floor interest rate, that limits the ability of the Federal Reserve, using the discount rate, to affect monetary policy goals. The current benchmark federal funds rate, a range of 0 to 25 basis points (0.25 percentage points), is at or below the effective lower bound (ELB).
40. https://www.federalreserve.gov/monetarypolicy/bst_recenttrends.htm.
41. FRB, Transcript of Chair Powell's Press Conference at 3–4 (December 16, 2020), avail. at https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20201216.pdf.
42. "We are all Keynesians now" is a famous *bon mot* attributed to Milton Friedman (he added nuance by noting that, as best as he could recall, he had said "In one sense, we are all Keynesians now; in another, nobody is any longer a Keynesian." *See* http://content.time.com/time/subscriber/article/0,33009,898916-2,00.html and later rephrased by U.S. President Richard Nixon.
43. *Id.*, at 5.
44. Avail. at https://www.congress.gov/bill/116th-congress/house-bill/133/text.
45. FRB, The January 2021 Senior Loan Officer Opinion Survey on Bank Lending Practices (February 1, 2021), avail. at https://www.federalreserve.gov/data/sloos/sloos-202101.htm.
46. FDIC, FRB, OCC, Shared National Credit Program 1st and 3rd Quarter 2020 Examinations (February 2021) ("**SNC 2020 Review**"), avail. at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20210225a1.pdf.
47. "Special mention," as applied to loans or commitments, is a supervisory classification.

    > Special mention commitments have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses could result in further deterioration of the repayment prospects or in the institution's credit position in the future. Special mention commitments are not adversely classified and do not expose institutions to sufficient risk to warrant adverse rating.

    SNC 2020 Review, Appendix A: *Definitions*.
48. "Classified," as applied to loans or commitments, is also a supervisory classification.

    > Classified commitments include commitments rated substandard, doubtful, and loss. The agencies' uniform loan classification standards and examination manuals define these risk rating classifications. Loans that are special mention and classified are considered non-pass loans.

    SNC 2020 Review, Appendix A: *Definitions*.

    > Substandard commitments are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard commitments have well-defined weaknesses that jeopardize the liquidation of the debt and present the distinct possibility that the institution will sustain some loss if deficiencies are not corrected.
    >
    > Doubtful commitments have all the weaknesses of commitments classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of available current information, highly questionable and improbable.
    >
    > Commitments classified as loss are uncollectible and of so little value that their continuance as bankable commitments is not warranted. Amounts classified as loss should be promptly charged off. This classification does not mean that there is no recovery or salvage value, but rather that it is not practical or desirable to defer writing off these commitments, even though some value may be recovered in the future.

    Id.
49. SNC Review 2020, *supra*, n.46, at 3.
50. *Id.*
51. Because the Agencies do not rely on third-party credit ratings, their use of "[t]he terms 'non-investment grade' and 'investment grade' … are based on bank-provided facility-level equivalent ratings." *Id.*, at n.4.
52. *Id.*
53. ECB, Introductory statement by Andrea Enria, Chair of the Supervisory Board of the ECB, at the press conference on the results of the 2020 SREP cycle (January 28, 2021), avail. at https://www.bankingsupervision.europa.eu/press/speeches/date/2021/html/ssm.sp210128~78f262dd04.en.html.

54. Where the debt is more than six times the earnings before interest, taxes, depreciation and amortisation (EBITDA).
55. The GAO, often called the "congressional watchdog," is an independent, non-partisan agency that works for the United States Congress.
56. GAO Report 21-167, Financial Stability: Agencies Have Not Found Leveraged Lending to Significantly Threaten Stability but Remain Cautious Amid Pandemic (December 2020), avail. at https://www.gao.gov/assets/720/711293.pdf.
57. The OFR is a part of the U.S. Treasury established by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 to support the Financial Stability Oversight Council and its member agencies by looking across the financial system to measure and analyze risks, perform essential research, and collect and standardize financial data.
58. GAO Report 21-167, at 40–41.
59. *Id.*, at 41–2.
60. *Id.*, at 42–3.
61. GAO, GAO-16-175, Financial Report: Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness (February 2016), avail. at https://www.gao.gov/assets/680/675400.pdf.
62. *Id.*, at 53.
63. Hearing, Financial Services Serial No. 116-29, The Subcommittee On Consumer Protection And Financial Institutions, 116th Congress, 1st Session, Emerging Threats To Stability: Considering The Systemic Risk Of Leveraged Lending (June 4, 2019), avail. at https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=403827.
64. Introductory statement by Andrea Enria, *supra*, n.53.
65. ECB, Financial Stability Review, Financial stability considerations arising from the interaction of coronavirus-related policy measures (November 2020), avail. at https://www.ecb.europa.eu/pub/financial-stability/fsr/special/html/ecb.fsrart202011_01~47160f35a4.en.html.

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As was the case with most aspects of life in 2020, chaos and unpredictability were hallmarks of the 2020 M&A and corporate lending markets. A perfect storm of market destabilisers and attendant uncertainties – the COVID-19 pandemic and quarantines, social and political unrest, a tumultuous presidential election, and corporate liquidity challenges – brought U.S. M&A deal value down 21% in 2020 from the prior year. While Q1 2020 deal volume was sluggish, Q2 2020 deal volume was nearly non-existent. Remarkably, deal volumes dramatically rebounded in the second half of 2020, exceeding second-half deal volumes of recent years.

A number of factors caused this rebound, including the following:

- Private equity funds started 2020 with huge cash balances, allowing funds to deploy capital opportunistically.
- Lenders did not face liquidity crises like in the Great Recession, and by the second half of 2020 were a key source of low-cost liquidity for companies across the market.
- Companies quickly shifted liquidity and business strategies to maintain cash.
- Government stimulus and Federal Reserve Bank action provided liquidity and stabilised markets.
- Equity markets continued to soar to their highest levels.

These and other factors resulted in a record second half, with deals seen across industries, company sizes and credit qualities. Unsurprisingly, in a stay-at-home environment caused by a viral pandemic, industries with the highest deal volumes were logistics, technology, pharmaceuticals, medical, and biotech.

Notable deals included Softbank's $40 billion sale of chipmaker ARM to AI computing platform NVIDIA, Salesforce's $27 billion acquisition of business communication platform Slack, and Pfizer's spin-off of its off-patent branded pharmaceutical business and combination with generic pharmaceutical manufacturer Mylan NV. Private equity acquisitions across industries saw a huge spike in the second half of 2020.

A few macro trends in the M&A and acquisition finance markets are worth noting:

- M&A purchase agreement terms are closely linked to acquisition finance and funding requirements, as described below. 2020's unique deal environment brought shifts in acquisition agreement terms, and additional disputes, which impact lenders. Absence of a material adverse effect (MAE) as a condition to the obligation to purchase a company and to fund acquisition loans saw added scrutiny in courts and new acquisition agreements with regard to the impact of COVID-19. Some deals signed but not closed before COVID-19 experienced disputes over whether the virus was an MAE, and many deals signed after COVID-19 included express language excluding COVID-19 and its impacts as an MAE. Additional disputes arose regarding whether common acquisition agreement covenants regarding a target's obligation to continue operating in the ordinary course of business were violated by the rapid changes in business and financial strategies caused by COVID-19. The evolution of acquisition agreement terms, and the manner in which M&A deals and financings close, will continue into 2021 and even after COVID-19 is controlled.
- Special purpose acquisition companies (SPACs) saw a huge resurgence in 2021 as an alternative IPO and liquidity structure for companies, regardless of the riskiness of the acquisition. Lenders had to pivot quickly to analyse and document financings for these transaction structures that had not be seen regularly for some time. SPAC structures will continue to be used in 2021, with more creative terms, and the volume of de-SPAC transactions will inevitably increase.
- COVID-19 government lending programs provided liquidity for many companies, including the Paycheck Protection Program (PPP), which was recently reinstated to allow new loans and a second funding of loans. However, the terms of these loans, and their chance for being forgiven, create concerns for certain PPP loan borrowers due to the many publicised companies whose eligibility for the government program has been retrospectively questioned. Diligence by buyers and their lenders of these issues is critical.
- The volume of convertible note offerings increased in 2020. The mix of low interest rates, a burgeoning streak market, limited operating covenants, and limited dilution compared to an equity offering and the search for capital in the first half of 2020 led to this increase. However, convertible notes often have potentially onerous terms upon the occurrence of an M&A transaction, which could result in some companies being disincentivised to launch an M&A transaction.
- Environmental, social, and governance (ESG) factors – whether related to climate change, privacy, diversity, labour, or other factors – were a continued focus for companies and investors. The impact of an M&A transaction on a company's ESG goals, and how to measure them, will continue to be a growing trend in M&A markets. Although not yet widely seen, capital and its costs linked to ESG impacts will develop as the market moves towards agreement on standards for measuring a company's ESG profile.

Indicators suggest that 2021 deal volume and financing will continue at strong levels. This optimism is tempered by the many unpredictable risks of the COVID-19 pandemic and its impacts on the global economy. But the 2020 second half

resiliency and flexibility of the M&A and financing markets is a cause for hope. Acquisition financing will continue to be a primary source of funds for acquisitions, particularly in the middle market. It is important to review the fundamentals of U.S. acquisition financing using secured loans and monitor trends in this constantly changing area of financing.

The Commitment Letter is Key

The commitment letter for a financing includes the material terms of the lenders' obligations to fund the loans and the conditions precedent to such obligations. Obtaining a suitable commitment letter from one or more lenders is of particular importance to acquisition financing and can be the deciding factor as to whether a seller will sign an acquisition agreement with a particular buyer where the buyer cannot otherwise prove itself able to fund the acquisition from its own funds or marketable securities. As in all committed financings, the borrower wants an enforceable commitment from its lenders that obligates the lenders to extend the loans, subject to certain conditions that have been mutually agreed upon. In acquisition financing, where the proceeds of the loans will be used by the borrower to pay the purchase price for the target company, in whole or in part, the seller will also be concerned whether the buyer has strong funding commitments from its lenders. If the buyer's lenders do not fund the loans, a failed acquisition could result.

In a typical timeline of an acquisition, especially one involving public companies, the buyer and seller execute the definitive agreement for the acquisition weeks, if not months, in advance of the acquisition. Following execution, the buyer and seller work to obtain regulatory approvals and other third-party consents that may be needed to consummate the acquisition, execute a tender offer if required, complete remaining due diligence, finalise the financing documentation and take other required actions.

Signing an acquisition agreement often results in the seller agreeing not to purse or interact with other potential suitors for a period of time while the parties work to complete the agreed upon acquisition. For example, acquisition agreements routinely contain covenants forbidding the seller from soliciting or otherwise facilitating other bids and requiring the parties to work diligently towards closing. Further, many acquisition agreements either do not give the buyer a right to terminate the agreement if its financing falls through (known as a "financing-out" provision), or require a substantial penalty payment to be made by the buyer if the transaction fails to proceed, including as a result of the financing falling through (known as a "reverse breakup fee"). Accordingly, at the signing of the acquisition agreement, and as consideration for the buyer's efforts and costs to close the acquisition, the buyer will want the lenders to have strong contractual obligations to fund the loans needed to close the acquisition.

Who Drafts the Commitment Letter?

Private equity funds (also known as "sponsors") are some of the most active participants in M&A transactions and related financings. With their sizable volumes of business that can be offered to banks, sponsors often have greater leverage in negotiations with lenders than non-sponsor-owned companies. Sponsors and their advisors monitor acquisition financings in the market and insist that their deals have the same, if not better, terms. As economic tides shift, the ability of sponsors to leverage their large books of banking business grows and wanes, and the favourability for sponsors of acquisition financing terms shift as well.

Who drafts the commitment papers is one area where sponsors are often treated more favourably than other borrowers. While lenders in most cases expect to have their attorneys draft commitment papers, sponsors are now regularly and successfully insisting that their lawyers prepare the draft commitment papers and requiring the lenders to use them. From the sponsors' perspective, controlling the drafts can result in standardised commitment letters across deals, and a more efficient and quick process to finalise commitment letters. To get the best terms, the sponsors often simultaneously negotiate with a number of potential lenders and then award the lead role in an acquisition financing to the lender willing to accept the most sponsor-favourable terms, not just the best pricing.

Conditionality

The buyer's need for certainty of funds to pay the purchase price puts sharp focus on the conditions that must be met before the lenders are contractually obligated to fund an acquisition loan. As a result, a buyer has a strong preference to limit the number of conditions precedent in a commitment letter, and to make sure that the commitment letter is explicit that only the included conditions are applicable to funding, in order to enhance funding certainty. The buyer and seller want to avoid a scenario where the conditions precedent to the buyer's obligation to close the acquisition have been met but the lenders' obligation to fund the loans has not. Particularly in the scenario where no financing-out clause is included in the acquisition agreement, if the acquisition financing falls through because the buyer cannot satisfy the conditions in the commitment letter, the buyer may not be able to close the acquisition and could be required to pay the seller sizable contractual breakup fees, as well as potentially be subject to lawsuits from the seller. Certain conditions discussed below are commonly subject to heavy negotiation in an acquisition financing.

Conditions Precedent, Covenants and Defaults

Commitment letters for general financings often contain vague and partial lists of documents and conditions that the lenders will require before funding the loans. Phrases like "customary conditions precedent" are often seen. In contrast, a commitment letter for an acquisition financing typically has a precisely worded (and limited) list of conditions.

If the lenders are permitted to require satisfaction of conditions precedent to funding that are not expressly set forth in the signed commitment letter (whether customary conditions or not), this increases the risk to the borrower that these additional conditions cannot be met. It is common in an acquisition financing to see an express statement from the lenders that the list of conditions precedent in the commitment letter are the only conditions that will be required for funding. In some cases, the list of conditions precedent in commitment letters for acquisition finance are so detailed that they are copied directly into the final forms of loan agreements.

Similarly, vague references to "customary covenants" and "customary events of default" in a commitment letter present similar funding risks from a borrower's perspective, particularly proposed inclusion of unreasonable provisions which could not be met by the borrower. To limit this risk, commitment letters for acquisition financings often include fully negotiated covenant and default packages (which may include pages of detailed definitions to be used for purposes of calculating financial covenants).

Form of Loan Documents

Some sponsors even require that the form of the loan agreement be consistent with "sponsor precedent", meaning that the loan documentation from the sponsor's prior acquisition financings will be used as a model for the new financing. Agreeing to use or be guided by "sponsor precedent" limits the risk to the sponsor that the financing will be delayed or fail to close because the lender and its counsel produce a draft loan agreement with unexpected terms and provisions.

Many acquisition financings, particularly in the middle market, involve multiple classes of loans with complex intercreditor arrangements. These financings include 1st/2nd lien, split-collateral, *pari passu* collateral, subordinated, holdco and unitranche financings. In complex and technical intercreditor agreements, lenders agree on many issues relating to their respective classes of loans, including priority of liens, priority of debt, control of remedies and certain technical bankruptcy issues. Negotiation of these agreements among different classes of creditors can be lengthy and frustrate closing time frames. As middle market M&A continues to grow, and more deals have complex intercreditor arrangements, some sponsors are also requiring lenders to use a specified form of intercreditor agreement.

Representations and Warranties

Loan agreements typically require that the included representations and warranties be accurate as a condition to funding. Lenders financing the acquisition also want the representations with respect to the target in the acquisition agreement to be accurate. This is reasonable because after consummation of the acquisition, the target is likely to be obligated on the loans (either as the borrower or a guarantor) and thus part of the credit against which the lenders are funding.

"Certain funds" provisions (also commonly known as "SunGard" provisions, in reference to an acquisition financing involving a company named SunGard Data Systems where these clauses were first seen) are now common in commitment letters for acquisition financings. These clauses are relevant to several provisions in a typical commitment letter. With respect to representations and warranties, these clauses provide that on the closing date of the acquisition loan, as a condition to the lenders' funding obligations, only certain representations and warranties contained in the credit agreement need to be accurate. Strong sponsors even negotiate the precise meaning of the term "accurate" preferring instead that the representations just be "made". The representations required to be accurate as a condition to the lenders' funding obligation in a typical SunGard clause include the following:

- The only representations and warranties relating to the target company are those that, were they untrue, would be material to the lenders and for which the buyer has a right under the acquisition agreement to decline to close the acquisition. While providing certainty of funding, this standard avoids a scenario where the loan agreement has broader or more extensive representations with respect to the target than the acquisition agreement.
- Only certain representations with respect to the borrower set forth in the loan agreement must be accurate (the "specified representations"). These continue to be negotiated, but often include those with respect to corporate existence, power and authority to enter into the financing, enforceability of the loan documents, margin regulations, no conflicts with law or other contracts, solvency, status of liens (see below regarding this topic) and certain anti-terrorism and money laundering laws. A financial covenant could also be included as a specified representation in some lower credit quality deals. As U.S. regulators have put more focus on national security, lenders have pushed hard to include stronger representations with regard to these concerns.

Only these limited representations and warranties must be made as conditions precedent to the funding of the loans used to consummate the acquisition. Even if the other representations in the loan agreement could not be truthfully made at the time of the acquisition funding, the lenders nonetheless are contractually obligated to fund those loans. For subsequent, post-acquisition funding of loans under the credit agreement, all representations and warranties would need to be truthfully made.

Company MAC

Company material adverse change (MAC), sometimes referred to as a "company MAC" or a "business MAC", is a type of representation typically included in acquisition agreements. This is a representation that no material adverse change in the business of the target has occurred. Inability to make the representations in the acquisition agreement typically permits the buyer to terminate the acquisition agreement and in the loan agreement it excuses the lenders from their funding obligations. A customary MAC definition in an acquisition agreement differs from that in a loan agreement. Acquisition agreement MAC clauses are often more limited in scope and the time frame covered, and have more exceptions (including for general market and economic conditions impacting the target). Like other representations, buyers and sellers often require that the MAC definition contained in an acquisition agreement be used in the related loan agreement, but solely for purposes of the initial funding of the acquisition loans (and not for ongoing draws under a working capital revolver or a delayed draw term loan, for instance).

Market MAC and Flex

"Market MAC" is another type of MAC representation in some commitment letters. Seen more in economic down-cycles when financing is harder to come by, these clauses allow the lenders to terminate their commitments if there has been a material adverse change in the loan and syndication markets generally. In recent years, these sorts of clauses have rarely been included in commitment letters due to strong and competitive financing markets.

As discussed above, the time between signing the commitment letter, on one hand, and closing the acquisition and funding the loans on the other, is often a lengthy period. Lenders whose commitment letters do not have a market MAC, especially those lenders who fully underwrite the commitments, risk possibly deteriorating financial markets during the syndication of the commitments and the resulting inability to sell down their commitments to other lenders. To some degree "flex" provisions may limit this risk and allow for amendments to certain agreed-upon terms of the financing without the borrower's consent when necessary to allow the lenders arranging the loan to sell down their commitments.

If, during syndication, there is no market for the loans at the price or terms provided in the commitment letter and term sheet, a flex provision will allow the committed lenders to "flex" the pricing terms (by selling the loans below par ("original issue discount" or "OID") or increasing the interest rate, fees or both) within pre-agreed limits or make other pre-agreed changes to

the structure of the loans (such as call protections, shorter maturities, etc.). While these changes provide some comfort to committed lenders in gradually deteriorating financial markets, they may not be as helpful in a dramatic downturn where there is little to no market for loans on any terms.

At times of financial and market uncertainty (and times of less competitive lending markets), flex clauses may become broader in scope and give lenders greater flexibility to change key terms of a financing. The types of provisions that can be subject to flex include interest rate margins, negative covenant baskets, financial covenant ratios, the allocation of credit between first lien, second lien and high-yield bonds and the amount and type of fees. In strong markets, sponsors use their leverage to limit the breadth of flex provisions, and to require greater limits on the scope of the changes that can be made without their consent.

One of the benefits of the direct lender market is that these lenders typically do not require flex provisions because direct lenders often do not intend to syndicate their loans. This can be a significant benefit to sponsors and borrowers seeking certainty of lending terms, particularly on deals that traditional lenders may find challenging to syndicate for structural, economic, market or other reasons.

Some sponsors require "reverse flex" arrangements. These provisions require the lenders to amend the financing terms under the commitment letters to be more favourable to the borrower if syndication of the loans is "oversubscribed", meaning that there is more demand from potential lenders than available loans.

Perfection of Liens

As in all secured financings, lenders in an acquisition financing need evidence that their liens on the borrower's assets are perfected and enforceable, preferably as a condition precedent to the initial funding under the loan agreement. However, ensuring perfection of the liens is often highly technical and can be a time-consuming process depending on the nature and location of the borrower's assets and the specific legal requirements for perfection. The time-consuming nature of lien perfection raises the risk (to the borrower and the seller) that closing may be delayed pending completion of the lien perfection process, and in an acquisition financing timing and certainty are at a premium.

Typical SunGard provisions limit this risk by requiring delivery at funding of only (i) Uniform Commercial Code financing statements which perfect a security interest in personal property that can be perfected by filing, and (ii) original stock certificates for any pledged shares. Borrowers are permitted to perfect security interests in other asset classes on a post-funding basis. The sorts of collateral perfected on a post-closing basis can include real estate, deposit and securities accounts, intellectual property, foreign assets and other more esoteric collateral requiring more complicated efforts.

Sponsors and high credit quality borrowers have pushed lenders on this further, getting agreements to have even more collateral diligence and perfection steps completed on a post-closing basis.

The Acquisition Agreement Matters

Delivery of the executed acquisition agreement is a condition precedent to the lenders' obligation to fund the loans. As discussed in more detail below, as a fallback, lenders sometimes accept a near final draft of the acquisition agreement, coupled with a covenant from the buyer that there will be no material changes without the lenders' prior consent. The terms of the acquisition agreement are important to lenders in a number of respects, beyond understanding the structure and business of the borrower after consummation of the acquisition. Lenders also regularly require inclusion of certain provisions in acquisition agreements.

Structure of the Acquisition

The structure of the acquisition is important to the lenders as it will dictate a number of issues for the financing, including collateral perfection, identity of the guarantors and borrowers and timing of the acquisition (i.e., how long the lenders need to have their commitments outstanding). There are a number of common acquisition structures. While the specifics of those structures are beyond the scope of this chapter, these include stock purchases (with or without a tender offer), mergers (including forward, forward triangular and reverse triangular mergers) and asset purchases. Each has its own unique structuring issues for the lenders.

Representations and Company MAC

As described above, the lenders often rely on the representations and warranties in the acquisition agreement, including the definition of material adverse change, and incorporate those terms into the loan agreement.

Obligation to Continue Operating

Lenders typically expect the acquisition agreement to require the seller, pending acquisition closing, to continue operating the business in the ordinary course and not to make material changes to the business. Again, the target is a part of the lenders' credit and the lenders do not want to discover after consummation of the acquisition that the target has been operated or restructured in a way that results in its business being less valuable or different than the lenders' understanding.

Indemnity

Lenders also typically consider the indemnities provided by the seller in the acquisition agreement. If, after the acquisition is consummated, it is discovered that the seller made a misrepresentation or, worse, committed fraud or other wrongdoing as part of the acquisition, those indemnities could affect the buyer's ability to recover against the seller. If the misrepresentation or wrongdoing results in the lenders foreclosing on the assets of the borrower, the lenders could inherit the indemnities if the rights of the borrower under the acquisition agreement are part of the collateral. Acquisition agreements typically contain anti-assignment and transfer provisions. It is important that those provisions expressly permit the lenders to take a lien on the acquisition agreement.

Purchase Price Adjustments and Earn-Outs

Any payments to be made to the seller by the buyer after consummation of the acquisition are important to the lenders. Many loan agreements define these payments, whether based on performance of the target or other factors, as debt or other restricted payments and their payment needs to be specifically permitted by the loan agreement. Beyond technically drafting

the loan agreement to permit payment of these amounts, the proceeds to be used to make these payments should be viewed as assets of the buyer that are not available to the lenders to repay the loans and this may impact the credit review of the loan facility.

Xerox Provisions

When a proposed acquisition terminates, the commitment letters for the acquisition financing typically state that the lenders' commitments also terminate. That is not always the end of the lenders' concerns. Many terminated acquisitions result in accusations of breach of contract, wrongdoing or bad faith by the parties. Litigation is not uncommon. Lenders want to make sure that any litigation brought by the seller does not look to the lenders for damages.

Xerox provisions (named for a financing with Xerox where these clauses were first seen) give lenders this protection in the form of an acknowledgment by the seller in the acquisition agreement that the seller's sole remedy against the buyer and its lenders for termination of the acquisition is the breakup fee specified in the acquisition agreement. If the acquisition terminates because the lenders fail to fund their commitments, the lenders may still be subject to a breach of contract suit brought by the buyer, but the Xerox provisions should insulate the lenders from suit brought by the seller. Conversely, sellers' focus on certainty of the financing has caused some sellers to push back on inclusion of these provisions. Some sellers with strong leverage even negotiate for the right to enforce remedies (or cause the buyer to enforce remedies) against the lenders under a commitment letter.

Since the lenders are not party to the acquisition agreement, applicable law creates hurdles for the lenders to enforce the Xerox provisions. To address these hurdles, lenders seek to be expressly named as third-party beneficiaries of the Xerox provisions. In the event the lenders have claims against the seller for breach of the Xerox provisions, lenders will have customary concerns about the venue and forum of any claims brought by the lenders under the acquisition agreement. Like in loan agreements, lenders often seek to have New York as the exclusive location for these suits and seek jury trial waivers in the acquisition agreement.

Efforts to Obtain the Financing

Lenders also pay close attention to provisions in an acquisition agreement regarding the buyer's obligations to obtain financing. Typically, buyers agree to use "reasonable best efforts" or "commercially reasonable efforts" to obtain the financing in the commitment letter. These provisions may include requirements to maintain the commitment letter, not to permit any modification to the terms of commitment letter without the seller's consent (with some exceptions), to give notice to the seller upon the occurrence of certain events under the commitment letter, and to obtain alternative financing, if necessary. As noted above, acquisition agreements may also contain provisions obligating the buyer to enforce its rights against the lender under the commitment letter, or even pursue litigation against the lender. Buyers with strong leverage will want to limit provisions in the acquisition agreement requiring specific actions against the lenders.

Cooperation with the Financing

As discussed above, the lenders have an interest in understanding the acquisition and the nature of the target's business. Further, the conditions precedent will require deliverables from the target, and the lenders' regulatory, credit and legal requirements demand that they receive certain diligence information about the target and its business. None of this can be accomplished if the seller does not agree to assist the buyer and its lenders. Lenders often require that the acquisition agreement include a clause that the seller will cooperate with the lenders' diligence and other requirements relating to the acquisition financing.

Amendments to the Acquisition Agreement

Lenders usually have the opportunity to review the acquisition agreement, or at least a near final version, prior to executing their commitment letters. The buyer and seller will want the lenders to acknowledge that the final agreement or draft is acceptable. The lenders, on the other hand, will want to receive notice of any amendments to the acquisition agreement and ensure they do not adversely impact the financing. To avoid the lenders' refusal to fund the loans because of an amendment to the acquisition agreement, buyers and sellers are often careful to ensure that no amendments to the acquisition agreement will be required. Some amendments are unavoidable and commitment letters often contain express provisions as to the nature of those amendments that need lender approval. If lender approval is not needed, then the lenders cannot use the amendment as a reason to refuse funding.

Negotiations of the "no-amendment" condition focus on the materiality of the amendments and whether the change has to be adverse or materially adverse, with some lenders negotiating consent rights for any material change in the acquisition agreement. Lenders often seek to negotiate express provisions that would be deemed material or adverse, including some of the above clauses that were included in the acquisition agreement at the requirement of the lenders. Some lenders with strong negotiating leverage even negotiate for a clause in the acquisition agreement that any amendments will require the lenders' consent.

Conclusion

Leveraged acquisitions in the United States raise unique structuring issues and techniques, only some of which are discussed here. Expect unpredictability of 2021 M&A and financing markets as the COVID-19 crisis continues into its second year, while watching for changes in both economic indicators and macro structuring issues with acquisition finance.

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A Comparative Overview of Transatlantic Intercreditor Agreements

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Introduction

The intercreditor frameworks applicable to a given financing structure in a particular market are often fairly settled, but in cross-border financings for European borrowers or other financings involving practitioners and business people in different parts of the world, deal parties may have different expectations as to the key intercreditor terms that ought to apply.

In this chapter, we will compare and contrast the key terms in U.S. second lien and European second lien intercreditors and discuss the blended approach taken in some recent intercreditor agreements for financings of European companies in the U.S. syndicated bank loan markets. Similar dynamics may be involved when documenting intercreditor agreements involving other non-U.S. jurisdictions as well, but for ease of reference, we will refer to these intercreditor agreements as "Transatlantic Intercreditor Agreements".

Assumptions

U.S. second lien intercreditors are predicated on two key assumptions: *first*, that the business will be reorganised pursuant to Chapter 11 of the United States Bankruptcy Code (Chapter 11); and *second*, that the first lien lenders will receive the benefits of a comprehensive guarantee and collateral package (including shares, cash, receivables and tangible assets) pursuant to secured transactions laws that effectively provide creditors with the ability to take a security interest in "all assets" of the borrower and guarantors. European second lien intercreditors, in contrast, (i) assume that it is unlikely that the borrower and guarantors will be reorganised in an orderly court-approved process and indeed more likely that, since there is no pan-European insolvency regime (and thus no pan-European automatic stay on enforcement of claims), the intercreditor terms will have to function in the context of potentially multiple and disparate insolvency proceedings (ideally outside of insolvency proceedings altogether), and (ii) contemplate that not all assets of the borrower and guarantors will be subject to the liens of the first lien and second lien secured parties. As a result, one of the key goals that European second lien intercreditors seek to facilitate is a swift out-of-court, out-of-bankruptcy, enforcement sale (or "pre-pack") resulting in a financial restructuring where the business is sold as a going concern on a "debt-free basis", with "out of the money" junior creditors' claims being released and so removed from the financing structure.

Overview

The first lien/second lien relationship in the U.S. closely resembles the senior/second lien relationship in Europe; however, for the reasons stated above, the key terms of U.S. second lien and European second lien intercreditors have been constructed on the basis of different assumptions, which therefore results in significant intercreditor differences.

European second lien intercreditor agreements typically combine claim subordination, payment blockages, lien subordination, broad enforcement standstill provisions restricting the junior lien creditors' ability to take enforcement action (not only with respect to collateral but also with respect to debt and guarantee claims) and extensive release mechanics. U.S. second lien intercreditors establish lien subordination, which regulates the rights of the U.S. second lien creditors with respect to collateral only, and include an enforcement standstill with respect to actions against collateral only, although there are generally protections against junior lien creditors receiving value in their capacity as an unsecured creditor that would be prohibited by the terms of the lien subordination (such as take-back equity that is not otherwise first issued to senior lien creditors). U.S. second lien intercreditors do not generally include payment or claim subordination and they rely heavily on waivers of the junior lien creditors' rights as secured creditors under Chapter 11.

European second lien intercreditors often have their original genesis in the Loan Market Association's form (the "LMA"), but are negotiated on a deal-by-deal basis. By contrast, there is no market standard first lien/second lien intercreditor agreement in the U.S., although the American Bar Association published a model first lien/second lien intercreditor agreement in May 2010 intended as guidance for secured creditor constituencies in the U.S. market.

As discussed below, recent intercreditors for financings of European companies in the U.S. syndicated bank loan markets vary even more significantly.

Key Terms of U.S. Second Lien Intercreditor Agreements and European Second Lien Intercreditor Agreements

1. Parties to the Intercreditor Agreement

U.S. second lien intercreditors are generally executed by the first lien agent and the second lien agent and executed or acknowledged by the borrower and, sometimes, the guarantors. In the current market, intercreditor agreements frequently allow for representatives of future classes of first lien and second lien debt permitted by the debt documentation to accede to the intercreditor agreement. U.S. second lien intercreditors also typically allow for refinancings of the first lien and second lien debt.

By contrast, the parties to European second lien intercreditors generally include a longer list of signatories. In addition to the first lien agent and initial lenders, the second lien agent and

initial lenders and the obligors, the obligors' hedge providers, ancillary facility lenders, the lenders of intra-group loans, the lenders of shareholder loans and the security agent will execute a European-style intercreditor agreement. The longer list of parties to European second lien intercreditors is largely driven by the senior creditors' desire to ensure that, after giving effect to the senior lenders' enforcement, the borrower group is free and clear of all claims (both secured and unsecured) against the borrower and guarantors coupled with a preference to ensure that any enforcement action by creditors is choreographed in a manner which maximises recoveries for the senior secured creditors (and thus indirectly for all creditors). It has become common for refinancing and incremental structural debt to be permitted in European deals. European intercreditors typically require such debt to be subject to the intercreditor agreement, although the treatment of unsecured debt can be subject to negotiation.

Hedge obligations are generally included as first lien obligations under U.S. second lien intercreditors, but hedge counterparties are not directly party to U.S. second lien intercreditors. By accepting the benefits of the first priority lien of the first lien agent, the hedge counterparties receive the benefits of the first priority lien granted to the first lien agent on behalf of all first lien secured parties (including the hedge counterparties) and the hedge counterparties are deemed to agree that the first lien security interests are regulated by the intercreditor agreement and other loan documents. The hedge counterparties under U.S. intercreditors in syndicated bank financings generally have neither the ability to direct enforcement actions nor the right to vote their outstanding claims (including any votes in respect of enforcement decisions). Hedge counterparties protect their interests through the terms of their swap agreements with the borrower or guarantors such that a swap termination event occurs upon certain events (e.g., amendments to the hedge status under the intercreditor agreement, changes to distribution of collateral proceeds or termination of security).

Cash management obligations (e.g., treasury, depository, overdraft, credit or debit card, electronic funds transfer and other cash management arrangements) are often included as first lien obligations under U.S. second lien intercreditors on terms similar to the terms relating to the hedge obligations. Historically, European second lien intercreditors typically did not expressly contemplate cash management obligations, although this position is increasingly negotiated. In European financings, the cash management providers that are initial lenders would typically provide the cash management services through ancillary facilities – bilateral facilities provided by a lender in place of all or part of that lender's unutilised revolving facility commitment. Ancillary facilities are not a traditional feature of U.S. credit facilities, although increasingly common. The providers of ancillary facilities would be direct signatories of a European second lien intercreditor.

2. Enforcement

a. Enforcement Instructions

The first lien agent under a U.S. second lien intercreditor takes instructions from the lenders holding a majority of the loans and unfunded commitments under the first lien credit agreement, which follows the standard formulation of required lenders in U.S. first lien credit agreements. (Note, however, that the vote required to confirm a plan of reorganisation in a Chapter 11 proceeding is a higher threshold – at least two thirds in amount and more than one half in number of the claims actually voting on the plan.) Where there are multiple first lien facilities, typically the agent for the facility representing the greatest amount of loans and unfunded commitments is the "controlling" agent acting for the first lien class, though in most cases the agent for the bank facilities (as opposed to a notes trustee) will be the controlling agent even if the bank facilities are smaller than outstanding senior secured notes.

The security agent under European second lien intercreditors, however, takes instructions from creditors holding 66⅔% of the sum of (i) the drawn and undrawn amounts under the senior credit agreement, and (ii) any actual outstanding liabilities (plus any mark to market value if the senior credit agreement has been discharged) under any hedging arrangements.

b. Enforcement Standstill Periods

U.S. second lien financings involve lien subordination as opposed to payment (also referred to as debt or claim) and lien subordination. The result of lien subordination is that only the proceeds of shared collateral subject to the liens for the benefit of both the first lien secured parties and second lien secured parties are applied to repayment in full of the first lien obligations before the second lien secured parties are entitled to receive any distribution of the proceeds of the shared collateral, but the second lien secured parties may receive other payments (such as payments of principal and interest and payments from other sources, e.g., unencumbered property) prior to the first lien obligations being paid in full. In the context of U.S. obligors, it is unlikely, in practice, that there would be substantial property that is unencumbered since the security granted would likely pick up substantially all assets – in contrast to a number of European obligors whose unencumbered assets may be significant due to local law limitations.

Payment subordination requires the junior lien creditors to turnover to the first lien secured parties all proceeds of enforcement received from any source (including the proceeds of any unencumbered property) until the first lien obligations are paid in full. In consequence, the difference in recoveries between lien subordination and payment subordination could be significant in a financing where material assets are left unencumbered, as is likely in a financing in which much of the credit support is outside the U.S.

U.S. second lien intercreditors prohibit the second lien agent from exercising any of its rights or remedies with respect to the shared collateral until expiration of a standstill period (typically 90 to 180 days after notice delivered by the second lien agent to the first lien agent of a second lien event of default or, in some cases, if earlier, second lien acceleration). The standstill period becomes permanent to the extent the first lien agent is diligently pursuing in good faith an enforcement action against a material portion of the shared collateral or upon a bankruptcy proceeding filing. An exercise of collateral remedies generally includes any action (including commencing legal proceedings) to foreclose on the second lien agent's lien in any shared collateral, to take possession of or sell any shared collateral or to exercise any right of set-off with respect to any shared collateral, but the acceleration of credit facility obligations, filing a proof of claim in a bankruptcy proceeding or ensuring continued perfection on collateral are generally not considered an exercise of collateral remedies.

European second lien intercreditors typically contain a much broader enforcement standstill provision than U.S. second lien intercreditors, principally because there is no pan-European equivalent of the Chapter 11 automatic stay. The scope of the restricted enforcement actions typically prohibits any acceleration of the second lien debt, any enforcement of payment of, or action to collect, the second lien debt, and any commencement or joining in with others to commence any insolvency proceeding, any commencement by the second lien agent or second lien creditors of any judicial enforcement of any of the rights and remedies under the second lien documents or applicable law, whether as a secured or an unsecured creditor. The

enforcement standstill period has traditionally run for (i) a period of 90 days following notice of payment default under the senior credit agreement, (ii) a period of 120 days following notice of financial covenant default under the senior credit agreement (although this is much less common since the introduction of cov-lite financings in the European market), and (iii) a period of 150 days following notice of any other event of default under the senior credit agreement. However, the enforcement standstill period is now often subject to negotiation and in some deals, for example, it is 120 days following notice of the relevant event of default. In European second lien intercreditors, the senior creditors firmly control enforcement (other than in some exceptional circumstances). In addition, the senior agent is generally entitled to override the junior agent's instructions to the security agent, leaving the second lien lenders only able to influence the timing of enforcement action after the standstill period.

Because the enforcement standstill in U.S. second lien intercreditors is limited to enforcement against shared collateral, U.S. second lien lenders, unlike their European counterparts, retain the right (subject to the Chapter 11 stay) to accelerate their second lien loans and to demand payment from the borrower and guarantors during the standstill period. However, in the event any second lien agent or any other second lien creditor becomes a judgment lien creditor in respect of the shared collateral as a result of enforcement of its rights as an unsecured creditor (such as the ability to sue for payment), the judgment lien would typically be subordinated to the liens securing the first lien obligations on the same basis as the other liens securing the second lien obligations under the U.S. second lien intercreditor agreement. This judgment lien provision effectively limits the effectiveness of the junior lien creditors' efforts to sue for payment, since the junior lien creditors ultimately will not be able to enforce against shared collateral, although the junior lien creditors could still precipitate a bankruptcy filing and/or obtain rights against any previously unencumbered assets of the borrower and guarantors.

3. Payment Blockages

U.S. second lien intercreditors do not generally subordinate the junior lien obligations in right of payment to the first lien obligations.

While recent European second lien intercreditors do not subordinate the junior lien obligations in right of payment to the senior lien obligations, they include payment blockages which achieve the same outcome. Payment blockage periods are typically co-extensive with a payment default under the senior credit agreement and of a duration of 150 days during each year whilst certain other material events of default under the senior credit agreement are continuing. The second lien creditors may negotiate for exceptions to the payment blockage periods, e.g., payment of a pre-agreed amount of expenses related to the restructuring or a valuation of the borrower group (other than expenses related to disputing any aspect of a distressed disposal or sale of liabilities). In addition, separate payment blockage rules typically apply to hedge obligations, shareholder loan obligations and intragroup liabilities in European second lien intercreditors.

4. Releases of Collateral and Guarantees

In order to ensure that the junior lien creditors are unable to interfere with a sale of the shared collateral, both U.S. second lien intercreditors and European second lien intercreditors contain release provisions whereby the junior lenders agree that their lien on any shared collateral (and, in Europe, the underlying debt and guarantee obligations) is automatically released if the first lien creditors release their lien in connection with a disposition permitted under both the first lien credit agreement and the second lien credit agreement and, more importantly, in connection with enforcement by the first lien creditors.

The release provisions are arguably the most important provision of European second lien intercreditors. Under European intercreditor agreements, in connection with enforcement by the senior creditors (or a "distressed disposal"), the junior security and debt and guarantee claims can be released (or disposed of) subject to negotiated conditions. Fair sale provisions are almost always included, i.e., public auction/sale process, court-administered process or independent fair value opinion. The LMA intercreditor agreement (and most market precedents) requires the security agent to take reasonable care to obtain a fair market price/value and permits the sale of group entities and release of debt and guarantee claims, and, in addition, the sale of second lien debt claims. European intercreditor agreements typically provide that the security agent's duties will be discharged when (although this list is not exhaustive): (i) the sale is made under the direction/control of an insolvency officer; (ii) the sale is made pursuant to an auction/competitive sales process (which does not exclude junior creditors from participating unless adverse to the sales process); (iii) the sale is made as part of a court supervised/approved process; or (iv) a "fairness opinion" has been obtained. Any additional parameters/conditions to the above will be negotiated, particularly in deals where the junior debt is privately placed or where specialist second lien funds are anchoring the second lien facility including: (i) the circumstances in which/whether the senior creditors are entitled to instruct a sale in reliance on a fair sale opinion rather than a public auction; (ii) terms of any public auction (i.e. how conducted, on whose advice, who can participate, who can credit bid); (iii) any requirement for cash consideration; and (iv) any information/consultation rights.

In addition to the release provisions, European second lien intercreditors typically allow (subject to the fair sale provisions discussed above) the security agent to transfer the junior lien debt, intragroup liabilities and/or shareholder loans to the purchasers of the assets in an enforcement situation. The disposal of liabilities option could be more tax efficient than cancelling the subordinated debt in connection with enforcement.

Many of these conditions with respect to sales of collateral are absent in U.S. second lien intercreditors because meaningful protections are afforded to silent creditor constituencies by the Uniform Commercial Code requirement for a sale of collateral to be conducted in a commercially reasonable manner and, in the case of a 363 sale process, by a court-approved sale in Chapter 11, as discussed more fully below.

In addition, the release provisions in U.S. second lien intercreditors are also premised on the first lien and second lien security interests being separately held by the first lien collateral agent and the second lien collateral agent and documented in separate, but substantially similar, documents that are meant to cover identical pools of collateral. In European second lien intercreditors, the release provisions assume that one set of security interests are held by one security agent on behalf of all of the creditors (senior and second lien).

5. Limitation on First Lien Obligations

U.S. second lien financings typically include a "first lien debt cap" to limit the amount of first lien obligations that will be senior to the second lien obligations. The analogous provision in European second lien intercreditors is referred to as "senior headroom". Amounts that exceed the first lien debt cap or

senior headroom will not benefit from the lien priority provisions in the intercreditor agreement. The "cushion" under the first lien debt cap or senior headroom is meant to allow for additional cash needs of the borrower group, whether as part of a loan workout or otherwise.

The first lien debt cap in U.S. second lien financings is typically 110% to 120% of the principal amount of the loans and commitments under the first lien facilities on the closing date plus up to 120% of the principal amount of any incremental facilities (or equivalent) permitted under the first lien credit agreement on the closing date. The first lien debt cap is sometimes reduced by the amounts of certain reductions to the first lien commitments and funded loans (other than refinancings), e.g. mandatory prepayments. The first lien debt cap does not apply to hedging obligations and cash management obligations, which are generally included as first lien priority obligations without limitation (although the amounts are regulated by the covenants in the credit agreements). In addition, interest, fees, expenses, premiums and other amounts related to the principal amount of the first lien obligations permitted by the first lien debt cap are first lien priority obligations, but are generally not limited by the cap itself. The trend in U.S. second lien financings is to allow for larger first lien debt caps or for the cap to not be set forth in the intercreditor agreement at all (and second lien creditors rely on their covenant protections against additional first lien debt in the second lien debt documentation). Additional capacity is also permitted in the case of DIP financings in the U.S. (as discussed below).

Senior headroom is typically set at 110% of senior term debt plus revolving commitments in traditional European second lien intercreditors, although the headroom concept is of limited relevance where (as is now common on top-tier sponsor deals) it has not been extended to cover incremental and other additional senior debt. Ancillary facilities that would be provided in European deals *in lieu* of external cash management arrangements would be naturally limited by the amount of the revolving commitments since they are made available by revolving credit facility lenders in place of their revolving commitments; however, with the increasing inclusion of separate intercreditor permissions for cash management facilities in European second lien intercreditor agreements on top-tier sponsor deals, this is of less relevance but naturally constrained by the cash management needs of the group. Hedging obligations are typically unlimited but naturally constrained to a degree by the fact that most credit agreements will restrict the borrower group from entering into speculative hedging.

6. Amendment Restrictions

In both U.S. second lien intercreditors and European second lien intercreditors, first lien lenders and second lien lenders traditionally typically specified the extent to which certain terms of the first lien credit agreement and the second lien credit agreement may not be amended without the consent of the holder of the other lien. Amendment restrictions are negotiated on a deal-by-deal basis and may include limitations on increasing pricing and limitations on modifications of maturity date and the introduction of additional events of default and covenants. The trend in both U.S. and European second lien intercreditors, in particular in financings of borrowers owned by private equity sponsors, is for no amendment restrictions. U.S. intercreditors generally require any liens granted to second lien creditors to be granted to first lien creditors on the same basis (and subject to the same subordination arrangement). In Europe, a similar principle applies (but this is subject to negotiated exclusions that are consistent with the limitations on the European security packages).

7. Purchase Options

Both U.S. second lien intercreditors and European second lien intercreditors contain similar provisions whereby the second lien creditors are granted the right to purchase the first lien obligations in full at par, plus accrued interest, unpaid fees, expenses and other amounts owing to the first lien lenders at the time of the purchase. This purchase option gives the second lien creditors a viable alternative to sitting aside during an enforcement action controlled by the first lien creditors by allowing them to purchase the first lien claims in full and thereby acquire the ability to control the enforcement proceedings themselves.

The European version of the purchase option is similar but also includes a requirement to buy out the hedging obligations, which may or may not be included in U.S. second lien intercreditors.

The triggering events for the purchase option in U.S. intercreditors vary. They generally include acceleration of the first lien obligations in accordance with the first lien credit agreement and the commencement of an insolvency proceeding. Other potential trigger events include any payment default under the first lien credit agreement that remains uncured and unwaived for a period of time and a release of liens in connection with enforcement on shared collateral. The triggering event for the European version of the purchase option also varies and may include acceleration/enforcement by the senior creditors, the imposition of a standstill period on second lien enforcement action or the imposition of a payment block.

8. Common U.S. Bankruptcy Waivers

First lien secured parties in the U.S. try to ensure that the first lien secured parties control the course of the Chapter 11 proceeding to the maximum extent possible by seeking advanced waivers from the second lien secured parties of their bankruptcy rights as secured creditors (and, in some cases, as unsecured creditors) that effectively render the second lien secured parties "silent seconds". These waivers can be highly negotiated. However, U.S. second lien intercreditors routinely contain waivers from the second lien secured parties of rights to object during the course of a Chapter 11 proceeding to a debtor-in-possession facility (or "DIP facility"), a sale by the debtor of its assets free of liens and liabilities outside of the ordinary course of business during Chapter 11 proceedings, with the approval of the bankruptcy court (a section 363 sale) and relief from the automatic stay. (The automatic stay stops substantially all acts and proceedings against the debtor and its property immediately upon filing of the bankruptcy petition.)

The enforceability of the non-subordination-related provisions in U.S. second lien intercreditors is uncertain because there is conflicting case law in this area. However, garden-variety subordination-related provisions are regularly enforced by U.S. bankruptcy courts to the same extent that they are enforceable under applicable non-bankruptcy law pursuant to section 510(a) of the Bankruptcy Code.

The second lien creditors in U.S. second lien intercreditors provide their advanced consent to DIP facilities by agreeing that, subject to certain conditions (including a monetary limit to the size of the DIP facilities), they will not object to the borrower or any other obligor obtaining financing (including on a priming basis) after the commencement of a Chapter 11 process, whether from the first lien creditors or any other third-party financing source, if the first lien agent desires to permit such financing (or to permit the use of cash collateral on which the first lien agent or any other creditor of the borrower or any other obligor has a lien).

In the U.S., second lien claimholders often expressly reserve the right to exercise rights and remedies as unsecured creditors against any borrower or guarantor in accordance with the terms of the second lien credit documents and applicable law, except as would otherwise be in contravention of, or inconsistent with, the express terms of the intercreditor agreement. This type of provision, for the reasons articulated above, does not have a counterpart in and would be inconsistent with the underlying rationale of European second lien intercreditors.

9. Non-cash Consideration/Credit Bidding

The LMA intercreditor agreement includes explicit provisions dealing with application of non-cash consideration (including "credit bidding") during the enforcement of security. Credit bidding facilitates debt-for-equity exchanges by allowing the security agent, at the instruction of the senior creditors, to distribute equity to senior creditors as payment of the senior debt or to consummate a pre-pack where the senior debt is rolled into a newco vehicle. However, as mentioned in section 4 above, the ability of the senior creditors to credit bid (in most market precedents) is subject to the negotiated "fair value" protections in respect of the junior creditors.

In the U.S., the term "credit bidding" refers to the right of a secured creditor to offset, or bid, its secured allowed claim against the purchase price in a sale of its collateral under section 363(k) of the Bankruptcy Code, thereby allowing the secured creditor to acquire the assets that are subject to its lien in exchange for a full or partial cancellation of the debt. In U.S. second lien intercreditors, the second lien creditors consent to a sale or other disposition of any shared collateral free and clear of their liens or other claims under section 363 of the Bankruptcy Code if the first lien creditors have consented to the sale or disposition. However, the second lien creditors often also expressly retain the ability to credit bid their second lien debt for the assets of the borrower and guarantors so long as the first lien obligations are paid in full in cash. In European intercreditor agreements, the second lien creditors would not typically have an explicit right to credit bid their second lien debt.

10. The Holders of Shareholder Obligations and Intragroup Obligations

In addition to direct equity contributions, shareholder loans are often used in European capital structures. Shareholder loans are less common in U.S. capital structures and, if present in the capital structure, would likely be unsecured and subordinated to the credit agreement obligations under a separately documented subordination agreement (i.e., not included as part of the typical U.S. second lien intercreditor agreement) and would not typically be included in U.S. first lien/second lien intercreditor agreements. The treatment of intragroup liabilities is often negotiated by the borrower and arrangers in U.S. syndicated credit agreements and, although results differ, the intragroup liabilities are often required to be documented by an intercompany note and made subject to an intercompany subordination agreement. The intercompany subordination agreement would subordinate the intragroup liabilities to be paid by the loan parties to their credit facility obligations and would generally include a payment blockage in relation to intragroup liabilities payable by borrowers and guarantors under the credit facilities during the continuation of an "acceleration event". In European second lien intercreditor agreements, both shareholder loan and intra-group loan liabilities are subordinated to the first and second lien debt claims, but in the case of intragroup loans, have a similar blockage on payments or enforcement during the continuation of an "acceleration event".

Blended Approach Taken in Recent Transatlantic Intercreditor Agreements

Recent intercreditor agreements for financings involving primarily non-U.S. companies in U.S. syndicated bank loan financings, and using NY law-governed loan documents, have taken different approaches to the intercreditor terms, which seem to be determined on a deal-by-deal basis depending on several considerations: (1) the portion of the borrower group's business located in the U.S.; (2) the jurisdiction of organisation of the borrower; (3) the governing law of the other loan documents; (4) the likelihood of the borrower group filing for U.S. bankruptcy protection; (5) the relative negotiating strength of the junior lien creditors and the borrower, who will be inclined to favour future flexibility and lower upfront legal costs; and (6) the markets where (or investors to which) the syndicated debt is being distributed and the expected capital structure. For these and other reasons, seemingly similar financings have taken very different approaches. Some intercreditor agreements ignore the complexities of restructuring outside of the U.S. and simply use a U.S.-style intercreditor agreement; other similar financings have been documented using the opposite approach – by using a form of intercreditor agreement based on the LMA intercreditor agreement; and still other similar financings have sought to blend the two approaches or to adopt an intercreditor agreement in the alternative by providing for different terms (in particular different release provisions) depending on whether a U.S. or non-U.S. restructuring is to be pursued. Given all of these various considerations, Transatlantic Intercreditor Agreements remain varied. We have highlighted below some of the more interesting points:

- the parties typically have included the holders of intra-group liabilities and shareholder loans, following the European approach, and have embedded restrictions on payment of the intra-group liabilities and shareholder loans under certain circumstances;
- the enforcement instructions are typically required to come from a majority of the first lien loans and unfunded commitments in the U.S.-style while the actual exposures of hedge counterparties (plus mark to market positions post-credit agreement discharge) are taken into account in calculating that majority in the European style;
- the European-style release provisions discussed above generally have been included either as the primary method of release or as an alternative method in the event that a U.S. bankruptcy process is not pursued;
- in certain deals, enforcement standstill and turnover provisions have been extended to cover all enforcement actions and recoveries (broadly defined), rather than just relating to collateral enforcement actions;
- claim subordination of the second lien debt has typically ***not*** been included;
- the full suite of U.S. bankruptcy waivers from the second lien creditors generally have been included; and
- it is sometimes the case, based on the underlying rationale of European intercreditors, that secured or (above an agreed threshold amount) unsecured incremental and refinancing debt (whether *pari passu* or subordinated) is required to be subject to the intercreditor agreement, primarily to ensure it can be released upon an enforcement of this group. Note that it would be very unusual for a U.S. investor in New York law-governed unsecured debt to agree to an LMA-style intercreditor agreement.

In addition, other provisions appear in Transatlantic Intercreditor Agreements that will not be familiar to those accustomed to the typical U.S. second lien intercreditors, such as parallel debt provisions (a construct necessary in certain non-U.S. jurisdictions in which a security interest cannot be easily granted to a fluctuating group of lenders), expanded agency provisions for the benefit of the security agent and special provisions necessitated by specific local laws to be encountered (or avoided) during the enforcement process (e.g., French *sauvegarde* provisions and compliance with U.S. FATCA regulations).

Conclusion

As the number of financings that touch both sides of the Atlantic continues to rise and the complexity of such financings increases, the intercreditor arrangements for multi-jurisdictional financings will continue to be important and interesting. Whilst there is not a standard or uniform approach to documenting such intercreditor terms, there is now a broad understanding on both sides of the Atlantic in relation to the different provisions and their underlying rationale. Accordingly, most transactions are implemented on a blended basis, combining many of the above-mentioned European or US elements into a US or European intercreditor, respectively. Having said this, as was the case with European second lien intercreditor agreements, a uniform approach is unlikely to emerge until the new forms of Transatlantic Intercreditor Agreement are stress tested in cross-border restructurings.

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Summary of Key Terms of U.S. Second Lien Intercreditor Agreements and European Second Lien Intercreditor Agreements

Key Terms	Traditional U.S. Second Lien Approach	Traditional European Second Lien Approach	Hybrid/Transatlantic Approach
Parties to the Intercreditor Agreement	The first lien agent and the second lien agent and executed or acknowledged by the obligors.	The first lien agent and lenders, the second lien agent and lenders and the obligors, the obligors' hedge providers, ancillary facility lenders, the lenders of intra-group loans, the lenders of shareholder loans and the security agent.	Generally follows the European approach, except with respect to each lender executing the intercreditor agreement (agents sign on behalf of lenders).
Enforcement Instructions	First lien agent takes instructions from lenders holding 50% of the loans and unfunded commitments under the first lien credit agreement.	Security agent takes instructions from creditors holding 66⅔% (or 50.1% where this the applicable threshold in the second lien facility agreement) of the sum of (i) amounts under the senior credit agreement, and (ii) any actual exposure under hedging agreements.	Generally follows the U.S. approach, but may include hedge counterparties.
Scope of Enforcement Standstill Provisions	Only applies to enforcement against shared collateral (i.e., lien subordination).	Fulsome enforcement standstill including payment default and acceleration (i.e., payment subordination).	Generally follows the European approach, but depends on negotiation.
Length of Enforcement Standstill Provisions	Typically 180 days but could be from 90 to 180 days depending on negotiation.	Historically (i) 90 days (in most cases) following notice of payment default under the senior credit agreement, (ii) 120 days (in most cases) following notice of financial covenant default (where included) under the senior credit agreement, and (iii) 150 days (in most cases) following notice of any other event of default under the senior credit agreement, plus (in some cases) 120 days if the security agent is taking enforcement action, but where negotiated, could be 120 days or longer.	Generally follows the U.S. approach, but depends on negotiation.
Payment Blockages	None.	Included.	Generally not included.
Releases of Collateral and Guarantees	Releases of collateral included.	Releases of all claims included.	Generally follows the European approach.

Summary of Key Terms of U.S. Second Lien Intercreditor Agreements and European Second Lien Intercreditor Agreements			
Key Terms	**Traditional U.S. Second Lien Approach**	**Traditional European Second Lien Approach**	**Hybrid/Transatlantic Approach**
Limitation on First Lien Obligations	Traditionally included a cap of 110% to 120% of the principal amount of the loans and commitments under the first lien facilities on the closing date plus 100% to 120% of the principal amount of any incremental facilities (or equivalent) permitted under the first lien credit agreement on the closing date plus secured hedging and other secured obligations. Many syndicated transactions have gravitated towards the European approach.	Rarely included (dictated by the debt and lien covenant in the second lien facility agreement).	Similar to the U.S. approach.
Amendment Restrictions	May be included depending on negotiation, but typically very limited restrictions.	Historically included but limited to day-one senior credit agreement. Top-tier sponsor intercreditors tend to follow U.S. approach.	Generally follows the U.S. approach.
Second Lien Purchase Options (to purchase the First Lien Obligations)	Included.	Included.	Included.
Common U.S. Bankruptcy Waivers	Included.	Not included.	Included.
Non-Cash Consideration/ Credit Bidding by First Lien Lenders	Included.	Included (in some circumstances).	Included.
Shareholder Obligations and Intragroup Obligations	Not included. Often covered by a separate subordination agreement.	Included.	Often included.
Material Unsecured Debt	Not included.	Sometimes included (above a threshold).	Generally not included.

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A Comparison of Key Provisions in U.S. and European Leveraged Loan Agreements

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Introduction

There are a number of similarities in the general approach taken in relation to drafting and negotiating documentation governing European and U.S. leveraged loan transactions. In the wake of economic disruption caused by the COVID-19 pandemic, both the European and U.S. leveraged loan markets experienced a tumultuous year in 2020. In Europe, early momentum in the leveraged loan market (typified by deal volumes aggregating €40 billion in January) came to an abrupt halt by mid-February, as the impact of the COVID-19 pandemic began to be felt across the continent. For much of the summer, European leveraged loan issuances remained well below 2019 levels, down 37.9% year-on-year by the third quarter of 2020.[1] However, the European loan market proved resilient and a surge in deal activity through the final three months of the year resulted in aggregate leveraged loan volumes of €120.7 billion by year end, a 3.7% increase on 2019.[2] The U.S. leveraged loan market experienced a year-on-year decline in the volume of leveraged loan issuances in 2020 and total institutional loan volume in the U.S. through mid-December 2020 reached a five-year low, continuing a downward trend since the last spike in 2017.[3] Low interest rates stoked a record year for high-yield bond issuances – a significant increase from the market's recent peak in 2017 – and this trend further dampened the leverage loan market in the U.S. That being said, overall 2020 institutional lending in the U.S. was down only 7% from 2019 levels (even though investment grade lending was down 36%).[4] Despite all this, the ratio of high-yield bond to leveraged loan issuances is expected to normalise in 2021,[5] and the volume of leverage loan issuances is expected to increase by as much as 30% from 2020.

In a year that was dominated by uncertainty, covenant relief amendments and emergency financings as well as government-backed liquidity and guarantee programmes, alternative markets (in addition to the roster of traditional lenders) still continued to develop for borrowers to obtain financing in both the U.S. and Europe, including from hedge funds, private equity funds and even insurance firms acting as direct lenders. In the U.S., the ability of private credit providers to close financings with speed and flexibility proved to be an important resource for borrowers during the early phases of the COVID-19 pandemic. While direct lenders also felt stress in the U.S. market, they generally remained open for business while many banks were on pause.[6] In Europe, the trajectory of the direct lending market largely mirrored the wider leverage loan market in 2020. Direct lending activity in Europe was 58% lower in the second quarter of 2020 as compared to the same period in 2019, only for this decline to be offset by a surge in deal activity through year end.[7,8]

As referenced throughout this chapter, the disruption caused by the COVID-19 pandemic had an impact on the terms of leveraged loan agreements in 2020, with volatile deal volumes translating into an unprecedented push-and-pull between sponsors/borrowers and investors/lenders. The pandemic impacted businesses across various industries; as a result, covenants tightened for a period in 2020, but it appears this period of relative discipline was short-lived.

Early European deals featured increasingly sponsor-friendly terms, continuing the erosion of lender protections that characterised the leverage loan market towards the end of 2019.[9] Subsequently, and as the European market slowed and amidst growing uncertainty as to the speed of any post-pandemic recovery, lender-friendly terms began to re-enter loan agreements and restrictions on borrowers seemed to be tightening. By year end, however, the surge in deal volume swung the pendulum back in favour of sponsors and borrowers, with European documentary terms reverting to pre-pandemic norms (and in some cases, going even further). The U.S. leveraged loan market experienced a similar trend. While the year began with aggressive, borrower-friendly terms, by mid-March covenants tightened significantly when borrowers facing the possibility of sharp declines in their revenues due to the pandemic sought to shore up their balance sheets by drawing cash on existing facilities or tapping new debt sources. In exchange for financial maintenance covenant relief, lenders imposed anti-cash hoarding covenants and reduced capacity for dividends and other distributions. Since then, investor demand for debt investments increased, as markets recovered from the impact of the COVID-19 pandemic. Initially, this increase in investing was largely in debt securities and the capital markets, but the term loan market has since recovered as well, indicating a strong start to 2021. As a result, bankers and analysts predict that the U.S. market scales will tip back in favour of sponsors/borrowers, and the debate will continue around erosion of typical investor/lender protections, despite the relatively uncertain recovery environment.[10]

Despite the various similarities, there continue to be significant differences in commercial terms and overall market practice in the U.S. and European leveraged loan markets. As sophisticated investors will seek out opportunities to access whichever market provides greater liquidity and/or better terms and conditions (including pricing) at any given time, it is important for all participants to understand where these markets have converged or continue to deviate.

This chapter will focus on certain of the more significant differences between market practice in the U.S. and Europe that may be encountered in a typical leveraged loan transaction, focusing primarily on non-investment grade borrowers, and is intended to serve as an overview and a primer for practitioners. References throughout this chapter to "U.S. loan agreements"

and "European loan agreements" should be taken to mean New York law-governed and English law-governed leveraged loan agreements, respectively.

This chapter is divided into four parts: Part A will focus on differences in documentation and facility types, Part B will focus on various operational provisions, including covenants and undertakings, Part C will consider differences in syndicate management, and Part D will focus on recent legal and regulatory developments in the European and U.S. markets.

Part A – Documentation and Facility Types

Form Documentation

In both the European and U.S. leveraged loan markets, the form of documentation chosen as a starting point for negotiation and documentation (whether a market or lender form or from a precedent transaction) will greatly influence the final terms. In Europe, both lenders and borrowers, through conduct adopted over a number of years, expect the starting point to be one of the very comprehensive "recommended forms" published by the LMA (or, to give it its formal title, the Loan Market Association) or, particularly on sponsor deals, the borrower's or sponsor's preferred prior transaction precedent. Conversely, in the U.S., although the Loan Syndications and Trading Association (the "LSTA"), an organisation of banks, funds, law firms and other financial institutions, has published a form loan agreement for investment grade transactions and standard forms of a more limited set of provisions (which are generally limited to tax provisions and operational matters) to be included in agreements governing non-investment grade transactions, it is unusual for such forms to be the starting point for drafting. Instead, the parties usually identify a "documentation precedent" – an existing deal on which the loan documentation will be based. In the case of sponsor-backed deals, the proposed precedent is usually based on the applicable sponsor's form, whereas a corporate borrower will either use the company's existing credit documentation or publicly available documentation for a similarly situated borrower.

In addition, sponsors and borrowers increasingly prefer that their counsel "holds the pen" for the production of the first draft of the documentation, as it is perceived that this initial draft will influence the final outcome. Traditionally, counsel on the lender side "held the pen" on documentation but, both in the U.S. and Europe, sponsor-backed borrowers continue to insist on taking control of, and retaining responsibility for, producing the key documents. This is becoming increasingly common for corporate borrowers as well. While key economic issues and financial definitions are negotiated at the term sheet stage (which sponsor/borrower counsel will often draft as well), sponsor/borrower control over the definitive documentation generally leads to a more borrower-friendly starting (and end) point, particularly with respect to negative covenant baskets and thresholds, as well as assignment provisions and rights to replace lenders.

In Europe, the LMA (comprising more than 760 member organisations, including commercial and investment banks, institutional investors, law firms, service providers and rating agencies) has achieved widespread acceptance of its recommended forms as a result of the breadth of its membership and the spread of constituencies represented at the "board" level. Formed initially with the objective of standardising secondary loan trading documentation, the LMA now plays a "senior statesman" advisory role in the European loan market by producing and updating (and giving guidance on key provisions in) its recommended forms for, amongst other things, investment grade loan transactions, leveraged acquisition finance transactions, developing market and commodity finance transactions, real estate finance transactions and private placement transactions. The LMA plays an active role in monitoring developments in the financial markets, responding to regulatory consultation requests and giving guidance on appropriate approaches in documentation in response to market, regulatory and political developments (indeed, most recently in the context of the transition away from LIBOR, the Green Loan Principles, the impact of the COVID-19 pandemic and the United Kingdom's withdrawal from the European Union): its influence and authority is significant.

The widespread use of the LMA standard forms has resulted in good familiarity within the European investor market which, in turn, has added to the efficiency of review and comprehension not just by those negotiating the documents, but also by those who may be considering participating in loans. Whilst, as noted above, the LMA recommended forms are only used as a starting point for European leveraged loan documents, the "back-end" LMA recommended language for boilerplate and other non-contentious provisions of the loan agreement will be only lightly negotiated (if at all). However, the commercial provisions (such as mandatory prepayments, financial covenants, representations and warranties, business undertakings, transfer restrictions, conditions to drawdown, etc.) remain as bespoke to the specific transaction as ever. A sponsor-backed borrower will likely identify existing documentation for another portfolio company of the sponsor, which puts the onus on the lead bank to identify any provisions that may negatively impact syndication. Leading sponsors now effectively have their own "required" forms, although even those are something of a moving target, as "improvements" secured on prior deals are elevated to be part of the "required" form, resulting in a "best-of-all-worlds" scenario for sponsor-backed borrowers.

In relation to market and regulatory developments that could affect both loan markets as a whole, it is worth noting that the LSTA and LMA often cooperate and coordinate their approach in issuing guidance and recommended language. By way of example, in May 2020, the LMA and LSTA (in conjunction with the Asia Pacific Loan Market Association) launched guidance documents aimed at growing and developing the global market for green and sustainability-linked loan products.[11]

Facility Types

The basic facility types in both U.S. and European leveraged loan transactions are very similar. Typically, a loan agreement will provide for a term loan facility and/or a revolving credit facility, which, if both are included, are most often secured on a *pari passu* basis (unless it is an "asset-backed" facility, in which case, though both facilities will be first lien facilities, there will be "split priority" collateral, an arrangement outside of the scope of this chapter).

In both the U.S. and Europe, loan agreements now typically provide for uncommitted "incremental facilities", which can take the form of additional term loans or revolving credit commitments. The borrower will have to satisfy certain customary conditions to obtain these incremental facilities (including obtaining commitments from entities that would be eligible assignees of existing loans), but the consent of the existing lenders is not required for the incremental facilities (which increase the overall facility size), subject to the limitations set forth in the loan agreement, which are discussed in more detail below in Part B.

In both the U.S. and in Europe, all lenders (whether revolving credit lenders or term loan lenders) in first lien facilities (other

than asset-backed revolving loans as briefly noted above) or unitranche facilities will share the same security package, the same ability to enforce such security and the same priority in relation to payments and the proceeds from the enforcement of security (unless there is a "first in last out" structure, which, as discussed below, is sometimes used in the U.S.). Alternatively, a financing transaction may adopt a first lien/second lien structure, in which the "first lien" and "second lien" loans are secured by the same collateral, but the liens of the second lien lenders are junior to those of the first lien lenders (i.e., no collateral proceeds or prepayments may be applied to any second lien obligations until all first lien obligations have been repaid (unless, in the case of prepayments, there is basket availability)). If there is a revolving credit facility, this will be included in the first lien facilities. The second lien facility will be a term loan with no amortisation payments. First lien/second lien structures are treated as two separate loans, with two sets of loan and security documents and two agents, with the relationship between the two lender groups set out in, and governed by, an intercreditor agreement.

In the U.S. (and often now in Europe), certain transactions (typically smaller deals) are structured as a unitranche facility, rather than as separate first lien and second lien facilities, in which there is a single loan with two tranches – a first out tranche and a last out tranche. In such a facility, there is only one set of loan documents, one agent, one set of lenders and, from the borrower's perspective, one interest rate (because the borrower pays a blended rate, and, depending on the market appetite for the different levels of risk, the lenders decide the allocation of interest between the first out lenders and the last out lenders). Usually, a separate agreement among lenders (an "AAL") governs the rights and obligations of the first out and last out lenders, including voting rights, and the allocation of interest between the lenders. Alternatively, the allocation of rights and obligations among the lenders may be included in the loan agreement itself, which borrowers may prefer, as it gives them better visibility on where the control of the voting rights sits in the lender group. That said, the *In re RadioShack Corp.* litigation in the U.S. Bankruptcy Court for the District of Delaware largely resolved any question as to whether a court presiding over a borrower's bankruptcy could construe and enforce an AAL in the bankruptcy (even though borrowers are not party to AALs) by implicitly recognising the court's ability to interpret and enforce an AAL, so either construct should be acceptable.

In Europe, driven by the rising prominence of debt funds and alternative capital providers, unitranche and direct loan facility structures play an increasingly significant role in the debt market, primarily in the smaller to mid-market transactions, though funds are keen to emphasise (and are continuing to demonstrate) their ability to do much larger financings. In Europe, alternative capital providers are increasingly providing funding to private companies, with a particular focus on sponsor-less corporates who are looking to obtain debt in order to achieve their medium- and long-term growth strategies. It is worth noting that debt funds and alternative capital providers may not always have the capacity to provide working capital facilities to borrowers and, as such, they may "club" with commercial banks to provide that component of the financing. In such instances, the commercial bank may retain a senior ranking over the debt fund/alternative capital provider in relation to the working capital facility.

Similarly to U.S. unitranche structures, European unitranche structures also utilise an AAL, and, typically, the borrower is not a party to this agreement. In the restructuring context, European unitranche structures have also raised their own issues – in particular, questions around whether the first out and last out creditors comprise a single class for the purposes of an English law scheme of arrangement under Part 26 of the Companies Act 2006, notwithstanding the various creditors' distinct economic positions and interests as set out in the AAL. Whilst unitranche structures and the rights of unitranche creditors in a scheme of arrangement have not been directly considered by the English courts, cases (such as *Re Apcoa Parking Holdings GmbH & Ors*)[12] suggest that unless creditors can demonstrate that their distinct economic rights are also accompanied by corresponding legal rights, enforceable against the borrower (which is not the case if the borrower is not party to the AAL), it is likely to be difficult for junior creditors to maintain that they should form a separate class in a scheme of arrangement (and, as such, the junior lenders may forfeit the potential hold-out value that may entail during the course of a borrower's restructuring). In June 2020, a new form of restructuring plan was introduced under Part 26A of the Companies Act 2006 (pursuant to the Corporate Insolvency Governance Act 2020) ("Part 26A Plan"). A Part 26A Plan offers companies experiencing financial difficulty (who fall within the jurisdiction of the English courts) an alternative to a traditional scheme of arrangement. Whilst a detailed summary is beyond the scope of this chapter, it is worth noting that the Part 26A Plan introduces a novel concept into English restructuring law – the court-sanctioned "cross-class cram-down" – drawing inspiration from U.S. Chapter 11 proceedings. Whilst a scheme of arrangement requires the approval of 75% (in value) of <u>each class</u> of creditors (granting them a *de facto* veto), an English court may force that same group to accept a Part 26A Plan – provided certain conditions are met. Consequently, even if unitranche creditors were to be considered a separate class in a European restructuring context, the application of a Part 26A Plan "cross-class cram-down" would limit their influence significantly. The English courts' power to sanction a Part 26A Plan and enforce a "cross-class cram-down" is discretionary – a power first exercised on 13 January 2021 in relation to a Part 26A Plan proposed by the DeepOcean group. Whilst the English court's willingness to apply a "cross-class cram-down" on a dissenting class of DeepOcean's creditors is a notable step, the concept remains in relative infancy and is likely to develop significantly in the coming years.

In the case of European borrowers with both secured high-yield debt and bank debt (usually revolving credit facilities) in their capital structures, so called "super senior" structures are also very common. In such structures, both the lenders under the revolving credit facility and the high-yield noteholders rank equally in regard to payment and the security package. However, the lenders under the revolving credit facility will rank "super senior" in that they take priority over the noteholders in relation to the proceeds of recovery from any enforcement action. In exchange for this, the high-yield noteholders typically will have the ability to enforce and/or direct enforcement, for a certain period of time.

Term Loan Types

The terms of a financing are influenced not just by the size and nature of the transaction, but also by the composition of the lending group. "Term A" loans (under what are most commonly referred to as "TLA facilities") are syndicated in the U.S. to traditional banking institutions, who typically require a five-year maturity, higher amortisation (which generally starts at 1% per year, but increases to 5% or 10% per year during subsequent years) and include at least one, if not multiple, financial covenants, which are tested quarterly. "Term B" loans (under what are most commonly referred to as "TLB facilities") comprise a

large percentage of the more sizeable leveraged financings (especially in the U.S.) and are typically held by institutional investors. First lien TLB facilities typically require amortisation in an annual amount equal to 1% of the original principal amount. TLB facilities are more likely to be governed by "covenant-lite" agreements, under which there will be a single leverage covenant that benefits the revolving credit facility only, and such covenant is only tested if revolving credit usage exceeds a certain percentage of the revolving credit commitments – typically 25% to 35%. The maturity date of TLB facilities will also be longer – typically, six or seven years, and a second lien TLB facility may even have an eight-year maturity – while a TLA facility will likely have a five-year maturity. To compensate for these more borrower-friendly terms, TLB facilities usually have a higher interest rate margin and other economic protections (such as "soft-call" and, in the case of second lien term loans, "no-call" periods, as well as "excess cash flow" mandatory prepayment provisions) not commonly seen in TLA facilities. It is worth noting that many facilities with leverage-based maintenance covenants (including some TLA facilities) were amended in the wake of the economic impact from the COVID-19 pandemic to replace the quarterly maximum leverage covenant with a monthly minimum liquidity covenant for a period of time, sometimes well into 2021.

Whilst historically European sponsors and borrowers unable to negotiate sufficiently flexible or desirable loan terms with their usual relationship banks had to resort to the U.S. TLB and high-yield bond markets in order to achieve the flexibility they desired, the growth of debt funds, direct lenders and the enthusiasm of U.S. institutional investors to participate in the European loan market led to the evolution of the English law "European TLB" market. Indeed, the European TLB market is now an established and attractive funding option for borrowers in larger leveraged transactions with terms frequently as flexible (and sometimes more flexible) than those seen in their U.S. TLB facility equivalent. Many larger borrowers and sponsors in the European TLB market have been very successful in negotiating generous borrower-friendly relaxations in their loan covenants (in particular relating to debt capacity, permitted disposals and acquisitions, and financial covenant cure rights, to the extent the loan is not "covenant-lite"), although most European TLB instruments are still likely to contain guarantor maintenance coverage tests (requiring the accession of additional guarantors and the provision of security by such new guarantors, if the required test thresholds are not met), and to have higher lender consent thresholds.

Certainty of Funds

In the United Kingdom, when acquiring a UK listed public company where all or part of the consideration is cash, the City Code on Takeovers and Mergers (the "Code") requires purchasers to have "certain funds" prior to the public announcement of any bid. The bidder's financial advisor is required to confirm the availability of the funds and, if it does not diligence this appropriately, may be liable to provide the funds itself should the bidder's funding not be forthcoming. Understandably, both the bidder and its financial advisor need to ensure the highest certainty of funding. In practice, this requires the negotiation and execution of loan documentation and fulfilment of the conditions precedent (other than those conditions that are also conditions to the bid itself) at the point of announcement of the public bid. The conditions to drawdown, and the lenders' rights to enforce during the period in which the bid is ongoing, are also significantly limited by the Code – only in very limited circumstances (relating to the bidder and not the target or its group) can the lenders decline to lend or accelerate and enforce.

Whilst not a regulatory requirement, the concept of "certain funds" has also permeated the private buyout market in Europe, so that sponsors are (in practice) required to demonstrate the same level of funding commitment as if they were making a public bid, albeit that this is not a legal or regulatory requirement for a private bid.

In the U.S., there is no regulatory certain funds requirement as in the United Kingdom and, typically, only commitment papers, rather than full loan documents, are executed at the time when the bid becomes binding on the bidder (that is, upon execution of a purchase agreement, merger agreement or other acquisition agreement). A detailed term sheet will be attached to the commitment letter that will outline agreed-upon key terms and other important concepts to be included in the final loan documentation (including a definitive list of what representations, warranties, covenants and events of default will be included and the definition of consolidated adjusted EBITDA, including "add-backs"). Such detailed term sheets set forth specific baskets and thresholds for covenants and events of default and identify leverage levels for the incurrence tests for debt, restricted payments, restricted debt payments and investments. In the U.S., commitment papers for an acquisition financing will contain customary "SunGard" provisions that limit the representations and warranties that are required to be accurate, and, in some cases, those that are required to be made by the loan parties, at closing and provide a post-closing period for satisfying collateral requirements and, in some cases, providing guarantees. Usually, closing requirements are limited to filing Uniform Commercial Code financing statements and delivering stock certificates (and related stock powers) of the borrower (if not a public company) and material U.S. restricted subsidiaries (and then only to the extent actually received from the target). Given the level of commitment implicit in New York law commitment papers and the New York law principle of dealing in good faith, the difference, as a practical matter, between European "certain funds" and SunGard commitment papers, is not as significant as it may appear, but it is clear that SunGard would not be acceptable in a Code public bid.

Part B – Loan Documentation Provisions

Covenants and Undertakings

Whilst the dominant theme of recent years has been the increasing inclusion in European deals of U.S.-style loan provisions that are more flexible and borrower-friendly – or "convergence" as it is commonly referred to – many differences remain between U.S. and European loan agreements in the treatment and documentation of covenants (as such provisions are described in U.S. loan agreements) and undertakings (as such provisions are described in European loan agreements). This Part B explores some of those differences and concludes with a recap of some thematic developments in response to the COVID-19 pandemic.

Both U.S. and European loan agreements use a broadly similar credit "ring fencing" concept that underpins the construction of their respective covenants/undertakings. In U.S. loan agreements, borrowers and guarantors are known as "loan parties", whilst their European equivalents are known as "obligors". In each case, the loan parties/obligors are generally free to deal between themselves, as they are all within the same credit group and bound by the terms of the loan agreement. However, to minimise the risk of credit leakage, loan

agreements will typically restrict dealings between loan parties/obligors and their subsidiaries and other affiliates that are not loan parties/obligors, as well as third parties generally.

In U.S. loan agreements, there is usually an ability to designate members of the borrower's group as "unrestricted subsidiaries" (subject to customary conditions, including sufficient investment capacity, *pro forma* financial covenant compliance and the absence of any default or event of default both before and after giving effect to the designation). The covenants, representations and warranties do not apply to members of the unrestricted group (other than certain fundamental matters, such as anti-money laundering and anti-terrorism provisions), and assets of unrestricted subsidiaries are not included in the collateral package. In exchange for such freedom, the loan agreement will limit dealings between members of the restricted group and those entities within the unrestricted group – in effect, treating the latter as though they were third parties. In addition, EBITDA attributable to the unrestricted group is not included in ratio tests (whether it is an incurrence test or for financial covenant compliance) unless distributed to a member of the restricted group, and debt of the unrestricted group is similarly excluded. Borrowers have sought more flexibility with respect to unrestricted subsidiaries, but lenders have been pushing back due to attempts by borrowers to use these unrestricted subsidiaries to consummate transactions not intended to be permitted. One notable example of such a manoeuvre came in December 2016 when J.Crew Group, which owned its domestic trademarks through a restricted subsidiary, transferred a significant interest in those trademarks to a foreign restricted subsidiary, which in turn transferred it to an unrestricted subsidiary (and subsequent transfers were made to other unrestricted subsidiaries). In response to the high-profile clash between J.Crew Group and the relevant lenders, some investors have been particularly focused on including a specific prohibition on transfers of material intellectual property to an unrestricted subsidiary – commonly known as the "J.Crew blocker".[13] Despite this focus, each of Travelport, Cirque du Soleil and Party City utilised the terms of their existing credit documentation in 2020 to designate entities with material assets as unrestricted subsidiaries. Other "trap doors" that could be used to strip value from the collateral and guarantee package have since been exposed, such as the ability to transfer nominal amounts of equity issued by a guarantor to a third party (which may or may not be affiliated with the restricted group). Some agreements include an automatic release mechanism that frees what becomes a non-wholly owned subsidiary from its guarantee obligations (and also releases its assets from the security interest granted to secure the debt).

Whilst not historically a feature of the European loan market, the use of the "restricted/unrestricted" subsidiary construct has been seen in a number of European loan agreements in recent years, particularly in the context of European TLB instruments. Of particular concern to lenders has been the increasing number of European leveraged loan agreements permitting unlimited transactions (e.g., loans, disposals, guarantees) between "restricted" subsidiaries, irrespective of whether those "restricted" subsidiaries are guarantors. This trend, coupled with the shift away from caps on obligor to non-obligor leakage and increasingly large non-obligor debt baskets, has increased lenders' exposure in the most aggressive sponsor-backed deals. Accordingly, and whilst there are some differences between European and U.S. loan agreements when it comes to papering the "restricted/unrestricted" construct, the substantive concerns of lenders with respect to leakage on both sides of the Atlantic are aligned (albeit with fewer high-profile examples in the European leveraged loan market to date).

Restrictions on Indebtedness

Leveraged loan agreements include an undertaking, referred to as an "indebtedness covenant" in U.S. loan agreements and a "restriction on financial indebtedness" undertaking in European loan agreements, that prohibits the borrower and its restricted subsidiaries from incurring indebtedness other than certain categories of permitted indebtedness. Typically, "indebtedness" of a person will be broadly defined in the loan agreement to include borrowed money and other obligations such as notes, letters of credit, contingent and lease obligations, hedging liabilities (on a mark-to-market basis) and guarantees of obligations of third parties that otherwise constitute indebtedness, as well as indebtedness of third parties secured by assets of such person.

In U.S. loan agreements, the indebtedness covenant is generally drafted to prohibit all indebtedness save for indebtedness falling within various baskets allowing for specific types and/or amounts of indebtedness. Some of these exceptions are customary, such as loans to entities within the credit group, non-speculative hedging obligations and debt to fund capital expenditures (up to an agreed cap), but others will be tailored to the business of the borrower. In addition, there are other baskets, such as the general "basket" for debt (which can take the form of a fixed amount or may also include a "grower" component based on a percentage of total assets or consolidated adjusted EBITDA), an "incurrence-based" basket, which requires *pro forma* compliance with a specified leverage or fixed charge ratio, and a basket for indebtedness incurred, acquired and/or assumed in connection with permitted acquisitions. These other baskets will be sized based on the borrower's business and risk profile and the lead bank's or underwriters' relationship with the sponsor or the borrower, as applicable.

Reclassification provisions (allowing the borrower to utilise one debt basket and then, later, reclassify such debt as being incurred under a different debt basket) are common in the U.S.; for example, some borrowers have negotiated the ability to refresh their free-and-clear basket by re-designating debt originally incurred under the free-and-clear basket as debt incurred under the leverage-based incremental capacity. Some U.S. loan agreements contain reclassification provisions applicable to other covenants (such as the lien and investment covenants, and, in more aggressive deals, the restricted payment and restricted debt payment covenants) in addition to indebtedness covenants. These reallocation provisions have the effect of allowing borrowers to reclassify transactions that were incurred under a fixed, dollar-based basket as having been incurred under an unlimited leveraged-based basket if the borrower de-levers or if its financial performance improves. Some agreements allow borrowers to use restricted payment and restricted debt payment capacity to incur debt or make investments. This is part of a more general trend of giving borrowers flexibility to use a basket designated for a specific purpose for other purposes.

The loan agreements of large cap and middle market U.S. borrowers also typically provide for an incremental facility allowing the borrower to incur additional debt under the credit agreement (on top of any commitments the credit agreement originally provided for), or, *in lieu* thereof, additional *pari passu* or subordinated incremental debt (which may be secured or unsecured) outside the loan agreement, under a separate facility (known as "incremental equivalent" provisions). Initially, the incremental facilities were limited to a fixed dollar amount (typically sized at 50% to 100% of closing date consolidated adjusted EBITDA), referred to as "free-and-clear" baskets, but now many borrowers can incur an unlimited amount of incremental loans so long as a *pro forma* leverage ratio is met (which will be a

first lien, secured or total leverage test, depending on whether the new debt is to be secured on a *pari passu* or junior lien basis or is unsecured). These levels are generally set to require compliance with closing date leverage levels or, in the case of unsecured debt, with a specified interest coverage ratio (typically 2.0×). Some deals include increased ratio incremental capacity for acquisitions by providing that the borrower may incur incremental debt even if the closing date leverage ratio would be exceeded, so long as *pro forma* leverage does not increase as a result of the acquisition.

Most U.S. loan agreements permit borrowers to simultaneously use the free-and-clear basket and the leveraged-based incremental basket without the former counting as leverage for purposes of the ratio test. A loan agreement may also provide for increases to the free-and-clear basket over the life of the loan, such as dollar-for-dollar increases upon voluntary prepayments of existing loans and/or voluntary reductions in revolving commitments and by adding a "grower" component to the free-and-clear basket that increases as the borrower's consolidated adjusted EBITDA (or total assets) grows.

Typically, incremental facilities have a most favoured nations ("MFN") clause that provides that, if the margin of the incremental facility is higher than the margin applying to the loans under the original facility, the original facility margin will be increased to within a specific number of basis points (usually 50 basis points) of the incremental facility's margin. Borrower-friendly loan agreements often include limitations with respect to MFN clauses, usually a "sunset" restricting their application to a certain timeframe, typically six to 18 months following closing. Such borrower-friendly agreements often incorporate further provisions aimed at eroding MFN protection, such as (i) limiting MFN protection to incremental term loans borrowed using the free-and-clear capacity or incremental term loans that mature within a certain period (usually, two years) of the latest-maturing existing term loans, and (ii) setting a threshold amount of incremental term loans that may be borrowed without triggering MFN protection. Alternatively, some U.S. deals limit MFN protection to incremental term loans incurred under the ratio incremental capacity. This approach, combined with the ability to reclassify debt, allows borrowers to incur incremental debt under the free-and-clear incremental basket and then reclassify such debt as incurred under the ratio incremental capacity, thereby avoiding the MFN provision and refreshing their free-and-clear incremental capacity.

U.S. loan agreements also typically include an exception to the debt covenant for refinancing debt. Historically, refinancing debt was subject to limitations as to principal amount (i.e., not to exceed the principal amount of the old debt *plus* accrued interest, fees and costs), maturity, weighted average life to maturity, ranking, guarantees and security. It is now common for the cap to also include the amount of any unused commitments.

The restriction on financial indebtedness undertaking typically found in European loan agreements is broadly similar to its U.S. covenant counterpart and usually follows the same construct of a general prohibition on all indebtedness subject to certain "permitted debt" exceptions (both customary ordinary course type exceptions as well as specifically tailored exceptions requested by the borrower). A notable recent trend in the European loan market (particularly in larger leveraged transactions) has been the relaxations around the ability of borrowers to incur additional debt. There is now a definite trend towards U.S.-style permissions, such as "permitted debt" exceptions based on a leverage and/or secured leverage (and sometimes interest coverage) ratio test combined with a general fixed permitted basket where such additional (or incremental) debt may be incurred within the loan agreement by way of an accordion facility, or outside the loan agreement by way of a separate side-car facility (demonstrated in the fact that the LMA now includes incremental facility language in its standard form documentation).

Whilst uncapped, leverage ratio-based incremental debt capacity has become a standard feature of large-cap European loan agreements, there has been a little to-and-fro on this over the last couple of years. In early 2019, lenders sought to counterbalance their exposure by resisting the inclusion of an additional "freebie" or "free-and-clear" amount. Through the first half of 2019, 77% of European loan agreements featuring incremental debt capacity also provided the borrower with a "freebie" (the use of which was not conditional upon the borrower's ability to meet the relevant incremental debt ratio test), down from 90% in the first half of 2018.[14] However, as 2019 progressed, lenders' resistance began to crumble – with a "freebie" featuring in nearly 90% of European loan agreements by year end.[15] Most of these "freebies" remained soft-capped grower baskets, determined by reference to EBITDA. In 2020, rather than pushing back on the overarching concept of "freebies" as they had in early 2019, lenders focused their attention on resisting the prevalence of "freebies" soft-capped at 100% EBITDA (and were often successful in reducing caps to 75%, or less).[16] Whilst it remains the case that "freebie" baskets are scrutinised further by investors in the European market as compared to their U.S. counterparts (predominantly driven by historic push-back during the syndication process), there was a notable shift towards convergence of European and U.S. terms with respect to "freebie baskets" in 2020 (reversing the trends seen in early 2019).

As in the case of U.S. loan agreements, European loan agreements with incremental facility provisions will invariably contain MFN protections. However, MFN protections are one aspect of European loan agreements that have changed significantly in the wake of the COVID-19 pandemic (even though such a shift was not observed in U.S. loan agreements). Changes have included a reduction in the amount of debt not subject to MFN protection, references to "margin" being flexed to "yield" (so as to take advantage of interest rate floors and original issue discounts), and the deletion of carve-outs for MFN protection for debt incurred under "permitted" baskets. 2020 also saw a considerable number of MFN protections under European loan agreements extended from six months to 12 months – as lenders gear-up for a potential wave of refinancings and restructurings in 2021 and beyond.

Restrictions on Granting Security/Liens

U.S. loan agreements will also invariably restrict the ability of the borrower (and usually, its subsidiaries) to incur liens. A typical U.S. loan agreement will define "lien" broadly to include any charge, pledge, claim, mortgage, hypothecation or otherwise any arrangement to provide a priority or preference on a claim to the borrower's property. This lien covenant prohibits the incurrence of all liens subject to certain typical exceptions, such as liens securing permitted refinancing indebtedness, purchase money liens, statutory liens and other liens that arise in the ordinary course of business, as well as a general basket that is based on a fixed dollar amount and may also include a "grower" component based on a percentage of consolidated total assets or consolidated adjusted EBITDA. This "general basket" for liens is often tied to the size of the general debt basket. In some large cap deals, both in the U.S. and in Europe, borrowers are able to secure permitted indebtedness based on a first lien leverage ratio or senior secured leverage ratio. The provisions that permit such indebtedness typically will provide

that the additional indebtedness may be secured on a *pari passu* basis, subject to a prohibition on earlier maturity and an MFN clause in order to prevent a borrower from incurring priming or dilutive debt.

The European equivalent, known as a "negative pledge", broadly covers the same elements as the U.S. restriction on liens (with the same business-driven exceptions), but typically goes further and restricts "quasi-security" where an arrangement or transaction is entered into primarily to raise financial indebtedness or to finance the acquisition of an asset. "Quasi-security" includes transactions such as sale and leaseback, retention of title and certain set-off arrangements.

Restriction on Investments

A restriction on the borrower's ability to make investments is commonly found in U.S. loan agreements. "Investments" include loans, advances, equity purchases and other asset acquisitions. Historically, investments by loan parties in non-loan parties have been capped at modest amounts. Depending on the borrower's business, particularly the size of its foreign operations, if any, and credit profile, loan parties may be permitted to invest significant amounts in any of their restricted subsidiaries, including foreign subsidiaries, who are not guarantors under the loan documents. Other generally permitted investments include short-term securities or other low-risk liquid investments, loans to employees and subsidiaries, permitted acquisitions and investments in other assets which may be useful to the borrower's business. In addition to the specific list of exceptions, U.S. loan agreements also include a general basket, sometimes of a fixed amount, but increasingly including a "grower" concept based on a percentage of consolidated adjusted EBITDA or total assets.

Investment covenant exceptions in U.S. deals are fairly permissive, and the tightening and exercise of "flex" seen with respect to other provisions has not had a notable impact on the investment covenant in loan agreements. Some deals still include an unlimited ability to invest in and acquire non-guarantor restricted subsidiaries or provide that capacity for investments in non-loan parties can be re-designated to the general basket, increasing general investment capacity. Increasingly, all restricted payment and restricted debt payment capacity may be reallocated and used for investments. This has its roots in the high-yield bond market where investments are treated as a type of restricted payment.

One area where there has been noticeable loosening of investment capacity is with respect to investments in unrestricted subsidiaries. It is now common for borrowers to have the choice of a variety of investment baskets for investments in unrestricted subsidiaries, including the general basket, the builder basket and the ratio basket. Some loan agreements also include baskets for investments in similar businesses and/or joint ventures. As discussed earlier in this Part B, some lenders are including a specific prohibition on transfers of material intellectual property to an unrestricted subsidiary. However, despite the media attention, many loan agreements (even those in sectors with valuable intellectual property) still do not include direct blockers of such transfers.

European loan agreements will typically contain stand-alone undertakings restricting the making of loans, acquisitions, joint ventures and other investment activity by the borrower (and other obligors) and commonly restrict such activity by way of fixed cap baskets and other additional conditions. The prevalence of builder baskets in European loan agreements continues to increase, and whilst they remain less common than in U.S. loan agreements, often acquisitions will be permitted if funded from certain specified sources, such as retained excess cash flow.

Whilst historically restricting acquisitions through ratio tests alone was not the norm in European loan agreements, it is now common for borrowers to be permitted to make acquisitions subject to satisfying a *pro forma* leverage ratio test (with fewer of the previously customary additional conditions on acquisitions). With increasing frequency, European loan agreements also permit unlimited acquisitions provided the acquired entity becomes a "restricted subsidiary".[17] Soft-capped baskets for acquisitions and investments (where the monetary limit is (i) based on the greater of a fixed amount and a percentage of earnings or asset value, and (ii) increasingly often, fixed at a percentage of consolidated adjusted EBITDA) are also now more commonplace in the European market. In 2020, parties to European loan agreements were particularly focused on soft-capped baskets (for acquisitions, investments and more broadly) in light of the economic uncertainty caused by the COVID-19 pandemic. A number of European loan agreements in 2020 tailored soft-grower baskets to incorporate "high-water marking" language – removing the floor from the basket's fixed value limb (i.e., limb (i) above). Rather than incorporate this limb as a fixed amount from the outset, the "high-water mark" language ties the fixed amount figure to the "peak" of consolidated adjusted EBITDA from time to time, irrespective of any subsequent decrease (by virtue of a downturn, asset sale or otherwise). This shift undermines certainty otherwise afforded to lenders by inclusion of the fixed amount and reveals a notable sponsor-friendly shift in late 2020 European loan agreements terms.

Restricted Payments

U.S. loan agreements will typically restrict borrowers from making payments to the holders of their equity, including repurchases of equity, payments of dividends and other distributions (all referred to as "restricted payments"), and from making payments on subordinated and/or junior lien debt. As with the covenants outlined above, there are typical exceptions for restricted payments, such as payments on equity solely in shares or stock, or payments of the borrower's share of taxes paid by a parent entity of a consolidated group. U.S. deals are incorporating increasingly permissive restricted payment baskets, reflecting investor comfort with expansive permitted investment capacity. For example, it is relatively common (especially with better-rated credits) to allow loan parties to make a distribution consisting of equity in unrestricted subsidiaries. Such a basket, together with the borrower-friendly investment covenant baskets described above (which permit larger investments in unrestricted subsidiaries), give borrowers greater flexibility to move assets outside the credit group, such as by contributing assets to an unrestricted subsidiary using their broad investment capacity and then distributing the unrestricted subsidiary to the borrower's shareholders. Under the terms of many loan agreements with these provisions, lenders would have no consent rights over such a transaction and no ability to exercise remedies as a result, even though the collateral package would be negatively affected. Another trend is the removal of event of default conditions on the use of baskets such as the available amount basket and the ratio restricted payment basket or limiting the condition to only the absence of payment and bankruptcy defaults.

In European loan agreements, such payments are typically restricted under separate specific undertakings relating to dividends and share redemptions or the making of certain types of payments to non-obligor shareholders, such as management and advisory fees, or the repayment of certain types of subordinated debt. As usual, borrowers will be able to negotiate

specific carve-outs (usually hard capped amounts) for particular "permitted payments" or "permitted distributions" as required (for example, to permit certain advisory and other payments to the sponsor), in addition to the customary ordinary course exceptions. In a further example of sponsor-friendly terms emerging in Europe, a number of European loan agreements in 2020 incorporated large "starter amount baskets" (up to 40%–50% EBITDA), permitting payments of cash to the sponsor in the short term, regardless of the borrower's consolidated net income.

Builder Baskets

Most U.S. loan agreements also include a "builder basket", which is typically referred to as a "Cumulative Credit" or an "Available Amount" and represents an amount the borrower can utilise for investments, restricted payments, junior debt prepayments or other (otherwise restricted) purposes. Historically, the builder basket would grow over time based on the portion of excess cash flow not required to be used to prepay the term loans (often referred to as "retained" excess cash flow). Increasingly, borrowers are gaining the flexibility to have their builder baskets grow based on 50% of consolidated net income, rather than excess cash flow. For a borrower with positive consolidated net income, this will result in a larger basket, as borrowers minimise the amount of excess cash flow required to repay their loans. Use of the builder basket is often subject to compliance with a certain financial ratio test, especially when used for restricted payments or for junior debt prepayments.

Historically, European loan agreements typically have not provided this broad flexibility, although this is changing in the context of large-cap deals and the increasing role of the European TLB market. Whilst strong sponsors and borrowers have typically been able to negotiate provisions permitting payments or distributions from retained excess cash flow, subject to satisfying a certain leverage ratio, deal trends over the past few years have revealed that the U.S. approach towards allowing restricted payments is now being accepted in Europe. In 2020, a significant number of European loan agreements included a "builder basket" for restricted payments, calculated upon 50% consolidated net income and subject to a zero floor. This trend, in addition to the prevalence of loan agreements containing an uncapped upstream payment ability (albeit subject to satisfaction of a *pro forma* leverage test) and the aforementioned "starter amount baskets", further illustrates the convergence of terms between the U.S. and European markets.

Call Protection

In both European and U.S. loan agreements, borrowers are commonly permitted to voluntarily prepay loans in whole or in part at any time. However, some loan agreements do include call protection for lenders, requiring the borrower to pay a premium if loans are repaid within a certain period of time (the "call period"). "Hard call" protection provisions (where term loan lenders receive the premium in the call period for any prepayment, regardless of the source of funds or other circumstances) are not common in the U.S. or European loan market, and are more commonly seen in the second lien tranche of loans and mezzanine facilities (typically containing a gradual step down in the prepayment premium from 2% in the first year, 1% in the second year, and no call protection thereafter). On the other hand, "soft call" protection premiums (also known as "repricing protection" and typically 1% of the amount repriced) are common in the U.S. and European TLB market. These apply to prepayments made within a certain period (typically six to 12 months after closing) that are funded with the proceeds of a refinancing or re-pricing of the existing term loans at a lower rate. There are often exceptions to call protection premiums for prepayments made in connection with any transaction that would constitute an initial public offering, a change of control or a transformative acquisition. Call protection is relatively rare in the European market for senior (bank held, TLA) debt, and some U.S. deals include no call protection at all.

Voluntary Prepayments and Debt Buybacks

Provisions regulating debt buybacks are typically found in both U.S. and European loan agreements, but such provisions generally do not receive much attention. However, "super priority uptier exchanges" that can utilise these provisions recently came into the spotlight in the U.S. loan market. In 2020, a simple majority of first lien term loan lenders under the Serta, Boardriders and TriMark credit facilities approved amendments allowing for "super priority" debt capacity. In connection with their consent to the incurrence of such debt, such lenders exchanged their existing first lien term loans into new "super priority" term loans. Lenders that did not participate were left with effectively subordinated debt, and in the case of Boardriders and TriMark, they also lost the benefit of most (if not all) of the affirmative and negative covenants.

U.S. loan agreements typically permit the borrower to offer to repurchase loans rateably from all lenders, in the form of a reverse "Dutch auction" or similar procedure. Participating lenders are repaid at the price specified in the offer and the buyback is documented as a prepayment or an assignment. Many loan agreements also permit loan buybacks through non-*pro rata* open market purchases. These purchases are negotiated directly with individual lenders and executed through a form of assignment. Unlike loans repurchased by the borrower (which are required to be cancelled), loans purchased by sponsors or other affiliates that are not subsidiaries of the borrower may remain outstanding. Loan agreements cap the amount that sponsors and affiliates (that are not *bona fide* debt funds) may hold (usually at 25% to 30% of the facility) and also restrict the right of such sponsors or affiliates in voting the loans repurchased.

Similarly, in European loan agreements, "Debt Purchase Transaction" provisions have been included in LMA recommended form documentation since late 2008. The LMA standard forms contain two alternative debt purchase transaction provisions – one that prohibits debt buybacks by a borrower (and its subsidiaries), and a second alternative that permits such debt buybacks, but only in certain specific conditions (for example, no default continuing, the purchase is only in relation to a term loan tranche and the purchase is made for consideration of less than par).

Where the loan agreement permits the borrower to make a debt purchase transaction, to ensure that all members of the lending syndicate have an opportunity to participate in the sale, it must do so either by a "solicitation process" (where the parent of the borrower or a financial institution on its behalf approaches each term loan lender to enable that lender to offer to sell to the borrower an amount of its participation) or an "open order process" (where the parent of the borrower or financial institution on its behalf places an open order to purchase participations in the term loan up to a set aggregate amount at a set price by notifying all lenders at the same time).

Both LMA alternatives permit debt purchase transactions by the sponsor (and its affiliates), but provide for the

disenfranchisement of the sponsor (or its affiliate) in respect of the purchased portion of the loan (i.e., so it cannot exercise votes attaching to the acquired loans and commitments).

Mandatory Prepayments and Change of Control

Most credit agreements require U.S. borrowers prepay term loans with the net proceeds of certain material asset sales and/or casualty events and with the net proceeds of specified debt. A loan agreement documenting a TLB facility typically will include an excess cash flow sweep, and the percentage of excess cash flow that is required to be used to prepay such term loans will decrease as leverage decreases. Often, the asset sale prepayment provisions carve out certain types or sizes of dispositions from the obligation to prepay, include generous reinvestment rights, and/or include a threshold amount under which the borrower need not use the proceeds to prepay. Some U.S. loan agreements include step-downs permitting borrowers to apply increasingly lower percentages of the net proceeds of asset sales to prepay loans as leverage declines and allow the borrower to use asset sale proceeds to rateably prepay *pari passu* debt.

In U.S. loan agreements, a change of control usually triggers an event of default, rather than a mandatory prepayment, as is commonly seen in European loan agreements. Delaware Court of Chancery cases have applied increasing scrutiny to the continuing director change of control provisions, particularly "dead hand" proxy put provisions. The issues raised in the cases include whether a change of control provision may restrict the ability of the existing board of directors to approve a dissident slate; whether a director breaches his or her fiduciary duty by failing to approve a dissident slate where such failure causes a change of control event of default under an existing loan agreement or indenture; and whether the administrative agent of a company's credit facility aids and abets a breach of fiduciary duty by such company's board due to adoption of a loan agreement containing a change of control provision restricting the ability of existing directors to approve a dissident slate.[18] As a result, the inclusion of any proxy put is disappearing in the U.S. market and the "dead hand" proxy put has all but disappeared.

Mandatory prepayment provisions continue to shift in the European loan market, as borrowers and lenders seek greater flexibility. Historically, a mandatory prepayment of the loan facilities triggered by a change of control event would be a standard feature of European loan agreements. This provision would provide relative inflexibility for certain syndicated lenders in the context of an acquisition, effectively imposing prepayment upon them (as a waiver of the borrower's prepayment would typically require all lender consent). However, there has been a notable rise in the inclusion of "put right" provisions for lenders in European loan agreements over the past few years, akin to the change of control provisions commonly found in high-yield bonds. Whilst the practice of the "put right" provisions in the context of leveraged loans is relatively untested (and the inclusion of a 1% prepayment premium as is common in high-yield bonds remains atypical), these "put right" provisions effectively grant the lenders and borrowers greater flexibility to negotiate terms prior to a contemplated change of control.[19]

Financial Covenants

Historically, U.S. leveraged loan agreements contained at least two financial maintenance covenants: a leverage test (total, first lien or secured, depending on the type of facility); and an interest coverage or fixed charge coverage test, each of which would be tested at the end of each quarter. Now, an interest coverage or fixed charge coverage financial maintenance covenant is unlikely to be seen except in an agreement governing a TLA facility, and, increasingly, such agreements only contain a leverage test.

In the U.S., "covenant-lite" loan agreements continue to dominate the leveraged loan market. A covenant-lite loan agreement typically contains only one financial maintenance covenant (usually a leverage covenant) which is applicable only to the revolving credit facility and only when a certain percentage of revolving loans and letters of credit are outstanding at the testing date (25%–35% is fairly typical, but this can be as high as 40%). However, as mentioned earlier in this chapter, existing maintenance covenants were modified or suspended in exchange for minimum liquidity covenants and other restrictions during applicable relief periods as part of many COVID-19 credit preservation and amendment packages in the U.S. in 2020. Covenant-lite loan agreements typically contain financial ratio incurrence tests – used as a condition to incurring debt, making investments, restricted payments or restricted debt payments or entering into other specified transactions. Unlike maintenance covenants, incurrence-based covenants are not tested regularly and a failure to maintain the specified levels would not, in itself, trigger a default under the loan agreement; it merely reduces flexibility by limiting basket use for so long as the *pro forma* incurrence test cannot be met.

European loan agreements historically included a full suite of maintenance financial covenants. With the influx of institutional investors and increased liquidity generally affording sponsors and borrowers increased bargaining power, "covenant-lite" and "covenant-loose" deal structures are much more prevalent, especially where it is intended that the loan will be syndicated to an institutional investor base. European deal activity in the first half of 2020 revealed that nearly 91% of loan transactions were "covenant-lite" (a slight increase from 90% in 2019), meaning that the facility contained only a single financial covenant for the revolving facility lenders (usually a leverage ratio covenant, tested on a springing basis) or contained no maintenance financial covenant at all.[20] In European "covenant-lite" loan agreements, springing covenants are typically tested only when the revolving facility is 40% drawn (excluding backstopped letters of credit, non-backstopped letters of credit up to a threshold and, for a year or two after closing, closing date revolving borrowings up to a threshold amount). Some more aggressive deals exclude any revolving facility drawings made in connection with acquisitions or investments, or any closing date utilisations, from the calculation of the test trigger.

As noted above, in the U.S., many agreements allow the borrower to designate "unrestricted subsidiaries", subject to the customary conditions, and the debt and consolidated adjusted EBITDA of unrestricted subsidiaries are not considered for purposes of leverage covenant compliance (unless, in the case of consolidated adjusted EBITDA, it is distributed to the borrower or a restricted subsidiary). Moreover, leverage covenants sometimes only test a portion of consolidated debt – sometimes only senior debt or only secured debt (and top-tier sponsor deals sometimes only test first lien debt). Lenders are understandably concerned about this approach as the covenant may not accurately reflect overall debt service burden. Rather, it may permit the borrower to incur unsecured senior or subordinated debt and still remain in compliance with the leverage covenant. This trend has not yet found its way over to Europe.

In the event a U.S. loan agreement contains a leverage covenant, it likely will be a "net debt" test that reduces the total indebtedness (or portion of debt tested) by the borrower's and its restricted subsidiaries' unrestricted cash and cash equivalents.

Lenders may try to cap the amount of cash a borrower may net out to discourage both over-levering and hoarding cash, but this is increasingly uncommon. In addition, aggressive deals do not include certain debt (such as purchase money and capital lease obligations, all subordinated debt, or even any debt up to a fixed dollar amount) in the portion of debt tested. The trends with regard to netting illustrate the continued success of higher-quality credits in pushing for greater flexibility, but this was offset during the height of the pandemic by the emergence of anti-cash hoarding provisions, which are described in more detail below.

In Europe, the total net debt test is generally tested on a consolidated group basis, with the total net debt calculation usually including the debt of all subsidiaries (excluding intra-group debt). Unlike the cap on netted cash and cash equivalents in some U.S. loan agreements, European borrowers net out all free cash in calculating compliance with the covenant.

With strong sponsor backing, borrowers have increasingly reduced the effectiveness of financial covenants by increasing the amount of add-backs included in the borrower's consolidated adjusted EBITDA calculation. In recent years, both U.S. and European loan documents have included broader and more numerous add-backs, including transaction costs and expenses, restructuring charges, payments to sponsors and costs and expenses related to certain extraordinary and/or non-recurring events. Most borrowers have negotiated add-backs (historically, generally to the extent reasonably identifiable and factually supportable and achieved within a certain time period) for projected and not yet realised cost savings and synergies. The trend had been for add-backs becoming increasingly vague and flexible – for example, add-backs "of a type" similar to those in the model delivered to arrangers during syndication or cost savings add-backs without a requirement relating to when the savings materialise and other broad add-backs that include all "business optimisation" expenses and references to "synergies" and "initiatives". In addition, it is increasingly common for such add-backs to be uncapped and not limited to a percentage of consolidated adjusted EBITDA.

In the wake of the economic disruption caused by the COVID-19 pandemic, many borrowers fully drew on their revolving facilities early in the year to be sure that they would be able to meet short-term cashflow needs. In many cases, these drawdowns led to additional financial testing (by virtue of a springing financial covenant), and, as a result, EBITDA add-backs took centre-stage in 2020. Borrowers sought to avoid potential financial covenant breaches by looking for ways to fit pandemic-related costs and expenses in their existing add-backs to consolidated adjusted EBITDA. For some borrowers, the permissive nature of existing EBITDA calculations and add-backs enabled them to maintain financial maintenance covenant compliance in 2020. This was typically predicated on the interpretation of uncapped add-backs for "extraordinary", "unusual", "non-recurring" or "exceptional" losses, costs and expenses. The European market even coined the phrase "EBITDAC" (earnings before interest, taxes, depreciation, amortisation and *coronavirus*), leading to unease amongst lenders as to the potential consequences of broadly construed COVID-19-related EBITDA add-backs in the future. In reality, while a handful of new European leveraged loan deals in 2020 did incorporate "EBITDAC" add-backs, they have been relatively modest in scope and were often limited to a pre-determined time period.[21] For many borrowers, though, these add-backs were not enough to offset sharply declining revenue, leading to the rash of amendments that replaced leverage tests with liquidity monitoring. Amendments related to COVID-19 are discussed in more detail below.

In the U.S., the Leveraged Lending Guidance and the federal regulatory agencies enforcing it (discussed further in Part D) have suggested that regulators may apply heightened scrutiny to definitions of consolidated adjusted EBITDA that provide for add-backs without "reasonable support". This regulatory scrutiny, even if less threatening in recent years, has led to greater negotiation of EBITDA add-backs for projected improvements in operating results, sometimes resulting in limits on the timing for the realisation of anticipated synergies. Whilst some U.S. deals do not limit the time period during which such cost savings must be realised or are expected to be realised, it is typical for deals to include a time period ranging from 18 to 24 months (occasionally, 36 months). There may be some negotiation over whether the cost savings must be reasonably expected to be realised during this "look forward" period or whether the borrower needs only to expect to have taken substantial steps toward realising such cost savings within the period.[22] In some cases, there also may be percentage caps on savings and synergies add-backs, typically 20%–35% of consolidated adjusted EBITDA in the U.S. As a result, some borrowers and sponsors turned to alternative lenders to whom such regulatory oversight does not apply. However, the effects of the global pandemic forced many borrowers in 2020 (regardless of their lenders' regulatory landscape) to the negotiating table to address the impact of sagging earnings that could not be dealt with by aggressive add-backs. To the extent borrowers did not already have broad and vague add-backs available, there was less flexibility for these borrowers to take expansive interpretations and weather the global pandemic without seeking covenant relief and credit preservation amendments.

In Europe, similar percentage caps on cost synergy add-backs have generally increased in recent years. However, lenders in the European market are increasingly aware of the pitfalls of including uncapped EBITDA add-backs in their loan documents with the majority of European leveraged loan deals coming to market in 2020 including a cap on adjustments. Furthermore, and in a rare step in favour of lenders in the European loan market in 2020, all European loan deals which came to market with uncapped EBITDA add-backs were flexed at syndication to include an average cap of 25% of consolidated adjusted EBITDA per relevant period.[23]

Equity Cures of Financial Covenants

The majority of sponsor deals in the U.S., loan agreements that contain maintenance financial covenants (whether or not "covenant-lite") also contain the ability for the sponsor to provide an "equity cure" to remedy any non-compliance. The proceeds of such equity infusion are usually limited to the amount necessary to cure the applicable default and, if the applicable capital contribution is made in cash or other approved equity, will be deemed added to EBITDA for this purpose. Because financial covenants are meant to regularly test the financial strength of a borrower independent of its sponsor, U.S. loan agreements place restrictions on the frequency (usually no more than two fiscal quarters out of four) and absolute number (usually no more than five times over the term of the credit facility) of equity cures. In some cases, arrangers have been successful in restricting the ability of sponsors to provide an equity cure in consecutive quarters.

In Europe, equity cure rights have been extremely common for many years. As in the U.S., the key issues for negotiation relate to the treatment of the additional cure equity; for example, whether it should be applied to increase cash flow or earnings, or to reduce net debt (and, if so, whether it should also be required to be applied in prepayment of the facilities). Whilst historically it was restricted to the latter, European deal

activity over the last few years has revealed a definitive trend towards "EBITDA cures" – that is, cure amounts being treated as an increase in earnings rather than as a reduction in net debt. Similar restrictions apply to equity cure rights in European loan documents as they do in the U.S. in respect of the frequency and absolute number of times an equity cure right may be utilised. In Europe, the frequency has traditionally been lower (and usually, an equity cure could not be used in consecutive test periods) and was subject to a lower overall cap (usually, no more than two or three times over the term of the facility). However, these restrictions are loosening, with the majority of European loan agreements permitting consecutive cures in 2019 and 2020 (following the U.S. loan market construct by allowing up to two cures in any four-quarter period).

One of the key differences that has remained unchanged between the U.S. and European approaches to equity cures is that, unlike in U.S. loan agreements, "over-cures" are typically permitted in European loan agreements (that is, the ability to inject more equity proceeds than is actually required to cure any financial covenant non-compliance). Such an ability is advantageous to some borrowers by allowing them to obscure any possible future underperformance. Another borrower-friendly trend which has emerged in the European loan market in the last three years has been the "prepayment cure", which allows a borrower to avoid being tested against a springing financial covenant by simply prepaying its revolving loans to a level below the relevant springing test threshold (which, as noted above, is typically set at the revolving facility being over 40% drawn). In most cases, a "prepayment cure" will not require the borrower to cancel the facility by the amount prepaid, and the borrower will not be prohibited from redrawing the prepaid amounts after the (avoided) test date. From a documentation perspective, it is also important to note that there is still no LMA recommended equity cure language.

LIBOR Successor Rate Provisions

Notwithstanding that U.S. leveraged loan agreements already include a prime rate interest rate alternative to LIBOR, the loan market continues to integrate "fallback" language into loan documentation to enable the transition to a new rate in anticipation of the discontinuation of LIBOR. Towards the end of 2020, the ICE Benchmark Administration commenced a consultation with the market on ending one-week and two-month USD LIBOR on 31 December 2021 and the remaining USD LIBOR tenors on 30 June 2023. A definitive statement is anticipated in 2021 regarding the final date for publication of USD LIBOR by tenor.[24] The LSTA has been working with the Alternative Reference Rates Committee (the "ARRC"), the body tasked with replacing U.S. dollar LIBOR, to develop more robust mechanisms for such fallback provisions. These provisions have three components: the trigger event (such as LIBOR cessation) that causes the transition to a replacement rate; the actual replacement rate and adjustment to the interest rate spread; and any required amendment process. While not yet the definitive replacement rate standard, attention has largely focused on variations of SOFR. This is based on the LSTA's and ARRC's belief that SOFR is a secured risk-free rate that has a liquid and deep basis in treasury repurchase agreements. Some variations of SOFR are more similar to LIBOR, such as Forward-Looking Term SOFR and SOFR Compounded in Advance, while others are less similar to LIBOR, such as SOFR Compounded in Arrears and Simple SOFR in Arrears. The ARRC published updated recommended fallback language for syndicated loans in June 2020 providing that, upon a trigger event, a successor rate would be determined in accordance with certain specified rate and spread adjustment waterfalls (i.e., the "hardwired" approach). The updated language does not provide a refreshed "amendment" approach. The ARRC has noted that hardwired fallback language offers certainty as to the successor rate and spread adjustment. The ARRC's prevailing argument is that both borrowers and lenders should prefer avoiding the logjam of necessary amendments and also that investors can take comfort in the fact that borrowers will not be able to take advantage of a transient market environment and to capture economic value with a non-representative rate.[25] Additionally, the ARRC suggests that hardwired fallback language will likely be more executable on a large number of transactions at the point of LIBOR transition. Surveys of LIBOR fallback provisions in recent years have indicated that the ARRC's recommended approach was less common in the syndicated loan market than in the floating rate notes market and few deals were using the hardwired approach. This continued to be the case in 2020. However, the syndicated loan market's sentiment began to change in 2020 as more deals adopted the hardwired approach.

In Europe, the LMA has continued its proactive approach with respect to the discontinuation of LIBOR by encouraging both borrowers and lenders to consider the implications of the forthcoming change in their loan documents. Despite the significant impact of the COVID-19 pandemic on the European loan market, the LMA has echoed comments from the Bank of England and Financial Conduct Authority – reiterating that there is no intention to delay the LIBOR transition and that market participants should be appropriately prepared.

Throughout 2020, the LMA (in conjunction with the Sterling Working Group) published numerous recommendations, conventions, webinars and exposure drafts to assist market participants in preparing for the end of LIBOR. These publications included (i) exposure drafts of two multicurrency term and revolving facilities agreements incorporating rate switch provisions (catering for both the "lag" and "observational shift" methodologies) (the "Exposure Drafts"), (ii) a revised recommended form of "Replacement Screen Rate Clause" and pre-cessation trigger, and (iii) a statement of recommendations for conventions for sterling loans based on the Sterling Overnight Index Average ("SONIA") compounding in arrears. The LMA is very keen to stress that the Exposure Drafts are not LMA recommended forms. They cite "*insufficient established market practice or infrastructure*" as the key reason for why the Exposure Drafts can only be considered "*focal points for consideration*", and note that the Exposure Drafts contain a greater number of blank placeholders and optional provisions than the LMA's recommended forms. However, the LMA does note that it is for market participants themselves to determine to what extent the Exposure Drafts are suitable as the basis for preparing loan documentation for transactions, and note that they envisage producing recommended forms as market practice and infrastructure develops in the relevant areas.

Despite substantial progress (and the LMA's protestations), most European leveraged loan documents in 2020 still adopted the LMA's "Replacement of Screen Rate" clause (or analogous provisions), rather than detailed rate switch or day one RFR referencing provisions. Whilst there were a small number of European deals during 2020 that either hardwired the switch from LIBOR to SONIA (or any other benchmark), or referenced them from day one, most were content to include the enhanced LMA "Replacement Screen Rate" language (or wording based thereon) to facilitate a smoother transition when the time comes. Nevertheless, the LMA has been keen to trumpet deals in the European market which have taken a progressive approach to the LIBOR transition, including (i) British American Tobacco's £6 billion multicurrency revolving credit facility (which contained a built-in switch mechanism from LIBOR to SONIA and

SOFR) in March 2020, (ii) GlaxoSmithKline's $2.5 billion and £1.9 billion SOFR- and SONIA-linked revolving credit facility (the first loan in the European market to be linked to reference free rates from day one) in September 2020, and (iii) Tesco's £2.5 billion sustainability-linked revolving credit facilities (the first loan in the European market to, amongst other things, reference the published conventions for compounded SONIA and SOFR loans) in October 2020. Whilst the aggregate quantum of these loans is undoubtedly significant, it is worth noting that all of them are backstop facilities and are relatively unlikely to be drawn.

Sanctions, Anti-Money-Laundering and Anti-Bribery Provisions

Both European and U.S. loan agreements include representations, warranties and covenants relating to anti-bribery, anti-money laundering and sanctions (the "Anti-Corruption/Sanctions Laws"). Because they are fundamental to the ability of any financial institution or investor to extend credit, in the U.S. market, SunGard provisions (discussed in Part A) identify representations with respect to Anti-Corruption/Sanctions Laws as specified representations, though these sometimes have "use of proceeds" qualifications. Similarly, in the European market, lenders invariably insist on such representations being characterised as "major representations" for certain funds purposes, at least in private acquisitions. Negotiation of these provisions may focus on whether it is appropriate to limit these provisions by materiality and/or by knowledge. Both European and U.S. borrowers often are concerned about their ability to fully comply with broadly drafted provisions without some form of knowledge, scope and/or materiality qualifiers.

QFC Stay Provisions

In May 2019, the LSTA published a market advisory regarding the U.S. QFC Stay Rules and their application to U.S. global systemically important banking organisations ("GSIBS").[26] The rules also apply to worldwide subsidiaries of GSIBs and U.S. subsidiaries, branches and agencies of foreign GSIBs. At a high level, the rules require GSIBs to include new language in certain credit agreements if the loan documents also support the borrower's obligations under swaps or other qualified financial contracts. The LSTA has proposed model language, which is loosely analogous to the Contractual Recognition Provision required by the EU/UK Bail-in Rule (discussed in detail below), and it is common for leveraged loan agreements in the U.S. to include the model language. As referenced above, the LMA produced a guidance note to its members on the U.S. QFC Stay Rules incorporating a link to the LSTA model language.

EU/UK Bail In Legislation

On 28 January 2019, the LMA published a revised version of its user guide pertaining to EU Bail In Legislation.[27] The updates were largely mechanical, following the adoption of enacting legislation relating to Article 55 of EU Directive 2014/59 in Norway and Lichtenstein. Of the 33 EEA states required to enact domestic implementing legislation pursuant to Directive 2014/59, 32 have now done so, with only Iceland outstanding. The LMA user guide provides market participants with guidance on the terms of the LMA Bail In Clause, together with guidance on the requirements under Article 55. The LMA also updated its recommended form of Bail In Clause (within section 3 of the user guide) in January 2020. The updates were again largely mechanical and intended to meet the expected requirements of the UK's post-Brexit contractual renegotiation of the bail-in regime. EU Directive 2014/59 (also referred to as the Bank Resolution and Recovery Directive, "BRRD") contains broad powers for EEA regulators to facilitate the rescue of failing EEA financial institutions. The BRRD confers power on the EEA regulators to write down and/or convert into equity failing institutions' liabilities. As a matter of law, those powers will be effective in respect of any liabilities under a document governed by the law of an EEA country, regardless of the terms of the relevant document. Article 55 of the BRRD speaks specifically to a scenario where an EEA financial institution assumes liabilities under a document which is governed by the law of a non-EEA country. Article 55 requires EEA financial institutions to include special terms into almost every document to which they are a party, in circumstances where that document is governed by the law of a non-EEA country. Under those special terms the EEA financial institution's counterparties acknowledge that the financial institution's liabilities under that document are subject to an EEA regulator's powers of write down and conversion (the "Article 55 Requirement"). The Article 55 Requirement applies to any loan market documentation governed by the law of any non-EEA country to which an EEA financial institution is a party, irrespective of the institution's capacity. In the context of European-based lending transactions, the most likely documents to be affected are security documents governed by the law of a non-EEA country. EEA financial institutions active in the U.S. are therefore likely to be impacted by the Article 55 Requirement, to the extent their documentation is governed by New York law.

COVID-19-Related Measures

COVID-19-related issues led to a variety of adjustments in the U.S. and European loan markets, including maintenance covenant relief or suspension, the addition of a temporary liquidity covenant and temporary negative covenant restrictions, changes to EBITDA for the expected impacted period, changes to "material adverse effect" or "material adverse change" representations, revolver upsizings and incremental debt incurrences.[28]

The pandemic's devastating economic impact had a direct effect on many borrowers' consolidated adjusted EBITDA calculations. The period of initial leverage covenant relief typically extended until a specified date (generally either the end of 2020 or the first or second quarter of 2021). In exchange, it was common in the U.S. for borrowers to agree to a minimum liquidity covenant during the same period. Additionally, for many borrowers, negative covenants were tightened to limit restricted payments, investments, junior debt payments and certain asset sales during the covenant relief period. These relief windows, and the related operational limitations, were sometimes further negotiated and subsequently extended, depending on the relevant borrower's recovery trajectory. In some cases, extensions were agreed through the end of 2021 for the sectors that were most severely impacted by the pandemic (such as the travel and entertainment industries).

Earlier in the pandemic, many borrowers were faced with having to determine whether a "material adverse effect" (or "MAE") (or, depending on the term used in the relevant loan agreement, a "material adverse change" (or "MAC")) had occurred. For any borrower that determined an MAE or a MAC had occurred, its ability to borrow under its credit facilities, including any revolving credit facility, was cut off at a time when having access to balance sheet cash had become essential.

This is because most credit agreements require a bring-down of representations and warranties as a condition to funding, and, in most non-investment grade credit agreements, this will include a representation that there has not been an "MAE". The failure to satisfy a condition tied to the absence of any "MAE" has historically been difficult to prove in a U.S. acquisition context (particularly when the acquisition agreement is governed by Delaware law), but U.S. credit agreements often do not contain the same types of exceptions to the analysis as appear in acquisition agreements (i.e., exclusions for adverse changes arising from general business, economic, national or international conditions, general changes in financial markets, and changes in law).[29] This gap left an opening for lenders to refuse funding on the basis that the no "MAE" condition to borrowing could not be satisfied and increased borrowers' concerns about making such a representation. In many cases (including both amendments to existing agreements and new financings) in the U.S., borrowers sought to exclude the effects of the COVID-19 pandemic from the "MAE" definition, alleviating any such concerns. In exchange for this and the move to liquidity covenants, lenders sought concessions.

One such concession has been found in the emergence of anti-hoarding provisions in U.S. credit agreements. These provisions were last seen in oil and gas sector loan agreements in 2016 – at the time, the falling price of oil devastated borrowers in those industries, and these provisions were implemented to prevent borrowers from creating negotiating leverage with their bank group in advance of an insolvency filing.[30] A common formulation prevents borrowers from accessing their revolving credit facility if, after receiving the proceeds, the borrower group would hold cash above a certain threshold. Some agreements go further and require a borrower to use any cash on hand in excess of that threshold to prepay amounts outstanding under the borrower's revolving facility – effectively adding a mandatory prepayment and not just an additional condition precedent to borrowing. Interestingly, analogous provisions are yet to make their way into European leveraged loan documents.

In Europe, borrowers sought similar waivers and amendments in order to avoid potential COVID-19-driven defaults. European borrowers with "MAE" or "MAC" provisions in their loan agreements were particularly concerned that the economic turbulence caused by the COVID-19 pandemic would give lenders a sufficient basis to refuse funding (or worse still, that lenders would opt to call "MAE" or "MAC" defaults as the global economy ground to an abrupt halt). However (as in the U.S.), "MAC" or "MAE" defaults in Europe are notoriously difficult to prove and many of the underlying provisions no longer include a "forward-looking" element – limiting lenders' appetite to call a "MAC" still further. Despite this, a number of borrowers in Europe sought comfort, often by way of technical waivers/amendments with respect to "MAE" or "MAC" provisions, or by opting to draw down under their facilities before the full scale of COVID-19's impact could be fully assessed.

Furthermore, given the considerable upheaval in working practices and the rapid reallocation of resources, many borrowers requested extensions for delivery of their financial statements (and other information-related deliverables) in the first few months of the COVID-19 pandemic. As the year progressed and the pandemic took hold, the main pressure points in Europe (as in the U.S.) concerned financial covenant compliance and whether the impact of COVID-19 on a borrower's business would trigger any other events of default under their loan documents. Echoing the calls for leniency and compassion from most European governments (reflected in a number of government-backed liquidity schemes), many lenders agreed to suspend financial covenant testing in 2020 (with some suspensions already scheduled to continue into 2021). As discussed earlier in this chapter, some borrowers also applied a broad interpretation for EBITDA add-backs in their existing financial covenant provisions – softening the immediate impact of the COVID-19 pandemic on their perceived financial performance.

Lenders were generally accommodating throughout 2020, though their consent to waivers and amendments with respect to certain covenants was often provided in exchange for the tightening of others. As in the U.S., the most common request for consenting lenders was the inclusion of a temporary monthly minimum liquidity covenant – providing a degree of comfort in the absence of typical financial covenants. Many lenders also requested (and received) monthly reporting on the borrower group's cash position.[31] It is also worth noting that a number of more conservative lenders also sought to suspend or reduce certain "permitted" baskets – with a particular focus on "permitted" payments, dividends and distributions (in part to counterbalance the knock-on effect of generous EBITDA calculations on "grower baskets").

Part C – Syndicate Management

Voting Thresholds

Traditionally, U.S. loan agreements only require a simple majority of lenders (that is, more than 50% of lenders by outstanding loans and unused commitment) for all non-unanimous issues. Such percentage constitutes the "Required Lenders". As discussed earlier in this chapter, the execution of "super priority uptier exchanges" in 2020 demonstrated the power of a simple majority.

Historically, European loan agreements contained a "majority lender" threshold set at two-thirds of the relevant commitments (drawn and undrawn). Whilst a two-third majority continues to be the threshold in most European investment grade loans, an increasing number of European leveraged loan agreements define "majority lenders" as a simple majority, continuing a trend first observed in 2019.[32] Furthermore, in many European loan agreements, certain votes that previously would have required unanimity may instead require only a "super majority" vote, ranging between 66⅔%–80% of lenders by commitments. Such super majority matters typically relate to releases of transaction security or guarantees, or an increase in the facilities (though not an increase that might result in an obligation to fund on the part of the non-consenting lender).

Historically, "unanimous" decisions in U.S. loan agreements are limited to releases of guarantors and liens (but notably, not subordination of liens or modifications to related covenants), voting provisions and *pro rata* sharing provisions, but fundamental economic matters (such as increases in pricing and extensions of maturity) usually only require the consent of "affected" lenders (and are not, therefore, truly unanimous). In European loan agreements (except where they may be designated as a super majority matter), decisions covering extensions to commitment periods, payment dates and reductions in amounts payable (even certain mandatory prepayment provisions), changes to currencies and commitments, transfer provisions and rights between lenders all typically require the unanimous consent of lenders (not just those affected by the proposed changes).

Yank-a-Bank

Both U.S. and European loan agreements often contain provisions allowing the borrower to remove one or more lenders from the syndicate in certain circumstances. A borrower may, for example, remove a lender that refuses to agree to an amendment or waiver requiring the consent of all lenders (or all affected lenders), if a majority of the lenders (or a majority of the affected

lenders, if applicable) have consented to such amendment or waiver. Other reasons a borrower may exercise "yank-a-bank" provisions are when a lender has become a "defaulting lender" or has demanded reimbursement for certain increased cost or tax payments. In such circumstances, the borrower is permitted to force the non-consenting (or otherwise impacted) lender's commitment and loans to another lender or other eligible assignee without the impacted lender's consent, and some loan agreements will permit the borrower to repay loans and terminate commitments of such impacted lenders on a non-*pro rata* basis.

Snooze-You-Lose

In addition to provisions governing the required votes of lenders, most European leveraged loan agreements will also contain "snooze-you-lose" provisions, designed to encourage lenders to respond promptly to requests for amendments, consents or waivers. Where a lender does not respond within a specified time frame, such lender's commitment is ignored when calculating whether the requisite vote percentage of commitments have approved the request. Similar provisions are rare in U.S. loan agreements.

Transfers and Assignments

Generally, borrowers have the right to consent to lender assignments unless an event of default then exists and, increasingly, unless a payment of bankruptcy event of default exists. Lenders in the U.S. may also be able to transfer funded term loans to another lender or affiliate of a lender and, in the case of revolving commitments and loans, to another revolving lender. In the U.S., the LSTA has recommended, and most loan agreements include, "deemed consent" of a borrower where a borrower does not object to proposed assignments within a specified period of time. A similar provision is very common in the European market. However, it is increasingly common for "deemed consent" provisions to apply only to funded term loans. Stronger European borrowers and sponsors and almost all U.S. borrowers are able to negotiate a "blacklist" (otherwise known as a "DQ" list) of ineligible potential lenders. In both the European and U.S. contexts, the blacklist or "DQ" list helps the borrower avoid becoming a borrower from lenders with difficult reputations or which are otherwise unattractive to the borrower, such as competitors. Sponsor-backed and more sophisticated corporate borrowers in the U.S. commonly push for expansive "DQ" lists and the ability to update the list post-closing (but lenders try to limit these updates to competitors and new affiliates of competitors and other disqualified lenders). This development has also made its way to European loan agreements.

Historically, most sub-investment grade European and U.S. deals provided that lenders were free to assign or transfer their loans and commitments to other existing lenders (or an affiliate of a lender) without consulting the borrower, or, in the European market, at minimum, free to assign or transfer their commitments to a pre-approved list of lenders (a whitelist). However, over the past few years, there has been an increase in restrictions on transfers to loan-to-own and distressed investors. For stronger borrowers in Europe, the lenders must obtain the consent of the borrower prior to any transfer or assignment to a lender that is not an existing lender (or affiliate).

In European loan agreements, lenders may assign their rights or otherwise transfer by novation their rights and obligations under the loan agreement to another lender. Typically, lenders will seek to rely on the transfer mechanism, utilising the standard forms of transfer certificates which are typically scheduled to the loan agreement. However, in some cases, an assignment may be necessary to avoid issues in some European jurisdictions which would be caused by a novation under the transfer mechanic (particularly in the context of a secured deal utilising an English-law security trust, which may not be recognised in some European jurisdictions).

Part D – New Regulatory and Legal Developments in the Loan Market

Leveraged Lending Guidance

U.S. federal bank regulators indicated during the third quarter of 2014 that they would more carefully scrutinise leveraged lending issuances following their determination that a third of leveraged loans they reviewed did not comply with the Leveraged Lending Guidance (the "U.S. Guidance") issued in March 2013 by the Federal Reserve, the OCC and the FDIC. The U.S. Guidance provides, among other things, that a total leverage ratio in excess of 6.0× when compared to consolidated adjusted EBITDA will raise regulatory concern for most industries and may result in the loan being criticised.

Since 2015, non-regulated financing sources have been more active in the U.S. lending market, which is at least partially due to the U.S. Guidance. Following the issuance of an interagency statement in 2018, which clarified that supervisory guidance does not have the force and effect of law, regulated financial institutions returned to the highly leveraged lending market. In that same year, public remarks by the Federal Reserve Board Chairman and OCC Comptroller on the topic were viewed by many industry observers as indicating that the federal banking agencies were already backing away from the U.S. Guidance.[33] Further, in November 2020, U.S. federal banking agencies issued a proposed rule to codify this interagency statement and to expressly provide that supervisory guidance will not serve as the basis for examiner criticisms and formal or informal enforcement actions. That said, while codifying how the market currently views the U.S. Guidance, adoption of the rule is not a meaningful shift from the current view of enforcement authority (or lack thereof).

Similar leveraged lending regulations have been introduced in Europe. On 16 May 2017, the ECB published its long-awaited guidance to banks regarding leveraged transactions (the "ECB Guidance"), effective November 2017. Whilst the ECB Guidance is not legally binding, affected institutions are expected to incorporate the ECB Guidance into their internal lending policies (in line with the size and risk profile of each banks' leveraged transaction activities relative to their assets, earnings and capital). The guidance outlines the ECB's expectations regarding risk management and reporting requirements, with a stated aim of providing senior management a comprehensive overview of the bank's leveraged lending activities.[34] The ECB Guidance applies to all "significant credit institutions" supervised by the ECB under the "Single Supervisory Mechanism". It does not, however, apply to "credit institutions" based in member states outside the Single Supervisory Mechanism and not directly supervised by the ECB (such as the United Kingdom, although the Bank of England has itself from time to time considered leveraged lending levels).

For the purposes of the ECB Guidance, a "leveraged" transaction includes all types of loans or credit exposure where the borrower's post-financing level of leverage (i.e., the ratio of total debt to EBITDA) exceeds 4.0×, as well as all types of loan or credit exposure where the borrower is owned by one or more financial sponsors. Under the ECB Guidance, affected credit institutions are expected to ensure that transactions which have a

"high level" of leverage – meaning transactions where the ratio of total debt to EBITDA exceeds 6.0× at the time of deal inception – remain "exceptional" (in a similar vein to the U.S. Guidance).

Whilst the full effectiveness of the guidance remains in question, the level of supervision from the ECB has certainly increased since its introduction in 2017; banks were required to provide an internal assessment of their implementation of the guidance in November 2018 and a multi-year programme of on-site inspections was launched in January 2019. However, despite an improved effort from banks to implement the guidance, the ECB still regards excessive leverage as a key supervisory concern and will expect banks to implement more rigorous risk management practices in order to achieve full compliance with the ECB's risk management expectations.[35] In May 2020, the ECB reiterated that the 2017 guidance is more important than ever for prudent lending, risk management and financial stability in a time of market uncertainty caused by the COVID-19 pandemic and that it remains the point of reference for dealing with current market conditions.[36]

Net-Short Debt Activism

A relatively recent development in the U.S. loan market has seen documentary protections introduced against activist investors holding net short positions, given the economic incentive for those investors to trigger manufactured defaults whilst maintaining substantial positions in credit default swaps. However, some investors have resisted these protections, also known as "anti-net-short provisions" in light of the broader market trend towards borrower-friendly loan agreements and arguments that these restrictions negatively impact liquidity.[37]

The genesis of anti-net-short provisions in loan documentation followed the bankruptcy of Windstream Holdings, Inc. ("Windstream"), a communications firm, in February of 2019. Prior to the filing, Aurelius Capital Management ("Aurelius") became the holder of more than 25% of Windstream's senior unsecured notes, while holding a material net short position. Aurelius then issued a default notice, claiming that the 2015 spin-off of certain of Windstream's assets into a newly formed, publicly traded REIT violated the sale-leaseback covenant in the notes, which pushed Windstream further into distress and left Aurelius with a return on its short position. Of concern to many borrowers is the fact that Aurelius purchased Windstream's notes following the spin-off that it alleged was a default, leading to claims that Aurelius manipulated the price of the Windstream debt and drove it into bankruptcy to bolster its own short position.

As a general matter, anti-net-short provisions automatically add lenders who have been identified as net short (including, in some cases, lenders whose affiliates are found in such a position) to the deal's blacklist or "DQ" list. Some debt investors resist these provisions on principle, but, more commonly, representations covering affiliates are resisted due to logistical challenges for debt investors to determine whether they can make such representations. However, covering affiliates may be the most effective way for borrowers to root out activists from their lender group, and, as a result, aggressive borrowers now frequently push for this protection.

ESG and Sustainable Financing

Despite initial fears that the COVID-19 pandemic and economic volatility would distract from the focus on environmental, social and corporate governance ("ESG") in 2020, the opposite transpired. A renewed focus on ESG globally included a rising interest in sustainable financing – for which the European loan market is expected to be the epicentre. As referenced in Part A of this chapter, the LMA and LSTA, in conjunction with the Asia Pacific Loan Market Association, published two guidance documents in May 2020 addressing some of the most frequently asked questions relating to the Green Loan Principles ("GLP") and the Sustainability Linked Loan Principles ("SLLP"). These publications hope to assist market participants in the practical application of the GLP and SLLP to their transactions, in order to facilitate further expansion of the market. In order to qualify for a sustainability-linked loan, a borrower must establish sustainability performance targets, which are often set against external ratings or key performance indicators ("KPIs").

The use of existing corporate KPIs to establish targets within loan agreements has emerged as the favoured approach for ESG-conscious borrowers. Royal Dutch Shell's $10 billion revolving credit facility (signed in December 2019) directly links interest and fee payments to the company's short-term net carbon footprint intensity target.[38] Similarly, payments and fees under the aforementioned Tesco revolving credit facilities (signed in October 2020) are directly linked to three of the company's KPIs (concerning greenhouse gas emissions, food waste and renewable energy targets).[39]

IFRS 16

The introduction of IFRS 16 in January 2019 has continued to have an impact on the European leveraged loan market in 2020, as borrowers have sought to "backdate" applicable accounting standards when calculating their covenant capacity and headroom under their loan documents. As a result of IFRS 16, certain leases (previously categorised as operating leases) should be recognised on a borrower's balance sheet: (as debt) together with the underlying assets. Aggressive sponsors have sought to "have their cake and eat it", picking and choosing where to apply (or not to apply) IFRS 16 on both sides of their consolidated adjusted EBITDA calculations – effectively increasing covenant capacity and headroom across the board.

Brexit

The implementation period established under the European Union (Withdrawal Agreement) Act 2020 came to an end on 31 December 2020, with the EU-UK Trade and Cooperation Agreement, agreed on 29 December 2020, taking effect from 1 January 2021. Given the prevailing uncertainty at the time of writing, changes to European leveraged loan documents have been fairly limited, though it should be noted that "Brexit" is now routinely designated an "Excluded Matter" (pursuant to which no representation, warranty or undertaking shall be deemed breached and no event of default shall occur).[40] There has also been market-wide adoption of the LMA's "Designated Entities" provisions (reflecting the fact that lenders based in the United Kingdom have lost their passporting rights under the EU Capital Requirements legislation as a result of Brexit). These provisions permit a lender based in the United Kingdom to nominate an EU-based affiliate to participate in specified utilisations in their place, without the need to transfer any part of the available commitment. It is worth noting, however, that most "Designated Entity" clauses do not allow the EU-based lending affiliate to automatically assume rights and obligations in relation to outstanding utilisations from the original lender. Finally, whilst the majority of new European leveraged loan agreements continue to be English law-governed, it remains to be seen whether this trend will extend into the post-Brexit era.

Conclusion

As highlighted in this chapter, it is important for practitioners and loan market participants to be aware of the key differences in the commercial terms and market practice in European and U.S. leveraged loan transactions, as well as the instances in which such terms and practice have converged or are converging. Whilst there are many broad similarities between the jurisdictions, borrowers and lenders that enter either market for the first time may be surprised by the differences, some of which may appear very subtle, but are significant. As more and more borrowers are prepared to look beyond their domestic market and willing to seek access to whichever debt market (whether U.S. or European) offers greater liquidity and more favourable pricing and terms at any given time, and as a wider range of alternative and non-bank investors are attracted to the investment opportunities presented by both the European and U.S. loan markets, the importance of having a greater understanding of the similarities and differences is even more critical to parties on both sides of a potential transaction.

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Fund Finance: 2020 Year in Review

Cadwalader, Wickersham & Taft LLP

Michael C. Mascia

It was almost Valentine's Day. We were in Miami at the Fund Finance Association (the "FFA") conference at the Fontainebleau Hotel. Magic Johnson had given what amounted to a stand-up comedy routine and then we all went outside laughing on the veranda for cocktails. The weather was perfect. Hillary Clinton had spoken the day before; David Rubenstein of the Carlyle Group had given arguably the best presentation in the history of the FFA. All of us were gushing optimism and our businesses were absolutely humming. On the veranda, I tried to convince Jeff Johnston, the Chairman of the FFA and the Head of Asset Management at Wells Fargo, that next year we should hire a great band – I suggested Darius Rucker – and have a charity concert to raise money for non-profit Project Sunshine as part of our FFA Cares initiative. Um. Did I mention there were cocktails? Perhaps COVID originated to temper my froth. As it turns out, we were lucky to even have a conference at all.

By February 24th, the pull back in the equities market had arrived with a jolt, and all our travel plans were cancelled. The markets vacillated wildly thru early March, with multiple limit up and limit down days whipsawing the NYSE. By March 20th, "WFH" had made Urban Dictionary and the FFA had postponed the European conference, which had been scheduled for June. And then the press assault on fund finance commenced. It started with articles suggesting private equity funds were accelerating capital calls, threatening already impaired limited partner liquidity. The denominator effect was going to cut off all fund formation. And then on March 31st, the now infamous article in Private Funds CFO titled "*LP defaults 'already happening.' Here's why, and what GP's options are*" hit our inboxes.

As if our April was not going to be busy enough doing KYC on all the qualified borrowers being joined to subscription facilities, a tsunami of information requests crashed down from senior management and risk departments at the banks. Every banker's calendar became blanketed with senior management presentations on the perceived risks in their portfolios (such overblown risks having been both forecasted by young members of the press without actual transaction experience and their likely impact embellished as systemically catastrophic by longtime private equity professor and critic Ludovic Phalippou).

What happened next made me very proud to be a part of the FFA. Jeff Johnston called a board meeting. The agenda: how can we get accurate information out to the market to redirect the inflammatory and misleading narrative? The response? The FFA Board members converted into walking whirlwinds. Jeff recorded a podcast with me where he shared Wells Fargo information that, despite the massive economic dislocations, the bank had not yet seen a single exclusion event from an institutional investor in its vast portfolio. At Cadwalader, we shifted Chris van Heerden from legal work to market analysis, and each week *Fund Finance Friday* put out written updates and video clips confirming the credit resilience of the fund finance market. Nick Mitra, the Vice Chairman of the FFA and Head of Fund Finance – US at Natixis, led a major initiative, somewhat akin to squirrel herding, whereby he organized group calls of all of the FFA sponsors, almost all of whom attended and continually reported near perfect funding performance by limited partners. On these calls, Mary Touchstone and Jocelyn Hirsch, leading borrower-side attorneys, confirmed that their fund clients were operating effectively and that their investors were funding capital calls, even out of China. Blackstone, TPG and Goldman Sachs participated, all projecting calm and confidence. Then on April 9th, the FFA, with extensive input from FFA board members Jeff Maier, Terry Hatton and Tina Meigh, published a COVID-19 market update response addressing the negative press and setting straight the actual facts, as reported by the FFA sponsors on the update calls. That piece became widely circulated throughout the market, and has even been referenced in quarterly bank earnings announcement calls. By April 15th, *The Drawdown* ran a headline: "*Nothing to see here: LP defaults are fake news*." Narrative corrected. Mission accomplished. The market steadied.

Truly great and impactful (and unpaid) industry leadership by Jeff Johnston and Nick Mitra during a time of real crisis. On behalf of the fund finance industry, thank you gentlemen.

However, steady did not exactly mean calm. While the leveraged finance and real estate markets hibernated in the second quarter, fund finance transaction volume exploded (Tiger King had ended so people were able to return to business I guess). April and May were incredibly busy; deal volume and portfolio maintenance at record levels. Prospective NAV financing calls dominated the days, as sponsors sought solutions to get liquidity into stressed portfolio companies. And the subscription finance market was full out. We all assumed that the increased flow was largely demand pulled forward; that is, deals that in the normal course that would have closed later in the year were being accelerated into early closings while financing remained available. That seemed validated to some extent in August and early September, as deal volumes moderated a good bit to a more familiar pace. But it was not the whole story.

During the summer, a giant injection of fiscal stimulus had reached the pockets of both individuals and (mostly) small businesses in the United States. Many local governments eased stay-at-home mandates and the consumer started buying things beyond toilet paper. And for those of us that thought Ben Bernanke had pushed the limits of aggressive monetary policy, Jerome Powell pulled the ultimate "hold my beer." The Fed ensured savers would earn no yield in fixed income for the foreseeable future and injected an elephant's worth of liquidity into the market (just commentating here, not criticizing: most

global markets reacted with a standing ovation). Fund finance was no different. The summer's policy maneuvers buoyed the equity markets and in turn investor and banker confidence, thus drawing back into the market many of the banks that had sat on the sidelines for the crisis' early innings.

And then came the autumn. With the benefit of hindsight, the stars seemed to have aligned in a way that should have completely constricted our pipeline. COVID infections spiked, and then spiked again month-after-month. Quarantine orders were reinstated, including in large metro areas like London and San Francisco. Fund formation had leveled off materially, with Preqin reporting a first half decline of 26% year-over-year, reducing opportunities. Social justice issues took center stage, rightly taking our attention from business as usual to more immediately pressing societal needs. And as if needing to pile on, the U.S. Presidential election and Brexit negotiations developed quite an unfortunate animosity and attempted to monopolize mindshare. The FFA had to again postpone its European and Asia conferences, ultimately converting them instead to a virtual program.

And yet fund finance deal flow, ever the salmon immune to the upstream, accelerated mightily again. In November and December, Cadwalader opened new fund finance matters at a pace that set two straight consecutive monthly records. Many of the lenders active in the market grew loan outstandings extensively during the fall, well into double digits. Even some of the banks that paused originations in the second quarter put on so much volume in the fourth quarter that they ultimately outperformed their 2019 results by a material spread. We at Cadwalader estimate something close to $100 billion of new fund finance commitments were extended during the course of 2020, an amount far in excess of corresponding runoff.

2020 was an amazing roller coaster of a year for fund finance. The credit wherewithal of the products, not only in subscription finance but also in virtually all of the NAV lending spheres, was battle tested and proven fit for service. And while we were certainly blessed and incredibly fortunate, the pristine credit performance in such unprecedented economic dislocation is a testament to the great liquidity management of the funds and their investors as well as the prudent transactions structured by the lenders and their counsel. I doubt many fund finance bankers or lawyers have been recognized, praised or rewarded for the outstanding work they did structuring transactions that thrived through this difficult environment. But they should be.

I know the year that fund finance professionals have had; I lived it with them. They were worried their parents were going to get sick. They were worried about their personal finances. They were worried pensions would walk away from capital commitments, undermining our entire industry's underpinnings. The urgency of the matters they were called on for counsel was more intense than anything in our recent past; probably more intense than ever. Our firms all enacted hiring freezes. So, while our transaction volumes and client needs accelerated, hiring was prohibited from keeping pace. The exhaustion just had to be carried; people just had to make do. And in most cases make do from their own kitchen table while trying to help a crying nine-year-old log onto an iPad for remote learning since school had gone virtual. And yet, they steered the fund finance market to both growth and zero credit losses.

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Recent Developments in U.S. Term Loan B

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Introduction

After a stable start to 2020, the leveraged loan market experienced a rollercoaster of a year following the outbreak of the 2019 novel coronavirus disease (***COVID-19***) pandemic. Between the first and second quarters of 2020, leveraged loan issuances dropped by more than 50%. Such period saw a run on drawing credit facility commitments as borrowers prioritized preserving liquidity over other transactions. According to one market report, borrowers drew down more than $300 billion of revolving facilities in the first half of 2020. The second half of 2020 saw a rally in the U.S. loan market, brought on in part by a strong response from the U.S. Federal Reserve Bank and a resilient bond market. However, despite this rally, the leveraged loan market still ended the year down 14% year over year by volume, falling to an eight-year low of $711 billion.

New money loans prior to the fourth quarter of 2020 were largely financings for liquidity as M&A, other event-driven new money financings, and opportunistic repricings and refinancings were put on hold. Market appetite for risky credits plummeted and lending to single B and CCC-rated credits was almost non-existent. There was an increase in M&A-related financings in the fourth quarter of 2020 due in part to optimism over news of an effective COVID-19 vaccine, and the loan market began to accept greater risk for yield as single B total volume jumped by more than 60% quarter over quarter. M&A loan volume over all of 2020, however, was the lowest in over 10 years.

With borrowers desperate for liquidity and lenders faced with an uncertain economic downturn, the first half of 2020 also saw some tightening of terms in loan documentation in the U.S. market. As the market normalized at year end, however, the trend towards favorable terms for Term Loan B (***TLB***) borrowers, which has been a consistent theme for the last few years, continued. This chapter examines some of those developments.

Market Fundamentals

Attitudes

Investment banks in today's TLB market operate an originate-to-distribute model, arranging the financing package before distributing all or a significant portion of TLBs to investors (although investment banks will usually retain part of the revolving or other liquidity facilities, which are still the domain of traditional banks). The ultimate TLB holders are more likely to be non-bank lenders, i.e., institutional investors such as hedge funds and issuers of collateralized loan obligations (***CLOs***).

Institutional investors take a different approach to their participation in a loan syndicate when compared to traditional banks, viewing loans as liquid, tradable and impersonal investments, rather than part of a broader banking relationship with the relevant borrower. Institutional investors buy and sell loans opportunistically instead of holding them to maturity, meaning that such investors are less reliant on the protections that a more traditional term loan covenant package affords. An institutional investor's overall portfolio will include high-yield bonds as well as loans and, accordingly, institutional investors have gotten comfortable with incurrence-based covenants (and a lack of financial maintenance covenants) for both bonds and leveraged loans in their portfolio. Sponsors and borrowers, knowing that investors will continue to tolerate weaker covenant packages and 'cov-lite' structures as long as the debt is sufficiently liquid, have been able to use this shift in composition of the lender base, in addition to the strong demand for the TLB product, to their advantage in order to push for greater flexibility in terms. The increase in secondary market activity, absence of a close relationship between a borrower and its lenders and increasing syndicate sizes mean that covenant flexibility becomes even more important for a borrower, since amendments to loan documentation cannot be obtained with larger and more impersonal syndicates as quickly, easily or cheaply as they could with small bank syndicates.

Legal and regulatory developments

(a) COVID-19 Government Programs

In March 2020, the United States passed the Coronavirus Aid, Relief, and Economic Security Act (***CARES Act***) in order to provide support to those facing economic hardship as a result of the COVID-19 pandemic. The U.S. government created or enhanced several lending and liquidity facilities including, among others, the Municipal Liquidity Facility, the Term Asset-Based Securities Loan Facility, the Primary Market Corporate Credit Facility, the Secondary Market Corporate Credit Facility, the Commercial Paper Funding Facility, the Money Market Mutual Fund Liquidity Facility, the Primary Dealer Credit Facility and the Economic Injury Disaster Loan Program. The CARES Act also contains various provisions allowing it to assist industries particularly affected by COVID-19 such as air carriers (and related businesses) and businesses critical to maintaining national security.

A number of TLB borrowers tapped two CARES Act programs in particular: the Paycheck Protection Program (***PPP***) and the Main Street Lending Program. The PPP allows the Small Business Administration (***SBA***) to provide loans to small businesses to finance payroll, rent, mortgage interest or utilities payments. These loans can be forgiven if the borrower retains a certain number of employees on its payroll and certain

compensation levels. Under the Main Street Lending Program, the Federal Reserve Board purchased participations in loans made by regulated banks to small and medium-sized businesses for general corporate purposes. Notably, the two programs were subject to the SBA's affiliation rules and, as a result, restricted many sponsor-backed borrowers from participating.

In 2020, many eligible borrowers needed to amend their existing credit facilities to permit borrowing under the PPP and Main Street Lending Programs. The changes varied from facility to facility but typically included: (a) carve-outs under the debt covenant allowing for the government loans; (b) covenants and/or representations confirming compliance under the government programs; (c) expanded reporting requirements to include documentation required under the government programs; (d) carve-outs with respect to government loan proceeds from mandatory prepayment provisions; and (e) cross-defaults to the government loans. Those that were able to obtain government support became subject to rules and covenants, most mandated by the CARES Act, that limited distributions, capped executive compensation and generally made M&A transactions more difficult. Those covenants will continue to apply for 12 months after the government support is repaid.

(b) U.S. LIBOR replacement

With the approach of the LIBOR sunset, U.S. market participants are hurriedly working to implement a successor rate. In late 2018, the Alternative Reference Rate Committee (***ARRC***), a committee organized by the New York Federal Reserve Bank (***NY Fed***), proposed contractual language that can be inserted into U.S. syndicated loan agreements in order to replace LIBOR as the reference rate for syndicated loans in the market. The Secured Overnight Financing Rate (***SOFR***), a reference rate established by the NY Fed and published daily since March 2018, is ARRC's preferred rate to replace LIBOR. SOFR is the average rate of the cost of borrowing cash overnight collateralized by U.S. Treasury securities.

Since the announcement of the planned discontinuation of LIBOR, market participants have largely adopted some variation of the 'amendment approach' promoted by ARRC in their loan agreements. Under the 'amendment approach,' the administrative agent and the borrower (often with negative consent of the required lenders) facilitate a streamlined amendment to replace LIBOR with a successor rate following a trigger event. The successor rate is typically determined by the then-prevailing market convention in syndicated loans in the United States. The Loan Syndication and Trading Association (***LSTA***) and ARRC have encouraged market participants to move away from the 'amendment approach' and adopt a 'hardwired approach' in their loan agreements instead. The move away from the 'amendment approach' was due in part to ARRC's concern over the impracticality and confusion that could result from amending thousands of loans when LIBOR ceases. In June 2020 and August 2020, ARRC released updated LIBOR transition language, which did not include the 'amendment approach' in either update.

Under the 'hardwired approach' promoted by ARRC, LIBOR is automatically replaced with a specified successor rate upon the occurrence of a defined trigger event. The specified successor rate recommended by ARRC is a waterfall that begins with Term SOFR, then Daily Simple SOFR and, if neither of these is available, a type of amendment approach. As of the time of writing this chapter, Term SOFR does not exist, but ARRC is working to create a Term SOFR rate that will function more like LIBOR. It is likely that market participants will switch to Term SOFR if it is available before the LIBOR sunset. Some recent loan agreements have adapted the 'hardwired approach' to allow a future flip forward to Term SOFR if the rate is created after LIBOR ceases. Daily Simple SOFR currently has the most momentum behind it and was preferred over Compounded SOFR in arrears by ARRC in its 2020 LIBOR transition language.

While there is a growing trend in the leveraged loan market towards adopting the 'hardwired approach,' the favored market approach remains an open question. In November 2020, ICE Benchmark Administration Limited (***IBA***), the administrator of LIBOR, cast doubt on the timing of the discontinuation of LIBOR by announcing that it expects to deliberate on its intention to cease publication of one-week and two-month LIBOR on December 31, 2021 and the remaining USD LIBOR settings on June 30, 2023. The announcement was welcomed by ARRC and the Federal Reserve Board as such an extension would give market participants additional breathing room for the transition of existing agreements, but regulators have made clear that new loans starting in the second half of 2021 should cease referencing USD LIBOR.

(c) LSTA loan documentation

A growing trend in recent years has been the move towards standardized loan documentation in the U.S. market. The LSTA continues to publish standardized loan documents and is increasingly taking on a more active role in the primary market. In 2014, the LSTA released new versions of its primary documents including an expanded publication of its Model Credit Agreement Provisions. In 2018, the LSTA published its first model credit agreement for revolving loan facilities. In 2019, the LSTA published a form of term loan credit agreement. In 2020, the LSTA published updates to both of these forms along with other model forms of common loan documentation. This trend towards standardized documentation in the U.S. mirrors the use of Loan Market Association documentation in parts of Europe, and we fully expect it to continue in the years to come. At present, the U.S. market has not adopted these models wholesale but has instead adopted select LSTA provisions relating to regulatory matters and secondary market trading. The form of documentation used in the market continues to be based primarily on the documentation used in a precedent transaction between the investment bank arranging the loans and the borrower.

(d) Direct lending

Direct lending refers to non-broadly syndicated debt provided by unregulated institutions and is increasingly becoming one of the most popular strategies in the private credit market. Direct lenders include standalone credit funds, credit funds affiliated with private equity funds, pension funds, unregulated affiliates of commercial banks, hedge funds, business development companies and unregulated investment banks. As the size of individual facilities increases, direct loans may replace or complement traditional syndicated facilities, removing significant transactions from oversight of bank regulators. Direct lending further challenges the distribution role of traditional investment banks in the syndicated loan market. Direct loan facilities are generally more restrictive than TLB facilities, with direct loan documentation including financial maintenance covenants, restrictive covenants and baskets and even prepayment premiums for voluntary and mandatory prepayments (known as 'hard call' protection).

In 2020, the direct lending market pulled back in the first half of the year and re-emerged in the second half once the markets stabilized. As the COVID-19 pandemic began to affect the markets, direct lending was the hardest hit sub-strategy of private debt while other sub-strategies, such as distressed debt, real estate debt, infrastructure debt and special situation funds, all posted year-on-year increases in capital commitments. In the third and fourth quarters of 2020, however, fund managers

observed a rebound in investment in direct lending. Investors continue to prefer established funds, with some firms predicting further concentration in funds that have experienced managers or safer portfolios. In the coming years, many analysts expect direct lending to continue to grow and reshape the TLB market. It is quite possible that terms in TLB documentation could become tighter as the two loan products compete for investors and the lender groups blend together.

(e) Liability Management Transactions

In 2020, distressed borrowers, sustaining the trend from recent years, continued to use restrictive covenant basket capacity, relaxed minority lender protections and any other tool available to enter into transactions intended to avoid insolvency filings and debt-for-equity swaps until market conditions, due to the COVID-19 pandemic or otherwise, could turn around. While providing borrowers with additional runway by managing their capital structure, such transactions frequently were at the expense of one creditor constituency over another.

A common method of managing liabilities and liquidity concerns continued to be for borrowers to use their ability to invest in 'Unrestricted Subsidiaries' not subject to the lien and indebtedness restrictive covenants (see the discussion on J.Crew below). With its assets no longer subject to liens and covenants, the Unrestricted Subsidiary could then incur indebtedness and upstream the proceeds to support its parent's capital structure; however, such investment in the Unrestricted Subsidiary could significantly decrease the value of TLB lenders' security interest in its collateral. Examples include the release of substantially all of a borrower's material intellectual property, whole (and profitable) business segments and the aggregate of a borrower's accounts receivables. While borrowers are not permitted to include the frequently positive EBITDA generated by such released investment in its leverage ratio calculations, the lack of tested financial covenants and robust EBITDA add-backs made such exclusion less of an issue.

Some borrowers also used restricted payment capacity to distribute to an affiliate a portion of the equity interests issued by valuable subsidiaries, resulting in the release of such subsidiary's liens and guaranties supporting the TLB lenders' obligations (see the discussion on PetSmart below). This unlocked collateral value may be used for additional financing, like the use of collateral transferred to an Unrestricted Subsidiary.

A more classic route is the use of rights to incur debt (see further discussions below on incremental facilities) to 'uptier' junior priority and unsecured debt, usually at a discount, into a facility under the loan agreement documenting the TLB on a *pari passu* basis with the TLB. While borrowers using such structure may benefit from decreasing overall interest expense, enhancing the borrower's liquidity profile by reducing indebtedness subject to a pending maturity or deleveraging more generally, the TLB lenders are disadvantaged by the dilution of its security interest in its collateral, potentially without any new capital infusion.

Some liability management transactions more overtly disadvantaged certain lender groups over another, including lenders within the same class of loans. A loan agreement typically permits majority lenders to amend application of proceeds waterfalls to incorporate superpriority facilities within such loan agreement or enter into a subordination agreement with respect to indebtedness outside of such loan agreement. Borrowers, together with majority lenders, have structured amendments to loan agreements that provide lenders participating in such new money priming facilities more favorable treatment with respect to their existing indebtedness as compared to the existing indebtedness of the lenders not participating in such new money facilities. Further, borrowers frequently do not afford minority lenders an opportunity to participate in such priming facilities, and, consequently, such lenders are denied the more advantageous treatment for their existing indebtedness. Open market purchase provisions commonly found in TLB facilities provide borrowers with further flexibility to effectuate such deals without *pro rata* treatment among similarly situated lenders. Moreover, 'covenant stripping,' previously a tactic typically limited to the high-yield market, was imposed on non-participating minority lenders to either coerce them into participating in the transaction or limit their future remedies in certain transactions.

Well-publicized liability management transactions did not result in meaningful TLB documentation changes to limit the covenant flexibility that permits these transactions. As discussed below, basket sizes and 'freebies' were more influenced by market conditions than attempts to limit borrower flexibility at the expense of lenders. However, there was some movement on including payment and lien subordination as 'sacred' voting issues requiring the consent of all adversely affected lenders, with traditional banks sometimes insistent on such language. We note that the presence of crossover lenders, i.e., lenders that are stakeholders in more than one portion of the capital structure, and the unpredictability of finding oneself as a participating lender (as opposed to a minority non-participating or coerced lender) complicates incentives to provide meaningful protections to minority lender groups upon the origination of TLBs.

Economic Terms

Pricing

In 2020, margins widened in the first half of the year before tightening in the second half of the year as the supply/demand imbalance initially favored lenders and then switched back to borrowers. Margins for double BB credits in the institutional market, for instance, went from an average of 225 bps at the end of the first quarter of 2020 to a high of 460 bps in the second quarter, finally closing out the year at 297 bps.

The COVID-19 pandemic also led to a significant drop in LIBOR rates, mirroring cuts in government interest rates by most central banks. The average three-month LIBOR rate in the institutional market was 0.58% in the second quarter of 2020 and 0.22% in the fourth quarter of 2020. In the face of these low interest rates, lenders pushed for LIBOR floors greater than zero. In the second and third quarters of 2020, most deals in the institutional market carried a 1% LIBOR floor. In the fourth quarter of 2020, only 30% of deals had a 1% LIBOR floor, while the majority had LIBOR floors ranging from 0.50% to 0.75%.

Market bifurcation

In 2020, the energy and retail sectors were two of the most troubled sectors in the U.S. economy. The COVID-19 pandemic, together with the price war between Russia and Saudi Arabia, had a devastating impact on the U.S. oil and gas sector. Crude oil prices fell more than two-thirds over the last year, and defaults accelerated during the pandemic, putting many well-established companies into bankruptcy. Similarly, the retail sector had a difficult year. Many brick-and-mortar stores were forced to temporarily close due to government-imposed lockdowns. These shutdowns, coupled with online competition and decreased consumer spending, led to a sharp drop in profits as well as the bankruptcies of many well-known retailers, including J.Crew, J.C. Penney and Neiman Marcus.

In contrast, the technology sector was one of the most successful sectors in the U.S. economy. It is projected to grow

from $131 billion in 2020 to $295 billion by 2025. Increased demand for apps and social media channels such as Google Hangouts, WhatsApp Video Call, Zoom, and Microsoft Teams is the key reason for this economic boost. In addition, many opportunities arose due to the increasing need for fifth generation technology (5G) to enable remote interactions during quarantine.

Optional prepayments

Unlike bonds, investors still generally accept that a TLB is repayable without penalty or premium. The volume of repricings overall was suppressed in 2020 due to the COVID-19 pandemic. However, some borrowers were able to take advantage of existing demand in the market to reprice (either by way of an amendment to a loan agreement or a refinancing of outstanding loans).

As a result, investors continue to demand that some limited pricing protection be included in TLB facilities from the outset. The typical protection is a 1% prepayment premium for refinancings at a lower interest rate within an agreed period of time (known as 'soft call' protection). In 2020, soft call protection provisions typically included a 'sunset' of six months, although some lasted for a full year after initial issuance. While soft call protection as a concept remained, borrowers continued to press for broader exceptions to the requirement to pay a prepayment premium, including when prepayments are made in connection with another transaction, such as a material acquisition, a change of control or an initial public offering. The broadest formulation of such a carve-out permits a prepayment without a premium where the repricing of the loan is not the 'primary purpose' of the transaction, which formulation featured in a significant number of leveraged loans with soft call protection in 2020.

Mandatory prepayments

Despite the COVID-19 pandemic, the overall trend of the 2010s that saw lenders retreating from requiring borrowers to de-lever continued in 2020. Excess cash flow (***ECF***) sweeps were absent from some sponsored deals and, where they were included, were often undermined by borrower-friendly deductions and carve-outs to the definition of ECF, as well as minimum thresholds for ECF before a prepayment is required.

In addition, step-down provisions associated with asset dispositions became more common in non-sponsored and middle market loans. These provisions, popular in large sponsored loans, provided that if certain leverage thresholds are met in connection with an asset disposition, the percentage of asset sale proceeds required to be used to pay down the TLB decreases (a concept borrowed from the ECF sweep provision). The amount of delevering required to decrease the percentage of asset sale proceeds to be used to make prepayments also decreased.

Restrictive Covenants

Due to the general decrease in volume in 2020, some loans experienced successful investor pushback on loose provisions, particularly in lower quality credits. Overall, however, investor pushback focused much more on pricing and yield, and there were relatively modest steps benefitting investors in the overall movement during the past decade toward covenants that are more favorable for borrowers.

In 2020, the format and structure of the covenants in TLBs, for the most part, remained consistent. TLB facilities have until now generally resisted incorporating high-yield covenants wholesale, although this approach has been seen in some circumstances (usually where the TLB sits alongside high-yield bonds in the capital structure). While the use of high-yield covenants in a TLB is still very much an outlier, the substance of TLB covenants continued to become more akin to high-yield bond incurrence covenants, where many corporate actions are permitted subject to the meeting of certain ratios on the date of such action. For example, most TLB facilities keep payments to shareholders (also known as 'restricted payments'), investments and prepayments of subordinated debt as separate covenants but have builder baskets and general baskets that net across the three covenants. This bond-like flexibility allows borrowers increasingly to enter into strategic transactions and incur or refinance debt without seeking the consent of their lender syndicate and without incurring the associated consent fees otherwise required to be paid.

As in high-yield bond indentures, TLB facilities typically include the concept of restricted and unrestricted subsidiaries, where the borrower may designate certain subsidiaries as unrestricted subsidiaries. Unrestricted subsidiaries are not subject to guarantee and security requirements, compliance with covenants and events of default, but their EBITDA (and debt) are excluded from the calculation of financial definitions and ratios. These provisions were thrown into the spotlight in 2017 after J.Crew took advantage of this flexibility in their credit agreement covenants to transfer approximately $250 million worth of intellectual property to an unrestricted subsidiary with the aim of borrowing against the transferred assets and using the proceeds to repay subordinated debt of its parent. Shutting off these 'trapdoor' provisions remained a major focus for investors in 2020 with a number of loans tightening unlimited investments in restricted subsidiaries that are not loan parties and limiting the creation and usage of unrestricted subsidiaries. Investor concern over 'J.Crew'-like transactions was rekindled in June 2018 when PetSmart, Inc. announced that it had spun off a portion of Chewy, Inc. – a key subsidiary of PetSmart – to its shareholders and transferred another stake to an unrestricted subsidiary. Chewy had been a guarantor and security provider for PetSmart's secured term loan and senior bonds, but such guarantee and security were released in connection with the transaction, which meant that these assets were now out of the reach of PetSmart's senior secured lenders' remedies. Although PetSmart did not rely on the same exemptions under its loan documents as J.Crew, the two transactions exemplify how covenant trends of recent years, along with generous baskets, may result in value-stripping transactions not previously contemplated by investors.

Financial covenants

The prevailing trend over the last few years toward 'cov-lite' TLBs continued in 2020, with no maintenance covenant protection available to term lenders. Despite the COVID-19 pandemic, the vast majority of large cap TLB deals in 2020 were 'cov-lite.'

Even if a traditional maintenance covenant is not included for the benefit of TLB lenders, a facility may include a 'springing' maintenance covenant solely for the benefit of the revolving lenders. Springing covenants are typically tested only when the relevant revolving lending facility is drawn above a certain threshold (which, historically, has been around 35% for large and mid-market sponsor deals). Inclusion of letter credit exposure in calculating the leverage covenant remained a hot button issue with respect to 'springing' maintenance covenants in 2020, and some sponsor loans excluded not only undrawn letters of credit from leverage calculations but all revolving borrowings, as well.

During the COVID-19 pandemic, there was an increased need for liquidity and many borrowers drew down on their revolving credit facilities. This, in turn, triggered financial maintenance covenants. Since many of these borrowers were facing economic difficulties and worried that they would breach their financial covenants, they sought financial covenant relief (e.g., covenant holidays, default waivers and agreements to reset financial covenant levels) under their loan agreements. Lenders generally acquiesced to their requests but, as part of this relief package, sometimes sought additional protections such as anti-hoarding provisions, minimum liquidity requirements and tightening of other negative covenants. Prior to the COVID-19 pandemic, minimum liquidity covenants were not very common, but by the middle of 2020 they appeared in a significant number of loan amendments. In addition to covenant relief, some borrowers also sought extensions for the delivery of audited financial statements for FY2019 at least in part because auditors could not make onsite visits.

Debt incurrence

TLB facilities continue to allow broad flexibility to incur additional debt, whether on a first-lien, junior-lien or unsecured basis, inside or outside the credit facility and/or in the form of loans or bonds. TLB facilities typically still include more stringent parameters around the terms of secured debt than unsecured debt, including tighter limitations on the borrowing entity, final maturity, weighted average life, prepayments and, sometimes, more restrictive terms (for example, requiring a 'most favored nations' (***MFN***) provision in the case of the inclusion of a financial covenant in any *pari passu* term debt).

Broadly, there is a distinction between refinancing or replacement loans, which may be incurred within certain parameters (relating to maturity, identity of the borrower and guarantors, etc.) and additional debt (including incremental facilities), which are subject to similar parameters but also to *pro forma* compliance with a financial ratio.

Additional debt (including incremental facilities)

TLB facilities in 2020 continued the ever-widening variety of approaches to providing borrowers flexibility to incur additional debt, and most loan documents will contain more than one overlapping means by which a borrower may incur additional debt. Permitted additional debt baskets can be grouped into those that will be governed by the borrower's original credit agreement and those governed by separate documentation.

Incremental Facilities. Additional debt incurred under a particular credit agreement is typically referred to as an incremental facility. For years, TLB credit agreements have included a right to add one or more new tranches of TLB (or increase the size of an existing tranche) on a *pari passu* basis within the framework of the original credit agreement. This ability is usually subject to both (i) a restriction on the aggregate amount of new debt that can be issued, and (ii) the protection of an MFN provision that ensures that any newly incurred debt will be issued with an all-in-yield of no more than a threshold amount (traditionally 50 basis points, although borrowers have been able to achieve 75 or 100 basis points of headroom) in excess of the all-in-yield on the original TLB facility. The MFN provision will require the margin of the original debt to be adjusted to ensure the variance is no greater than the threshold, and as a result, MFN provisions provide further economic disincentive for a borrower considering incurring debt under an incremental facility at a higher price. For this reason, borrowers typically push for an MFN provision to expire (or 'sunset') after a certain period has passed since the initial closing.

MFN Sunset Provisions. The details of MFN provisions were again heavily negotiated in 2020. In underwritten financings, MFN sunsets remained a focus of flex provisions, even if seldom exercised by the arrangers, resulting in a significant number of deals with a sunset provision in 2020. The incidence of sunsets decreased in the first half of 2020 but steadily increased in the second half, ultimately reaching record numbers in the fourth quarter. The duration has varied from anywhere between six and 24 months, with the most commonly agreed period being 12 months.

Exceptions to MFN for Incremental Facilities. Some TLB facilities also incorporate other exceptions under which the borrower may incur additional debt that is not subject to the MFN provision. These exceptions include MFN provisions that are not triggered by additional debt maturing later than the maturity date of the original term loan by an agreed period (typically more than two years). Some transactions include the right for a certain amount of incremental loans to mature earlier than the existing senior secured term loans and to be exempted from the MFN provision. Earlier maturing debt is not common in middle market or in non-sponsor deals but has gained traction in sponsor transactions. Other deals include a new basket for additional debt that is not subject to the MFN, either for the 'freebie' basket of additional debt discussed below or another agreed fixed amount, and separate exceptions from the MFN where the incremental debt is raised to finance an acquisition or other permitted investment. Finally, with an increasing number of cross-border facilities, it is becoming more common for TLB facilities to specify that the MFN will apply only to the original term loans incurred in the same currency as the new incremental facility.

Amount of Incremental Debt. The total amount of incremental debt that TLB borrowers are permitted to incur has also evolved. Size was typically determined by one or more of the following three components: (1) a 'freebie' amount that may be incurred irrespective of *pro forma* compliance with a financial ratio; (2) a ratio amount limited only by such *pro forma* compliance; and (3) an add-on amount equal to voluntary prepayments of the existing debt. While 'freebie' baskets typically are a fixed dollar amount, a significant number of 'freebie' baskets in large and mid-market sponsor TLB loan agreements included a 'grower' concept that set the size of the 'freebie' basket at the greater of a fixed amount and a percentage of EBITDA, providing greater flexibility to the borrower to incur debt without the limitations of *pro forma* compliance. The ratio used to determine *pro forma* compliance is a point of negotiation as well. A first lien leverage ratio (often set at first lien leverage on the closing date) is the most common, but overall secured leverage is common as well, and a small number of TLBs will determine the size of the ratio amount by reference to total leverage.

Incremental Equivalent Debt. In recent years, TLB facilities have also included a right to incur additional debt within the same parameters negotiated for incremental facilities under documents other than the original credit agreement – called 'incremental equivalent debt' or a 'side-car facility' – that meet certain pre-agreed criteria on the theory that the economic effect is the same as an incremental facility. Lenders typically permitted borrowers to incur incremental equivalent debt under bond offerings, but some TLBs include a right to incur side-car facilities in the form of term loans. The incurrence of such loans typically does not trigger MFN protections, although there has been some push by investors for the MFN to apply to side-car facilities that are incurred in the form of *pari passu* secured term loans.

Reclassification. Other debt that TLB credit agreements permit a borrower to incur includes capital expenditure-related debt, acquisition-related debt and permitted ratio debt, among others, with basket sizes typically comprised of an initial 'seeded' amount

plus an amount that can be incurred subject to a *pro forma* ratio compliance test. A significant number of TLB facilities now allow the borrower to reclassify debt that was initially incurred under the initial 'seeded' amount as debt incurred under the ratio amount when capacity becomes available under the ratio (a concept borrowed from high-yield bonds). These 'reclassification' provisions have been incorporated into the additional debt baskets as well as the incremental facility amount. In practice, reclassification permits a borrower to refresh the initial 'seeded' amount it can borrow without complying with the ratio tests whenever capacity under the ratio amount or another additional debt basket later becomes available. Such provisions will also now typically provide that additional debt is deemed to be incurred first under any ratio capacity before the 'seeded'/'freebie' basket in order to preserve the amount that may be borrowed without being subject to the ratio cap.

Acquisition Debt. To facilitate using incremental facilities to finance acquisitions and provide the borrower (and an acquisition target) with more certainty around the availability of their financing to close the acquisition, it is now common to allow the testing of the conditions to incurring an incremental acquisition facility (including projected compliance with any ratios and whether a default or event of default has occurred, other than a payment or insolvency default) to be tested only at the time of signing the related acquisition agreement. TLB facilities have not settled, however, on whether a borrower must calculate and comply with ratio thresholds while the acquisition is pending by reference to financials that assume the acquisition has not occurred, *pro forma* figures that assume closing of the acquisition or both. It is also increasingly common to permit the use of incremental facilities, incremental equivalent debt and other ratio-based debt baskets for acquisitions, even if the borrower does not currently comply with the financial ratio, so long as the ratio is the same or better after consummation of the acquisition on a *pro forma* basis – a so-called 'no worse' prong to debt incurrence. Borrowers argue for these provisions, noting that growth benefits lenders with a larger collateral pool and increased EBITDA; however, lenders are hesitant to increase the debt load of companies that cannot meet the ratios otherwise agreed for new debt based on *pro forma* projections that may not be achieved.

Replacement debt. Typical TLB facilities provide flexibility to borrowers to incur debt pursuant to provisions that permit refinancings, repricings, rights to 'amend and extend' outstanding loans and rights to add tranches of debt, in each case, typically subject only to the consent of the lenders participating in such debt and the agent. Each form of replacement debt is accompanied by a list of requirements regarding the form that the replacement debt may take, generally limiting the final maturity and weighted average life, and otherwise requiring that the replacement debt be on terms no more favorable to the new lenders than the old debt being refinanced.

Day-one debt capacity. Under most loan documents, borrowers are able to access rights to incur additional debt immediately. For example, the incremental 'freebie' basket is in many cases sized at the equivalent of 100% of Consolidated EBITDA. Such amounts of debt that could be borrowed immediately after closing was an area of investor attention in 2020. Investors focused particularly on the amount of first lien debt that could be incurred immediately and whether that debt could be structurally senior to a TLB facility as a result of, for instance, being incurred by a subsidiary that was not a guarantor of the borrower's facility. While it is unclear whether the attention paid by investors in 2020 to these provisions resulted in significantly different terms, investor focus may lead to more pushback in 2021.

Other covenants and covenant exceptions

Permitted acquisitions, investments, restricted payments and junior debt prepayments

The conditions to making acquisitions, investments, restricted payments, junior debt prepayments and similarly restricted transactions continue to be borrower favorable. One typical condition to such transactions has traditionally been an absence of either (i) a continuing event of default, or, (ii) more restrictively, any event which after the giving of notice or passage of time would give rise to an event of default if not cured (i.e., a 'Default'). It has become more common for conditions to be limited to events of default only (so a restricted transaction may be permitted while a Default is continuing), and in some cases such transactions are permitted even while an event of default has occurred or is continuing so long as the event of default does not arise as a result of a non-payment or an insolvency proceeding. Conditions for permitted acquisitions and investments may also be tested upon the signing of an acquisition agreement, mirroring the flexibility provided for incurring acquisition debt as discussed above.

For acquisitions, borrowers are increasingly permitted to acquire entities that are not required to accede as guarantors. Similarly, a majority of loans to sponsor-backed borrowers in 2020 permit unlimited investments in subsidiaries that are not required to accede as guarantors, and this ability is particularly common where a borrower has significant non-U.S. operations or a non-U.S. growth strategy.

The borrower generally remains subject to the overriding requirement that material wholly owned subsidiaries must become guarantors and grant security. The level of materiality before a subsidiary is subject to these requirements and whether materiality is determined solely by reference to the EBITDA or also the assets of each subsidiary are heavily negotiated points. As a result of this structure, loans will often not require controlled foreign corporations (or in some cases, all foreign subsidiaries) to become guarantors. EBITDA calculations to determine the guarantor threshold may also have specific exclusions that further reduce the number of subsidiaries that must become guarantors.

Ratio-based permissions and available amount baskets

There is no dominant approach as to which financial ratio should govern ratio-based covenant exceptions, including those for debt incurrence – first lien leverage; total secured leverage; total leverage; and a fixed charge coverage ratio are all used.

Borrowers are also now often permitted to reclassify prior transactions among dollar baskets so that any such transaction is deemed to have been permitted under another exception within a particular covenant (such as the restricted payment covenant or the investments covenants) in the same manner as discussed above with respect to debt baskets. Some TLB facilities will also permit reclassification across certain covenants, such as, for example, reclassifying a fixed dollar basket for restricted payments to be used to make a junior debt prepayment. TLB facilities rarely specify that a borrower must give notice or justify a reclassification (as reclassification is a borrowed concept from high-yield bonds, which do not require notice or explanation of reclassification).

As with the 'freebie' basket for incremental facilities, it is also typical for TLB loan agreements to provide flexibility to borrowers to undertake acquisitions, investments, restricted payments, junior debt prepayments and similarly restricted transactions that would otherwise require *pro forma* ratio compliance up to a total maximum amount without such ratio

compliance. This maximum amount, called the 'Available Amount,' 'Cumulative Amount,' or, more colloquially, the 'builder basket,' has traditionally been pegged to earnings that were not swept as ECF, resulting in the basket's size building up over time. Now, instead of retained earnings, a majority of large TLB facilities peg the size of the 'Available Amount' to a percentage of consolidated net income (usually 50%), which permits the borrower to build the basket faster. In addition to this performance-based component, the Available Amount will generally include an event-based component (e.g., equity issuances, debt exchanged for equity, declined proceeds from mandatory prepayments, etc.) that can be used to grow the builder basket. In 2020, some deals included asset sale proceeds that were not subject to an asset sale sweep in the event-based component of the builder baskets. Moreover, the 'Available Amount' now typically includes a fixed 'seeded' amount that is available immediately, and an increasing number of large TLBs provide that the seeded amount is the greater of a fixed dollar amount and a 'grower' amount equal to a percentage of borrower's EBITDA (or sometimes total assets). Seeded amounts permit borrowers to effectuate investments, restricted payments and other transactions from day one (an issue of focus for investors, as noted above). Grower baskets, like those that are now being used for seeded amounts, remain a generally accepted TLB concept for many covenant baskets, including restricted payment baskets. Often, the size of these baskets is generally pegged to a percentage of EBITDA, although in non-sponsored and middle market deals the size may be pegged to a percentage of total assets.

Financial definitions

The ways in which borrowers can calculate the ratios that permit additional debt incurrence have been more heavily negotiated than ever.

On the cash flow side, EBITDA definitions historically permitted borrowers to add back to EBITDA prospective cost savings from synergies arising from reorganizations and acquisitions, but such savings historically needed to be expected to be realized within a period of time (traditionally 12 months) and the amount of the add-back was capped to a percentage of total EBITDA. Borrowers have pushed for more flexibility in several ways. First, more recent definitions expand the scope of what qualifies as a reorganization transaction. Some TLB facilities now even permit add-backs for expected synergies arising from any 'cost savings initiative' (i.e., not in connection with a specific acquisition or an overall reorganization plan) and leave it to borrowers to determine what initiatives qualify. Other TLB facilities permit synergies 'of a type' reflected in the sponsor's related quality of earnings (***QOE***) report and, in some cases, a future QOE report. Second, the period of time within which cost savings must be expected to be realized has increased. While 12 months used to be typical, 18 to 24 months is now the new standard, and, in some cases, the period can stretch out to 36 months or not have any time limit at all. Some TLB facilities no longer require the cost savings to be expected to be realized within the agreed period but rather require only that the borrower have taken substantial steps toward (or, in some cases, only state that it has committed to) completing the reorganization or acquisition that will give rise to the expected cost savings within the agreed period. Finally, the cap on the amount of EBITDA add-backs has either increased (in 2020, this settled most commonly at 25%) or been removed. As of the third quarter of 2020, approximately half of large syndicated TLB facilities permitted such add-backs without a cap, a slight increase from 2019. Where a cap is present, it will still generally apply to all add-backs over a four-quarter period as opposed to per individual transactions, which is a formulation sometimes seen in European deals.

Also on the cash flow side, in the first half of 2020, many borrowers requested amendments to EBITDA definitions to address pandemic-related issues. These amendments included permitting: (i) add-backs for lost revenue as a result of the pandemic; (ii) add-backs for one-time non-recurring or unusual costs relating to compliance with social distancing and other pandemic-related control measures; and (iii) use of pre-pandemic EBITDA from historical quarters. In general, lenders resisted increasing EBITDA figures to reflect lost revenues but were open to including add-back expenses incurred to comply with public health requirements.

On the debt side of the ratio, TLB facilities have for some time permitted borrowers to calculate debt net of unrestricted cash held by the borrower and its subsidiaries. Cash netting was traditionally capped to a maximum dollar amount, but the number of TLB facilities that permit cash netting without any cap has increased over time and is now present in the majority of TLB facilities.

Assignments and Amendments

Some constraints on assignments of TLB remain customary. In general, a borrower's consent to assignments (not to be unreasonably withheld) is required. However, the consent requirement is falling away while certain events of default (typically limited to non-payment and insolvency) are continuing. Generally, consent will also be deemed to be given if the borrower fails to respond within a specified period. The length of such period continues to be a point of negotiation, with borrowers pushing for periods longer than the LSTA-recommended position of five business days.

Assignments to disqualified institutions (i.e., competitors and other identified institutions) are also typically prohibited. A list of disqualified institutions is typically frozen at the start of primary syndication (other than as to competitors, which can be updated over the life of the TLB). Many TLB facilities now state that the list will be provided to individual lenders upon request instead of posted generally, making it more difficult for a lender to widely market a loan to secondary purchasers who do not know whether a trade will ultimately be permitted and settle. One increasing trend in recent years has been loan investors buying debt with the intention of profiting if the loan fails to perform, either through a loan-to-own strategy or through large credit default swaps that will pay off if the borrower defaults (so-called 'net short' investors). In response to this strategy, 2020 continued to see an increasing number of borrowers looking to restrict transfers to such loan-to-own or net short investors as a general overriding rule and without naming specific institutions on the list of disqualified institutions (given the rapid emergence of new players in this space). These restrictions do not typically apply to regulated banks or to revolving lenders that were part of the syndicate at closing.

Finally, assignments to the borrower and its affiliates are generally permitted, although the total amount of loans that may be held by any lenders affiliated with the borrower is generally capped to an agreed percentage, typically falling around 20% to 25%, but *bona fide* debt funds of affiliates are often excluded from this cap.

As for amendments to loan agreements, the thresholds have historically been set at a simple majority of lenders. Fundamental rights (including economic rights and release of substantially all guarantees and security) require the consent of all lenders. These thresholds now typically permit partial refinancings of

TLB and incurrence of additional debt with consent only from 'each affected lender,' so that lenders who do not agree to participate in the change do not have any blocking right. In practice, some amendments (e.g., the release of all or substantially all guarantees and/or collateral) will still require unanimous consent. Agents are typically permitted, however, to agree to consequential amendments (such as those to security documentation) that implement permitted additional or replacement debt already permitted under the relevant loan agreement without any further lender consent.

Conclusion

In 2020, the COVID-19 pandemic had a significant impact on the leveraged loan market. The first half of the year saw a steep decline in leveraged loan volumes while the second half of the year marked a robust recovery. 2021 has begun on a similarly positive note, seeing a surge of activity, including in opportunistic transactions such as dividend recapitalizations. Given the low interest rate environment and the need for lenders to utilize their capital, most market analysts predict a continued recovery and an overall strong 2021. This also means that TLB covenant packages are likely to continue to erode in favor of increasing bond-like flexibility.

2021 will also see an increase in special purpose acquisition companies (***SPACs***). SPACs surged in popularity in 2020, providing market participants an alternative to a traditional initial public offering. This trend does not appear to be slowing down and it will be interesting to see how SPACs impact the leveraged loan market.

Direct lending will also continue to grow and become a dominant force in the loan markets. LIBOR transition will remain a focus for market participants this coming year, in particular as different jurisdictions (for instance, the United States and the United Kingdom) work to harmonize their respective LIBOR transition provisions. In addition, new government lending programs will support struggling companies and bring increased liquidity into the markets.

Assuming the COVID-19 pandemic remains under control, 2021 has given many cause for optimism.

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Introduction

While 2020 started with a strong pipeline of leveraged finance transactions both in Europe and the US, the onset of the COVID-19 pandemic and the resulting lockdowns had a profound impact on the leveraged finance market in 2020. Notably, there was an increase in amendments and waivers required by borrowers (in particular relating to financial covenant compliance) under existing finance documentation and additional liquidity raisings (including pursuant to state aid programmes) required due to the lockdown measures to combat the pandemic. Notwithstanding the impact of the pandemic, there were a number of deals that were syndicated during 2020 and auction processes had started to return by the second half of the year. In respect of such transactions, global sponsors and their advisers continued the trend of successfully exporting their experiences from financing transactions in the US leveraged loan and global bond markets to the European leveraged loan market. Momentum behind the continued adoption of US covenant-lite and bond market terms into European loans remains strong as there is now a significant source of European "cov-lite" precedents to such an extent that cov-lite loans are now considered customary for European leveraged finance syndicated loan transactions (not, to date, in direct lending transactions) and will likely continue to be so considered in the absence of a market correction. While underwritten terms and investor focus were slightly more conservative during 2020, there has been no such market correction at the time of writing, with terms in leveraged finance transactions quickly returning to be broadly the same as prior to the onset of the pandemic. Investors were, however, more successful in pushing back on certain pricing and documentation terms during 2020. The use of terms that originally were designed for high yield bond augurs for consideration of a number of documentation issues.

Covenant-lite Loans

In a covenant-lite loan, typically there is a single financial covenant and it is solely for the benefit of the lenders under the revolving credit facility, with no financial maintenance covenant for the term lenders. The covenant benefitting the revolving lenders is almost always a "springing" covenant, i.e., tested only if the revolver is drawn as of the end of a fiscal quarter (often first tested from the second or third complete quarter after the closing date) and such usage exceeds a specified percentage of the revolving facility commitments (often 35–40%), with the applicable levels set with significant EBITDA "cushion" or "headroom" (from financing EBITDA included in the base case model) of around 30–40%, and often with no step downs. The types of drawings that are included in the calculation of the trigger are also narrowing to exclude all ancillary facilities and letters of credit, amounts utilised to fund fees, costs and expenses and flex at closing and, in some instances, amounts drawn to fund acquisitions and capital expenditure. In an increasing number of deals, cash and cash equivalent investments are deducted from the amount of revolving facility commitments that are drawn at the relevant testing date (with cash, unlike in an LMA-based credit agreement, not being defined).

Associated provisions customary in US covenant-lite structures are regularly being adopted in Europe. For example, the US-style equity cure, with cure amounts being added to EBITDA and no requirement for debt pay-down, has been accepted on cov-lite deals in Europe for quite some time. Interestingly, the European market generally permits over-cures, whereas the US market limits cure amounts to the maximum amount needed to ensure covenant compliance. Another divergence between European cov-lite loans and US covenant-lite loans is the prevalence of deemed cures in European cov-lite loans, which are rarely if ever seen in US covenant-lite loans. It is, however, common in both the US and Europe to have a cap on the number of permitted cures – most commonly limited to two quarters in any period of four consecutive quarters and a total of five cures over the life of the loan. In more recent European deals, the cap on permitted cures only applies to EBITDA cures and so debt cures are uncapped. Another interesting development in relation to equity cures in European cov-lite loans is the ability to prepay the revolving facility below the springing threshold within the time period a debt or EBITDA cure could be made following testing of the financial covenant (such that it is deemed not to be tested rather than actually curing the breach).

Documentation

In the past there was a "battle of the forms" in relation to documenting European covenant-lite loans, with the first cov-lite loans emerging in Europe in 2013 being documented under New York

law. The next generation were governed by LMA-based credit agreements, stripped of most financial covenants and otherwise modified in certain respects to reflect terms that were based on looser US practice at the time. We now have LMA-based loan agreements that, in addition to the absence of financial covenants for the term loan, adopt more wholesale changes based on US market practice, primarily in that they introduce leverage or coverage-based incurrence-style ratio baskets rather than what in prior periods were regarded as "traditional" loan market baskets fixed at a capped amount. A more dramatic departure from US practice which is now widespread in European sponsor-led leveraged finance transactions is to base the reporting requirements, affirmative covenants, negative covenants, and events of default on high-yield bond-style terms, and which are tacked onto the English law governed secured facilities agreement as schedules interpreted under New York law (much like the format of a super senior revolving facility).

A number of the other features of current cov-lite European leveraged loans are considered below.

Increased Debt Baskets

Limitations on borrowings often have US-style characteristics, so rather than a traditional debt basket with a fixed capped amount, we now see permitted debt limited solely by a net leverage or secured leverage test with a fixed capped ("freebie") basket alongside (with that basket often being a soft "grower" basket). Occasionally, unsecured debt is permitted up to a 2x interest coverage test (a concept imported from the high-yield bond market). This debt can be raised through an incremental "accordion" feature or separate "sidecar" financings. European cov-lite loans may also permit acquired or acquisition debt subject to a "no worse than" test in terms of the leverage ratio of the group *pro forma* for the acquisition and incurrence of such debt (although this has seen investor pushback in certain transactions). This style of covenant leads to far greater flexibility for a borrower to raise additional debt as pari secured, junior secured, unsecured or subordinated loans or bonds (often with no parameters as to where the debt can be incurred within the group). In some financings, reclassification is permitted so that the "freebie" basket can be used if the ratio basket is unavailable, and then subsequently moved into the ratio basket once the ratio is met, thus freeing up the "freebie" basket. The net effect of these provisions is to allow borrowers to continually re-lever up to closing leverage plus the amount of the "freebie" basket, which itself often allows for up to another turn of leverage to be incurred. The most favoured nation ("MFN") protection relating to new incremental loans continues to be a focus of negotiation, both as to sunsets (typically six months – unlike the US cov-lite loan market where sunsets continue to be longer), carve-outs of certain debt baskets (acquired and acquisition debt and the freebie basket) and whether it applies to sidecar debt incurred outside the loan agreement. Other more recent areas of focus from investors have been the inclusion of a non-guarantor debt cap and whether revolving facility drawings are excluded from ratio testing (the latter point still being in a small minority of deals in Europe despite being more common in the US).

Builder Baskets

Another durable trend from the US cov-lite loan market (which is a long-standing feature of the high-yield bond market) that has been adopted in European loan deals is a "restricted payments builder basket" (the so-called "Available Amount"), where the borrower is given "credit" as certain items "build up" to create dividend capacity, starting with the borrower's retained portion of excess cashflow ("ECF"), IPO and other equity proceeds, unswept asset sale proceeds and (perhaps most aggressively) permitted indebtedness, usually subject to a net leverage ratio governor as a condition to usage. Typically, there is no limit to distributions (or the source of financing such distribution) if a certain leverage ratio test is met. An even more aggressive variant based more closely on the high-yield bond formulation that has become commonplace credits a percentage of consolidated net income ("CNI") (usually 50%) rather than retained excess cashflow, with the disadvantage for lenders in that CNI is not reduced by the deductions used to calculate ECF and because the build-up may begin years prior to the onset of the ECF sweep. The builder baskets may also have additional "starter amounts," usually soft capped by reference to EBITDA, and in certain deals there is a "floor" on the CNI builder basket, such that, unlike bond transactions where 100% of losses are deducted from the CNI builder basket, no losses are deducted.

US-style Events of Default

While previously US-style events of default continue to be resisted by European loan syndicates, it is now more customary for loan financings to include defaults more akin to the US loan approach (such as removal of material adverse change default and no audit qualification default) or, more typically, the high-yield bond approach (more limited defaults, including cross-acceleration rather than cross default, with longer remedy periods, which regarding bankruptcy defaults is unusual in Europe).

Other Provisions

There are other provisions we have seen migrate from the US cov-lite (or high-yield) market to Europe (or otherwise evolve within the European market) to become well established, including:

- "Permitted Acquisitions" controlled by a leverage test (or no test at all) rather than by imposing absolute limits – and generally fewer controls on acquisitions.
- "Permitted Disposals" similarly trending towards a high-yield formulation that does not impose a cap and has varying requirements for reinvestment/prepayment and cash consideration.
- Guarantor coverage ratios are trending towards an EBITDA test only (at 80%).
- Change of control mandatory prepayment being adjusted to allow individual lenders to waive repayment (becoming effectively a put right).
- Increased use of general "baskets" (as distinct from and in addition to ratio-based incurrence tests) with a soft dollar cap that increases as total assets or EBITDA grows, including for "baskets" relating to events of default.
- Provisions that state that if FX rates result in a basket being exceeded, this will not in and of itself constitute a breach of the debt covenant (or other limitation).
- Use of the concept of a "Restricted Group" and ability to designate subsidiaries as "Unrestricted" and therefore outside the representations and covenants.
- EBITDA addbacks (as used in financial ratios for debt incurrence purposes) that are capped per individual action rather than per relevant period and often with a relatively high cap such as 25% or 30% of EBITDA. It is now unusual to see any third-party verification of addbacks, and realisation periods can extend to 24 or 36 months in certain deals.
- An increasing trend for Majority Lenders to be set at 50% rather than the traditional European percentage of 66⅔% (sometimes with the lower percentage used for consents and the higher percentage for acceleration rights).

- Greater restrictions on transfers to competitors and "loan to own" funds, with more limited default fall aways (e.g., payment and insolvency only).
- The inclusion of a "covered jurisdiction" concept whereby guarantees and security will only be given in a pre-defined list of jurisdictions (as opposed to all jurisdictions other than those which the agreed security principles will exclude).
- A more limited security package consisting of material bank accounts, shares in Material Subsidiaries and intra-group receivables in respect of proceeds loans.

While anti-net short provisions (limiting the voting rights of lenders that hold a net short position in respect of the relevant credit) have begun to emerge in the US syndicated loan market, such feature has not yet widely appeared in European cov-lite loan deals, although there are limited examples.

Economic Adjustments

Economic adjustments such as a 101% (or 100.50%) soft call for six or 12 months, a EURIBOR or LIBOR floor, and nominal (0.25%) quarterly amortisation are also often introduced to make loans more familiar to US loan market participants. Other relevant considerations for a US syndication in respect of a European credit include all asset security (which is typically expected in the US), whether a disqualified list in respect of transfers will be used instead of a more European approved list concept, more fulsome MFN and maturity restrictions in relation to debt incurrence and the inclusion of a US co-borrower in the structure.

Structural Consequences – the Intercreditor Agreement Revisited

Adopting products from other jurisdictions brings with it the risk of unintended consequences. US terms and market practice have developed over decades against a background of the US bankruptcy rules and US principles of commercial law. The wholesale adoption of US terms without adjustment to fit Europe's multiple jurisdictions can lead to a number of unintended consequences.

A good example of this relates to European intercreditor agreements, which have over time developed to include standstills on debt claims and release provisions. At the heart is the continuing concern that insolvency processes in Europe still, potentially, destroy value. Although significant steps have been taken in many jurisdictions to introduce more restructuring-friendly and rescue-driven laws, it remains the case that in Europe there is a far greater sensitivity to the ability creditors may have in times of financial difficulty to force an insolvency filing by virtue of putting pressure on boards of directors through the threat of directors' liability under local laws. A significant feature of the restructuring market in Europe for many years has been the use of related techniques that creditors, particularly distressed buyers, adopt to get a seat at the table by threatening to accelerate their debt claims. Standstill provisions evolved to prevent creditors from using this type of action to disrupt a restructuring without having to resort to a bankruptcy proceeding to provide a stay and thereby obtain increased recoveries.

Another intercreditor provision of great focus over the years has been the release provision, which provides that in the case of distressed asset sales following default and acceleration, the lenders' debt and guarantee claims against, and security from, the companies sold are released. In some deals from the last decade, these protective provisions had not been included, with the result that junior creditors could gain significant negotiating leverage because their approval was needed for the release of their claims and security, without which it is not possible to maximise value in the sale of a business as a going concern.

The potentially significant debt baskets referred to above become relevant in this context. In the US, where this flexibility originated, debt baskets do not legislate as to where in the group debt can be raised – structural subordination does not often play a significant role in a US bankruptcy because typically the entire group would go into Chapter 11. In Europe, structural subordination can have a dramatic effect on recoveries (as suffered by the first wave of European high-yield bonds in the 1990s, which were structurally subordinated). Even if those subsidiaries have granted upstream guarantees, the value of the claims under such guarantees are often of limited value.

Provisions allowing the incurrence of third-party debt do not typically require the debt providers to sign up to the intercreditor agreement unless they are sharing in the security package. With more flexibility to incur third-party debt, it is very possible that an unsecured creditor (or a creditor that is secured on assets that are not securing the cov-lite loan given the more limited security package) under a debt basket can have a very strong negotiating position if the senior secured creditors are trying to sell the business in an enforcement scenario, given the lack of standstill and release provisions. We are seeing requests that third-party debt (including unsecured debt) over a materiality threshold is required to become subject to the main intercreditor agreement (and, therefore, the critical release provisions described above) but most cov-lite deals do not include this requirement.

These provisions become even more important to structure appropriately given the new trend is to seek to adopt "lifetime" intercreditor agreements which remain in place for future debt structures.

What Does This Mean for 2021?

While there remains some uncertainty around the pandemic and the timeframe for return to a relative "normal" at time of writing, it seems likely that low interest rates may continue to prevail in Europe, and the depth of the investor base looking for yield will continue to permit significant flexibility in covenant and documentation issues. The trend of greater investor push-back on certain deals is likely to continue. Experience suggests that it is only where a particular credit generates surprising losses upon a default that there is any significant resetting of market terms, and the pandemic does not seem to have reset the market in any material way.

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Restructuring Across the Pond and Back: A Comparison of Chapter 11 and the New UK Act

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In the U.S. and UK, Chapter 11 cases under the U.S. Bankruptcy Code, schemes of arrangement under the English Companies Act 2006 and company voluntary arrangements under the English Insolvency Act 1986 have, for many years, offered reliable and tested ways for companies to restructure their debts. However, on June 26, 2020, the Corporate Insolvency and Governance Act 2020 (the UK Act) came into force, ushering in the most significant changes to UK insolvency law that have been introduced in over a decade. The UK Act makes both permanent and temporary amendments to UK insolvency and restructuring laws.

Chapter 11 has proved to be a very powerful tool for restructuring the debts of distressed companies. The wide automatic stay provides breathing space while a debtor formulates a proposed plan of reorganization; and the ability to cram-down dissenting classes of creditors in connection with the approval of a plan of reorganization ensures that restructurings can proceed without full consensus among affected creditor classes. Finally, the long-armed reach of the U.S. Bankruptcy Court has meant that these measures are available for use by non-U.S. companies, even those with minimal nexus to the U.S. In light of the broad successes of the Chapter 11 approach to avoid liquidation and foster meaningful restructurings that preserve value and jobs, numerous non-U.S. legislatures have re-evaluated their own insolvency regimes in an attempt to emulate some of the most effective features of Chapter 11.

Prior to the implementation of the UK Act, the absence of a cross-class cram-down mechanism has long been regarded as a limitation of the UK restructuring toolkit. This has led to the successful development of alternative structures, most notably the combination of a scheme and a "pre-packaged" administration to deliver a senior creditor-led restructuring notwithstanding the existence of non-consenting shareholders and/or junior creditors. Such structures add to the cost of any restructuring. The new "restructuring plan," introduced by the UK Act by adding a new part to the Companies Act 2006, closely resembles Chapter 11 in many key areas, but with several notable differences as further discussed below.

Overview of Chapter 11 and a Restructuring Plan under the UK Act

A Chapter 11 case begins with the filing of a petition in bankruptcy court, which grants the bankruptcy court broad oversight over the debtor, its business assets and liabilities during the Chapter 11 case. Asset disposals outside the course of normal business, incurrence of post-petition debt and the granting of any new security and the approval and implementation of a reorganization plan are all subject to bankruptcy court review and approval. Chapter 11 cases generally culminate in the proposal and confirmation (via court approval) of a plan of reorganization (or, sometimes, liquidation) pursuant to which claims against and interests in the debtor may be compromised and discharged. In relation to a reorganization plan, the bankruptcy court will consider issues of jurisdiction, feasibility, good faith, the best interests of the creditors, and whether the plan is fair and equitable under the circumstances for dissenting creditor classes.

A bankruptcy filing under Chapter 11 operates as an immediate and continuing injunction, known as the "automatic stay," which prohibits virtually all creditor actions against the debtor or its property wherever located (the so-called "extraterritorial effect" of Chapter 11). Either the debtor or its creditors can commence cases pursuant to Chapter 11; however, the debtor has the exclusive right to propose a plan of reorganization in the first 120 days of the cases, which period can be extended by the court by up to 18 months (or shortened for cause). During this exclusivity period, no competing plans can be filed. If the debtor fails to file a plan before expiration of the exclusivity period, any party in interest (including the debtor) is free to file its own plan and there may be numerous competing plans that must be evaluated by the court.

Eligibility to be a debtor under Chapter 11 is well known and codified and is available to companies with (a) domicile, (b) a place of business, or (c) property (even of *de minimis* value) located in the U.S. In practice, this threshold is very low, as even possession of a bank account in the U.S. has been found to be a sufficient nexus to establish jurisdiction over a foreign debtor. However, there are some limitations to the jurisdiction of the bankruptcy courts. Generally, domestic U.S. banks and insurance companies are not eligible to be debtors under the U.S. Bankruptcy Code as these entities are subject to special federal and state regulation.

There is no insolvency or other test that must be satisfied before relief can be obtained by a debtor filing a voluntary petition under the U.S. Bankruptcy Code. However, for involuntary petitions, filed by creditors intending to commence the case against the debtor, there are a number of requirements. First, if the debtor has 12 or more creditors, the involuntary petition must be filed by at least three creditors. Further, these three creditors must hold claims against the debtor aggregating to at least USD 15,775 in excess of the value of any lien on property of the debtor, and the claims must be non-contingent as to liability and may not be the subject of a *bona fide* dispute as to liability or amount. Finally, the filing creditors must assert that the debtor is generally not paying its debts as they fall due – known as the "cash-flow insolvency" test.

In the UK, a company, its creditors or its members can propose a restructuring plan, introduced by the UK Act without

an application to the court. However, the court in the UK does have oversight of the restructuring plan process and indeed there are two court hearings as part of the approval process. In the first court hearing, the court must approve the class formation and the convening of restructuring plan meetings. If sufficient creditors or members approve the plan at the relevant meetings, the court will consider, in the second court hearing, whether it is a proper exercise of its discretion to sanction the plan. In doing so, the court will consider whether the classes of creditors or members were properly constituted, whether it has jurisdiction to sanction the plan and whether the plan is fair. If sanctioned, the plan will be binding on all creditors and members regardless of whether they, individually or as a class, approved the plan. Generally, the scope of a restructuring plan is very broad, but unlike a scheme of arrangement, which can be proposed by a company in financial distress or a completely solvent company, there are primary conditions related to financial distress that must be met. First, the company must have encountered or be likely to encounter financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern. Second, the plan must reflect a compromise or arrangement proposed between the company and its creditors or members (or any class of either) where the purpose of such compromise or arrangement is to eliminate, reduce, prevent or mitigate the effect of any of the financial difficulties the company is facing. So long as those criteria are met, it will be possible to use the new restructuring plan to reorganize the debtor's liabilities.

Finally, like Chapter 11, the restructuring plan is available to UK and overseas companies; specifically, the restructuring plan will be available not just to companies incorporated in the UK but to any company with a "sufficient connection" to the UK. "Sufficient connection" may involve more than the *de minimis* nexus required for a Chapter 11 but can usually be founded on the basis that the debt being compromised is governed by English law.

The Role of the "Debtor-in-Possession"

Under Chapter 11, and unless the U.S. Bankruptcy Court orders otherwise, the debtor and its management remain in possession of the debtor's business and property during the pendency of the debtor's bankruptcy case. The so-called "debtor in possession" continues to operate its business and is empowered to deal with its contracts and property in a manner provided by the U.S. Bankruptcy Code under the bankruptcy court's oversight. The debtor in possession has nearly all the powers and duties of a trustee appointed by the U.S. Bankruptcy Court. However, a party-in-interest (or the U.S. trustee – a statutorily required representative of the Department of Justice commissioned with protecting the integrity of the administration of the cases and adherence to bankruptcy laws) can request that a trustee be appointed by the court to assume control of the business. A trustee is likely to be appointed in cases where the existing management have been fraudulent or dishonest, or have grossly mismanaged or abandoned the business. It should be noted that it is not unusual for the existing management to be replaced by new managers as an alternative to appointing a trustee.

Under the UK restructuring plan, the directors of a company that proposes a restructuring plan will remain in control of the company at all times during the process. As discussed further below, the UK Act also provides for a moratorium that is similar to that under Chapter 11, which can be used in conjunction with a restructuring plan (although it has not been used to date). For as long as the moratorium applies, it would prevent the enforcement of security, the commencement of insolvency proceedings or other legal proceedings against the debtor and forfeiture of a lease. The moratorium will last for an initial period of 20 business days with an ability to extend for a further period of 20 business days without consent and with the possibility of further extensions of up to one year or more. If a moratorium is used in conjunction with a restructuring plan, an insolvency practitioner must serve as "monitor" during the moratorium to protect creditors' interests.

Step-by-Step: Implementation and Costs of Restructuring Plans Under Chapter 11 and the UK Act

The steps required for a UK restructuring plan and Chapter 11 share many similarities. For a UK restructuring plan, the process is outlined by: (1) application to the court for leave to convene the class meetings to consider the restructuring plan; (2) a court hearing held to consider classes and summon the meetings of creditors and members; (3) notice is then provided summoning the meetings and providing an explanatory statement of the plan to be sent, or otherwise advertised, to creditors and members; (4) creditor or member meetings occur and a vote is conducted; (5) provided requisite majorities are reached, there will be a second court hearing to sanction the compromise or arrangement; and (6) provided the court sanctions the compromise or arrangement, the plan will become binding on all creditors and members in accordance with its terms once the court order has been delivered to the registrar of companies (in the case of a company incorporated in the UK) or published in the Gazette (in the case of an overseas company).

In a similar vein, the process under Chapter 11 provides generally that: (1) the Chapter 11 case is commenced by the filing of a petition in bankruptcy court (which is deemed in a voluntary case to be the "order for relief"); (2) the commencement of a Chapter 11 case creates an estate, which comprises all of the debtor's property; (3) in the case of a reorganization plan proposed by a debtor, the plan will be filed at court along with a disclosure statement; (4) a disclosure statement hearing will be held, at which the adequacy of disclosure will be considered by the court and dates set for the voting deadlines and confirmation hearing; (5) votes on the plan from the relevant creditors must be submitted before the voting deadline; (6) following the vote, there is a 28-day period in which objections to the confirmation of the plan can be filed; and finally (7) a confirmation hearing is held to confirm the plan and the plan is implemented.

There is not a specified time limit on the duration of a Chapter 11 case and the time period will depend largely on the type of reorganization proposed and whether the Chapter 11 was pre-arranged or whether the reorganization plan is negotiated during the case. A pre-arranged Chapter 11 can be concluded in as little as two to three months (or in rare cases with simple capital structures, even faster). However, the average lifespan of a major Chapter 11 case is estimated to be between six to 18 months, depending on the complexity of the case, including any litigation that may need to be resolved.

However, in the UK, the timetable is expected to be similar to that of schemes of arrangement, which generally take between six to eight weeks from launch.

Key considerations in any restructuring and choice of procedure are the costs and time. The costs of Chapter 11 processes are generally significant in large, complex reorganization cases, but are often justifiable given the protections and benefits afforded by Chapter 11, whereas the costs for a restructuring plan in the UK are likely to be similar to a scheme of arrangement and generally slightly less than in the U.S. However, if

cross-class cram-down or cram-up is proposed and the court is required to consider competing evidence on valuation, this would most likely significantly increase costs.

Two Key Tools: The Moratorium and *Ipso Facto* Termination Prohibition

The standalone moratorium and *ipso facto* provisions (also known as the termination clause override) under the UK Act are comparable to the automatic stay (as discussed above) and the exercise of *ipso facto* clauses (provisions that terminate or modify the contract on the basis of the company's insolvency) under Chapter 11, as well as the safe harbors for qualified financial contracts thereunder.

Generally, the moratorium and termination clause override do not apply where the insolvent entity is an excluded entity type, which includes certain insurers, banks, payment institutions, infrastructure providers, and securitization companies, and overseas entities with similar functions.

Where the insolvent entity in a Chapter 11 is not an excluded entity type, the termination clause override does not apply where the counterparty is a bank, insurer or other excluded entity type (including U.S. institutions that fall within the identified categories of excluded entity). Hence, even if the insolvent entity is not barred from triggering the *ipso facto* provisions generally, an excluded entity counterparty would still be able to terminate its contract as a result of the commencement of those insolvency proceedings.

Finally, even where the insolvent entity (or the counterparty) is not an excluded entity, there are protections under the UK Act for certain excluded types of financial contracts (such as swaps, repos, loan agreements and bonds). Such contracts are protected from the effects of the termination clause override and, in the case of the moratorium, are not subject to the payment holiday. For example, if the counterparty has an excluded contract, it will be able to exercise a contractual termination right or set-off right, but would be barred by the moratorium from attaching assets, suing for any deficiency or enforcing security (except for financial collateral). Given that financial contracts (including loan agreements and bonds) are not subject to the payment holiday in the moratorium, it may be that such counterparties would not need to take enforcement action in any event.

The U.S. Bankruptcy Code provides for certain exceptions to the automatic stay, including for governmental policing and regulatory powers and for set-off and netting rights under certain financial contracts. A key tool for the debtors under Chapter 11 is that the automatic stay lasts for the duration of the Chapter 11 case, until the conclusion of the bankruptcy case, unless the court orders relief to lift or modify the stay. However, in the UK, when an application is made for a restructuring plan or a scheme of arrangement, there is no automatic stay; if the company wanted to make use of the standalone moratorium, it would need to do this separately from, and in addition to, the proposals for the scheme or restructuring plan. To date, the moratorium has not been used in conjunction with the new restructuring plan, possibly due to the large number of exclusions and safe harbors. Indeed, the moratorium has only been used to date for small companies.

Is Interim Financing Available Under the UK Act?

Chapter 11 provides relief to allow a debtor to obtain new unsecured or secured financing subject to bankruptcy court review and approval to fund the debtor's ongoing operations and the costs of administration of the bankruptcy case, colloquially referred to as "debtor-in-possession" or "DIP" financing. One of the most important considerations for DIP financers is that the DIP financing will often enjoy super priority status over other (unsecured) administrative priority claims and general unsecured claims against the debtors arising before the bankruptcy filing. Subject to certain requirements, where the interests of the existing, pre-bankruptcy secured lenders are deemed to be "adequately protected," there also is scope for the bankruptcy court to authorize new secured DIP financing that would be senior or *pari passu* with the liens of the existing secured creditors. The ability of debtors to obtain new financing under the tiered incentive structure set forth in the U.S. Bankruptcy Code is a distinguishing feature that often makes Chapter 11 a preferred path for a debtor to reorganize.

Neither the UK Act nor the pre-existing insolvency legislation in the UK includes specific mechanisms to enable rescue financing similar to Chapter 11 DIP financing (although the administration procedure allows monies lent post-administration to rank as an "administration expense," in priority to floating charge security). However, based on scheme precedents, restructuring plans should be sufficiently flexible to enable new money financing to be raised through the restructuring plan itself. Subject to satisfying the terms of the cross-class cram-down process and depending on the rights of the creditors under the existing finance documents, this new financing could be structured on a super senior basis and with rights to participate allocated to certain classes of creditors only.

Treatment of Existing Contracts

In the U.S., courts often approve payment of pre-petition obligations to "critical" vendors (who may or may not have contracts with the debtor) who, among other things, may put the debtor's business at risk as a result of missed payments or who may be entitled to payment or priority of payment under certain bankruptcy provisions or non-bankruptcy laws. The debtor has the power to assume, assume and assign, or reject executory contracts and unexpired leases. If the debtor assumes (or assumes and assigns) an executory contract or lease, the debtor must cure all defaults or provide adequate assurance that the default will be cured promptly.

Under the UK Act, there are no specific provisions for the treatment of existing contracts. But, as noted above, there is a broad prohibition on the termination of any contract for the supply of goods and services to a company, or "doing any other thing" in respect of that contract, by reason of the company entering into an insolvency procedure.

Designating Classes and Determining Their Composition

In a Chapter 11, a reorganization plan must designate classes of claims under the reorganization. Generally, a reorganization plan will classify claim holders as secured creditors, unsecured creditors entitled to priority, general unsecured creditors, and equity security holders. Section 1122(a) of the U.S. Bankruptcy Code provides that a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class. The plan proponent has some discretion in how to propose a classification scheme under plan.

Under the UK restructuring plan, a debtor has the option to divide creditors and shareholders that are subject to the restructuring plan into separate classes. The constitution of the classes will then be considered by the court at the convening hearing. It is expected that the principles relating to the determination

of classes should be similar to the determination of classes for schemes of arrangement. When determining the classes of creditors or members for the purpose of requesting the convening of relevant meetings, the court will apply the test of whether, in relation to any given group of creditors or members, their rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest. Where the rights are not so dissimilar, creditors or members should be placed in one class for the purpose of the restructuring plan meeting and voting. But, where they are so dissimilar, they ought to be placed in separate classes. Under the restructuring plan, determining the relevant classes requires an analysis of the rights that are to be varied or released under or in connection with the restructuring plan and new rights (if any) that the restructuring plan or the related restructuring gives to those creditors whose rights are to be released or varied.

Stakeholder Voting and Thresholds

In Chapter 11, creditors whose claims are impaired under a plan of reorganization are generally entitled to vote on whether to accept or reject the plan. A creditor is impaired if such creditor's legal and equitable rights as they existed pre-bankruptcy are altered in any way by the plan. Classes that are not impaired under a plan are presumed to have accepted the plan. Each impaired class of claims and interests is entitled to vote on the plan and the plan is confirmed if at least two-thirds in value and more than one-half in number of each class of claims vote in favor of the plan, and provided the other requirements for confirmation are satisfied.

Under the UK restructuring plan, every creditor or member of the company whose rights are affected by the compromise or arrangement must be permitted to participate in the meeting and vote on the plan, but there is no need to include creditors or members whose rights are not affected. Furthermore, a court may exclude even a creditor or member whose rights are affected where it is satisfied that none of the members of that class has a genuine economic interest in the company. As for voting thresholds for each class, at least 75% in value of creditors or members present and voting (in person or by proxy) of each class must agree to the compromise or arrangement. This is similar to the threshold in a scheme of arrangement but, unlike with a scheme of arrangement, there is no numerosity requirement that there must be at least 50% by number of creditors voting in favor of the arrangement.

Ability to Cross Cram-Down and Cram-Up

A Chapter 11 cram-down allows for a reorganization plan to be confirmed notwithstanding rejection of the plan by a dissenting class of claims, provided that at least one impaired class of claims votes in favor of the plan, the plan is "fair and equitable," the plan does not discriminate unfairly and all other requirements for confirmation are met.

The U.S. Bankruptcy Code provides guidance as to what may be considered by the court to be "fair and equitable" treatment – generally a plan is said to be fair and equitable to a class of dissenting:

- secured creditors, if (1) (a) the holders of such claims retain the liens securing their claims (whether the collateral is retained by the debtor or transferred) to the extent of the allowed amount of their claims, and (b) each holder of a claim of the class receives deferred cash payments equal to the allowed amount of such secured claims, or (2) in a sale of collateral, liens attach to proceeds of any sale made free and clear of liens, or (3) the plan provides for secured creditors to realize the "indubitable equivalent" of their claim;
- unsecured creditors, if (1) each holder in the class receives or retains property equal to their allowed claim, or (2) no junior classes of creditors or equity will receive a distribution under the plan (the so-called "absolute priority" rule); and
- equity interests, if (1) such class will receive distributions taking into account allowed fixed liquidation preferences, or, if any, the redemption price or value of equity, or (2) no junior classes of equity will retain an interest or receive a distribution under the plan.

Under the UK restructuring plan, the compromise or arrangement must be proposed between the company and its creditor or members (or any class of either). The restructuring plan also enables a restructuring of both "out of the money" debt and equity to be implemented within the existing corporate structure without the need for a sale of the business and/or subsidiaries through a pre-packaged administration. Under such restructuring plan, even in the absence of approval by all classes, the court may still sanction the plan, provided that:

- the court is satisfied that none of the dissenting classes are any worse off under the plan than they would be in the event of the "relevant alternative" (referred to below); and
- the plan has been agreed by a number representing 75% in value of a class of creditors or (as the case may be) of members, present and voting (in person or by proxy) who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative.

The "relevant alternative" is meant to encompass the most likely outcome for the company and its stakeholders if the restructuring plan were not sanctioned by the court. Courts are granted broad discretion to make this determination and it is expected that the appropriate comparator test used for assessing class composition in schemes of arrangement will be a good starting point for this evaluation.

Provided that the conditions for sanctioning a cram-down plan have been met as set out above, it is open to the court to sanction a plan that is approved by a junior class of lenders but rejected by a senior class. As noted, the protection for the senior class is that the courts will test the fairness of the plan to determine whether the senior class will ultimately receive value at least equal to what they would have received in the relevant alternative.

The Absolute Priority Rule

The "absolute priority rule" requires that no class of creditors or interest holders may recover in Chapter 11 unless the claims of all creditor and interest holder classes senior to them have been satisfied in full, barring agreement by a senior class to lesser treatment of its claims. There is a limited exception to this rule (the "new-value" exception) where equity holders agree to invest new capital to "buy back" their equity interests even though senior creditors will receive less than full payment. However, in these circumstances, the absolute priority rule would still be violated where, in the absence of a "market test," existing equity was given an exclusive opportunity to purchase its equity.

In the UK, when the government originally consulted on the introduction of the restructuring plan, they indicated that they intended to incorporate a modified form of the absolute priority rule. The government proposed to give the court a discretion to approve a plan even where it deviated from the absolute priority rule where deviation was necessary to achieve the aims of the restructuring and was just and equitable in the circumstances (sometimes referred to as the "relative priority" rule). Neither of these requirements are expressly included in the UK Act in respect of the restructuring plan. This gives the restructuring plan much greater flexibility but also places significant

responsibility on the court to adjudicate on the fairness of the restructuring proposal as a whole in determining whether or not to exercise its discretionary power to sanction the restructuring plan.

The Significant Role of Valuations

Valuations play a significant role in both a Chapter 11 and the UK restructuring plan. Under the "best interests of creditors" test in a Chapter 11, each holder of a claim in an impaired class must either accept the plan or the plan must provide that such holder shall receive or retain under the plan on account of such claim, property of a value that is not less than the amount such holder would receive in a hypothetical liquidation. In considering this test, the court plays a significant role in assessing valuation evidence from creditors and shareholders. Valuations are also important for various matters at different stages of the Chapter 11 process, including in the context of avoidable transfer litigation, treatment of existing lenders in adequate protection disputes, and, as noted, under a plan of reorganization to determine outcomes for creditors and equity holders.

In the UK, valuations are likely to be key and even more hotly contested than in a scheme of arrangement given the need to identify whether a given class of creditors has a genuine economic interest in the company and the important consideration of whether creditors are expected to receive at least what they would receive in the relevant alternative. It is anticipated that courts will increasingly be expected to undertake detailed consideration of competing expert evidence from creditors and shareholders in relation to the above matters.

Appeal Process

Bankruptcy orders and court decisions can be appealed under both the U.S. and UK regimes. In the U.S., appeals will usually be made to the U.S. District Court, and from there to the Federal Courts of Appeal, and ultimately to the U.S. Supreme Court (if the Supreme Court grants a writ of certiorari). Much like the process for schemes of arrangement and restructuring plans, the U.S. bankruptcy court is likely to have made a number of determinations and orders throughout the life of the Chapter 11 case, and to have considered any objections to the reorganization plan at the confirmation hearing and therefore final appeals of the final order tend to be infrequent.

In the UK, while the court's decision to approve the restructuring plan can be appealed, generally speaking, it is extremely rare for a schemes of arrangement to be appealed. This is largely due to the court's considerable involvement throughout the process and the ability for opposing creditors to appear at the court hearings, which factors contribute to extensive analysis and deliberation over the relevant appealable issues at the initial proceeding. However, it remains to be seen whether the inclusion of the cross-class cram-down leads to a greater number of appeals given the greater role of discretion in the court's determination.

International Recognition

Chapter 11 cases are often recognized under private international law principles or the UNCITRAL Model Law on Cross-Border Insolvency Proceedings (the Model Law). The automatic stay purports to prohibit virtually all creditor actions against the debtor or its property worldwide. Creditors with U.S. operations, U.S. business or any other U.S. nexus will be reluctant to breach the automatic stay, regardless of formal recognition of the local courts.

There is some debate as to how the UK restructuring plan will be recognized, particularly in Europe given that very few Member States have implemented the Model Law. Where the restructuring plan seeks to compromise an English law contract, the principles of the Rome I Regulation will apply (where the applicable law of the contract will determine the circumstances in which that debt can be varied or discharged). The restructuring plan may also be recognized under private international law principles. However, given the UK's departure from the European Union (and the end of the Brexit transition period on December 31, 2020), some of the mechanisms for the recognition of a scheme of arrangement (including recognition under the Recast Brussels Regulation) will no longer be available. Recognition in Europe may also depend on whether the restructuring plan is treated as an "insolvency proceeding" for various purposes. As with schemes, we expect that a restructuring plan will be capable of having international effect and could be recognized in other jurisdictions on the basis of private international law where the creditors have submitted to the English courts and under Chapter 15 of the U.S. Bankruptcy Code. Whether it will be recognized as an insolvency proceeding for other jurisdictions that have implemented the Model Law will depend on how those jurisdictions have implemented the Model Law.

Preferences and Fraudulent Transfers

One of the key powers of a trustee in a Chapter 11 is the broad powers under the U.S. Bankruptcy Code to challenge and avoid certain pre-bankruptcy transactions that had the effect of removing property from the debtor's estate or encumbering the estate, and to recover the property or the value of the transferred property from certain transferees, specifically through the ability to attack "avoidable preferences" and "fraudulent transfers."

The bankruptcy trustee or debtor-in-possession may void any transfer of property of the debtor as a preference if it can establish that: (1) the transfer was to or for the benefit of a creditor and the transfer was made for or on account of an antecedent debt (i.e., a debt owed prior to the time of the transfer); (2) the debtor was insolvent at the time of the transfer; (3) the transfer was made within 90 days of the date of the filing of the bankruptcy petition or was made between one year of the date of the filing of the petition to an insider of the debtor; and (4) the transfer has the effect of allowing the creditor to receive more on account of its claim than such creditor would have received in a hypothetical chapter 7 liquidation of the debtor. However, there are certain statutory defenses to a potential preference including transfers that were made in the ordinary course of business and transfers for new value given to the debtor.

In addition to avoidable preferences, the U.S. Bankruptcy Code authorizes the avoidance of obligations or transfers made or incurred by the debtor with the intent to hinder, delay or defraud a past or future creditor (i.e., for actual fraud). The U.S. Bankruptcy Code also provides similar relief for constructive fraud. A constructively fraudulent transfer does not require malicious intent, but arises when a debtor transfers property or incurs an obligation that is made or incurred within the two-year period before the debtor's bankruptcy case, and for which (voluntarily or involuntarily): (i) the debtor received less than the reasonably equivalent value in exchange for such transfer or incurrence; and (ii) (1) the debtor was insolvent on the date that the transfer was made or the obligation was incurred or became insolvent as a result; or (2) the debtor was engaged in a business for which its remaining property was an unreasonably small capital given the nature of the debtor's business; or (3) the debtor intended to incur, or believed that it would incur, debts that would be beyond

the debtor's ability to pay such debts as they matured; or (4) in the case of transfers to insiders of the debtor, the debtor made such transfer or incurred such obligation under an employment contract and outside the ordinary course of business. It should also be noted that each of the 50 U.S. states have adopted laws that provide for the avoidance of constructively fraudulent transactions pursuant to similar standards, which state laws can be applied inside or outside a bankruptcy case (and which generally provide for longer reach-back periods).

Under the UK Act, there are no separate provisions for avoidable preferences and fraudulent transfers *per se*. There are existing English insolvency law rules in relation to such antecedent transactions that apply in the context of insolvency proceedings such as liquidation or administration but these provisions do not apply in the context of a restructuring plan (although they may be taken into account when considering the relevant alternative).

Conclusion

The introduction of the restructuring plan through the UK Act is a welcome addition to the global restructuring landscape. On its face, the differences with Chapter 11, sometimes subtle and sometimes significant, mean that once parties get accustomed to the various procedures, there might be compelling reasons why the UK restructuring plan might work when Chapter 11 will not be suitable or vice versa. This might only become apparent once a restructuring starts to take shape under the UK Act. In the coming months and years, it will be important for debtors and creditors alike to consider whether their chosen venue is the most appropriate for their given facts and circumstances and work with legal advisors who possess the necessary expertise to assist in evaluating and weighing the merits of pursuing relief under each of these regimes.

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Analysis and Update on the Continuing Evolution of Terms in Private Credit Transactions

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Introduction

For the past 10 years, The Private Credit Group at Proskauer Rose LLP has tracked deal data for private credit transactions (our "data"). The data referred to in this chapter reflects trends and evolving terms in over 204 private credit transactions closed by The Private Credit Group at Proskauer Rose LLP in 2020 and may not be indicative of overall market trends.

Our data shows that over the past 10 years, the middle market has experienced an influx of financing terms traditionally found only in large cap financings, albeit with a middle market orientation in many cases. During these years, lenders have faced increased competition for deal origination resulting from a growth of direct lending by unregulated financial entities, a surplus of dry powder and a limited supply of attractive investment opportunities. We saw a slight slowdown in this trend in 2018 in light of speculation around the end of the current credit cycle but in 2019, data demonstrated that these large cap financing terms appeared in the middle market at an increased pace as compared to 2018. Given that large cap terms assume a profitable, durable business model and stable economic climate, it may have seemed inevitable to many that lenders in 2020 would reject any further influx large cap financing terms into middle market transactions and attempt to unwind any previously adopted provisions. Cases like Serta, Boardriders and Trimark (in which borrowers were able to exploit favourable documentation to subordinate existing lender debt to new lender debt to achieve restructurings without the consent, and to the detriment, of existing lenders) were also fresh in lenders' minds and highlighted the risk inherent in allowing large cap terms in middle market credit documents.

Nevertheless, the private credit market continued to demonstrate its durability in 2020 against a backdrop of economic uncertainty and the devastating effects of the COVID-19 pandemic. Our data shows that in 2020, large cap financing terms continued to appear in middle market financings in a manner generally consistent with prior years. A discussion of the factors leading to this result follows.

The private credit market enjoyed a strong start to 2020. Despite the persisting uncertainty of many around the end of the current credit cycle, lenders continued to bring a surplus of dry powder to the market and competition for investment opportunities remained high. As Q1 came to a close, it became clear that the COVID-19 pandemic would irreparably leave its mark on the world economy. Financial reporting from borrowers that would follow in the coming weeks showed the first effects of declining revenues. The mining, oil, transportation, employment services, travel, leisure and hospitality industries were particularly hard hit, but borrowers in a myriad of industries began to feel the fallout from this pandemic. Q2 brought more of the same for borrowers, and with the benefit of strong financial performance from prior quarters rolling off borrowers' books, speculations began to run high that many borrowers would soon face payment and financial covenant defaults under their credit documents and need to restructure their current credit facilities. At the end of Q1 and the beginning of Q2, many financings in the pre-commitment stage also came to a halt and the private credit market experienced a temporary slowdown in the number of new financing opportunities coming to market. However, despite the economic uncertainty (and predictions by many experts that COVID-19 would lead to one of the deepest recessions in U.S. history), the private credit market quickly rebounded and remained strong for the duration of 2020.

In most cases, borrowers did not default on principal and interest payments. Our data shows that, as of December 31, 2020, a payment default had occurred in only 1.4% of active deals. Many borrowers fully drew down on previously committed revolving facilities to build cash reserves. The borrowing conditions for these revolving facilities are limited to basic items (such as no event of default, a bring down of representations and warranties that are qualified by materiality, and delivery of a borrowing notice) so they are easy for a borrower to access. Credit documents also do not typically contain anti-cash hoarding covenants. As a result, borrowers had flexibility to access the full capacity of their revolving facilities for working capital purposes in anticipation of falling financial performance and tightening liquidity. In addition to this, many borrowers also took the opportunity to draw down on pre-committed delayed draw term loan facilities. This afforded borrowers a secure financing source for future acquisitions and investments. Although slightly more onerous than for revolving facilities, the borrowing conditions for delayed draw facilities are still limited to basic items (such as no event of default, a bring down of representations and warranties that are qualified by materiality, *pro forma* compliance with a leverage ratio, and delivery of a borrowing notice). Credit documents do not typically require that the proceeds of delayed draw loans be drawn and concurrently applied to fund the applicable transaction. As a result, borrowers were able to draw on the delayed draw facilities while their leverage ratios remained low and retain the cash proceeds on their balance sheets for future use in anticipation of deteriorating leverage and financial performance.

Borrowers were also able to maintain healthier-than-expected leverage ratios and, in many cases, avoid financial covenant breaches altogether. Our data shows that, as of December 31, 2020, a financial covenant default had occurred in only 2.1% of active deals. Following years of fierce competition for a limited

supply of financing opportunities, borrowers have been able to negotiate credit documents that are covenant lite or covenant loose (discussed below). A borrowers' earnings can deteriorate significantly before the total net leverage financial covenant typically found in middle market credit documents is breached and many borrowers' strong pre-pandemic fiscal quarters buoyed declining financial performance in the short term. In addition, these credit documents also typically have flexible definitions of Consolidated EBITDA (a component of the total net leverage covenant). For instance, Payment Protection Program loans and other government grants provided during the pandemic were reported as net income in certain instances. The effects of extraordinary and non-recurring losses and restructuring costs incurred as a result of changing business landscapes were also added back to income, often in uncapped amounts. As a result, net income for purposes of testing financial covenants was often inflated as compared to net income prepared in accordance with GAAP and not necessarily reflective of a borrower's current performance.

Because borrowers were able to avoid defaulting on their credit facilities in many cases, debt restructurings occurred at a level that was lower than many expected. Our data shows that events of default under active deals (i.e., deals closed by Proskauer that remained active in 2020) remained low in 2020, at around 4% of all active deals. As 2020 progressed, it also became apparent that modern medicine was likely to provide economic relief from the pandemic in the near future. In light of this, many lenders viewed decreases in their borrowers' financial performance as a temporary issue and showed a willingness to work with their borrowers on out-of-court solutions in cases where credit defaults were impending or likely to occur. As a result, many borrowers avoided bankruptcy proceedings and in-court restructurings remained lower than expected.

It also became apparent that many industries (e.g., delivery services, online retailers, online entertainment and remote workforce solutions) would be unaffected by or even expand as a result of COVID-19. This quelled fears for many of a complete economic crash. Although new deal activity had slowed slightly for a time, the market for new financing opportunities did pick up and remained competitive through the end of the year. Borrowers also remained active raising incremental loan facilities (discussed below) from the lenders of their existing credit facilities to finance acquisitions of new target companies to add to their existing corporate structures. Lenders showed interest in committing this additional capital. Closing leverage measures remained generally consistent with those in 2019, and deal terms did not change materially in many cases (although our data shows a slight increase in interest rate margins in 2020). Our 2020 data demonstrates that large cap financing terms continue to appear in middle market financings, and, despite all that occurred in the financial markets in 2020, lenders had a limited ability to unwind this trend. To the extent that the economy continues to weather the COVID-19 pandemic, we expect the influx of large cap financing terms to continue.

Although middle market lenders' appetite for certain large cap financing terms differ based on institutional biases, the treatment of such terms in credit documents can be summarised by the size of the borrower's consolidated EBITDA. As a general matter, our data shows that large cap deal terms become less prevalent as the consolidated EBITDA of a borrower decreases. In addition, as the consolidated EBITDA of a borrower decreases, the inclusion of large cap terms with conditionality and additional provisions intended to mitigate inherent risks in such terms becomes more prevalent. This allows us to divide the middle market into the "lower middle market", "traditional middle market" and the "upper middle market" for purposes of this analysis and discussion. This chapter will examine the continuing evolution of certain key financing terms in the private credit middle market, and set forth proprietary data pertaining to the usage of such terms within the middle market. The analysis will also discuss the related market drivers and trends influencing such terms in light of the continuing evolution of private credit.

Overview of Proskauer Rose LLP Private Credit Transactions in 2020

The top five industries represented in middle market transactions, as shown in our data, include (a) business services, (b) consumer products and services, (c) healthcare, (d) financial services, and (e) software and technology. These primary industries comprise 62% of our deals in 2020. Technology was the leading industry for transactions in 2020 (overtaking healthcare) and accounted for 22% of deals, up from 19% in 2019. First lien, second lien and senior secured transactions increased for the year, whereas mezzanine loan transactions represented 0% of all deals in 2020 (declining from 3% in 2019 and 5% in 2018). Interest rate margins (the percentage points added to a benchmark rate for purposes of calculating a floating or variable rate) across all deal types in our data have trended lower since 2015 (with a slight increase in interest rate margins in 2020). In 2015, only 16.7% of deals had margins less than 7.0%. The percentage of deals having margins less than 7.0% decreased from 71.4% in 2019 to 64.1% in 2020. The impact to lenders of decreasing interest rate margins in past years was partially offset by a strong LIBOR benchmark. In 2019 and 2020, LIBOR has fallen dramatically. With respect to commitment fees and original issue discounts (OID), in 2020, 53% of commitment fees and OID were between 2.0%–2.49% of the principal amount of the loans and commitments at closing, with a slight increase in commitment fees and OID over 2.49% in 2020.

Closing leverage for middle market transactions in our data remains stable with only a slight decrease from 5.40× in 2019 to 5.33× in 2020. Sixty-four percent of deals had a closing leverage between 4.00× and 6.99× (lower than 72% of deals in 2019, indicating that closing leverage varied more across transactions in 2020 than in previous years). Trends in closing leverage should also be considered against the backdrop of the loosening of parameters relating to the calculation of consolidated EBITDA across the middle market, which effectively lowers closing leverage multiples and results in more forgiving financial covenants. In transactions with EBITDA greater than $50MM, only 25% of them had a cap on general non-recurring expenses as an add-back to EBITDA; whereas in transactions with EBITDA that is less than $50MM, 67% of them had a cap on general non-recurring expenses (which is fairly consistent with 29% and 63%, respectively, in 2019, but is lower than in prior years). Additionally, add-backs for run-rate cost savings/synergies and restructuring costs have become almost ubiquitous and negotiated caps apply with increasing frequency only to cost savings/synergies applicable to acquisitions and restructuring activities after the initial closing date of a financing (and not to cost savings/synergies applicable to closing date transactions or to any restructuring costs).

Covenant lite deals, meaning deals that do not contain the usual protective covenants that benefit lenders, decreased in 2020 to 7% (*vs.* 10% in 2019) in deals with EBITDA greater than $50MM according to our data. However, we have seen an increase to 61% of deals with EBITDA greater than $50MM in our data of transactions that are covenant loose, meaning with financial covenant cushions equal to or greater than 40% against a borrower's model. Although financial covenants typically include a total leverage ratio test, in 2020, 17% of our deals

also included a fixed charge coverage ratio test (up 15% from 2019), showing a turning of the tides on this term, which has been steadily falling out of credit documents in recent years. Of the transactions with financial covenants, 44% of them had five or more covenant step-downs (down slightly from 48% in 2019). Of these transactions, 86% of them had EBITDA of less than $50MM. Step-downs will fall away in transactions with EBITDA over $50MM.

The general trend towards borrowers' counsel controlling the drafting process at both the commitment papers stage and the definitive deal documentation stage continued in 2020. In most circumstances, the borrower will also select the precedent credit agreement to be used as a starting point for definitive deal documentation in a particular transaction. Frequently, the lender will not have participated in the prior transaction or the proposed precedent document will reflect a more upper market orientation than the current deal. As a result, and in light of frequently time-sensitive commitment periods and healthy competition for investment opportunities in the current market, lenders often agree to work with these proposed precedent credit agreements and accommodate terms that are more typically found in larger transactions.

Debt Incurrence

Flexibility for a borrower to incur significant additional debt facilities (both within and outside the applicable loan facility) was one of the most transformative structural changes to make its appearance in the middle market. Consistent with 2019, incremental facilities, incremental equivalent facilities, ratio debt and acquisition debt continue to be customary features of upper middle market and traditional middle market financings. However, following the pandemic, lenders have been more successful in excluding incremental equivalent facilities from new financings and, to a lesser degree, other forms of ratio-based indebtedness.

Incremental Facilities and Incremental Equivalent Facilities

An incremental facility (also commonly referred to as an "accordion") allows a borrower to incur additional term loans or revolving loan commitments under an existing credit agreement subject to certain limitations and conditions without the consent of the existing lenders. Incremental equivalent debt typically has the same features as an incremental facility except that the debt is incurred outside the existing credit documentation, either pursuant to a separate credit agreement or through the issuance of notes outside of the credit agreement (either issued in a public offering, Rule 144A or other private placement).

The migration of these additional debt facilities into the middle market can be summarised as follows: (a) the upper middle market will typically accommodate both incremental facilities and incremental equivalent facilities; (b) the traditional middle market will generally accommodate incremental facilities and is increasingly accommodating incremental equivalent facilities (subject, however, to stricter conditions, as discussed below) but remains stratified with respect to incremental equivalent facilities in approach depending on the consolidated EBITDA and the leverage of the borrower and its subsidiaries; and (c) lower middle market deals sometimes include incremental facilities but generally do not provide for incremental equivalent facilities. Our data shows that 77% of traditional middle market deals include incremental facilities, which is down from 94% in 2019. Additionally, 47% of traditional middle market deals include both incremental facilities and incremental equivalent facilities, consistent with 47% in 2019.

Incremental amount

- In large cap and upper middle market transactions, and increasingly in the traditional middle market, credit documents will permit the incurrence of an incremental facility up to (1) a fixed incurrence amount (known as a "starter basket" or "free and clear basket"), plus (2) an unlimited incurrence amount, subject to compliance with one or more leverage ratios as further discussed below. The fixed amount will generally be no greater than 1.0× of consolidated EBITDA and will often have a "grower" component (e.g., the greater of (i) a fixed dollar amount, and (ii) the corresponding percentage of consolidated EBITDA measured as of the closing date). Our data shows that 38.3% of traditional middle markets deals with incremental facilities contain a starter basket for the incremental facility equal to or greater than 1.0× of consolidated EBITDA, compared to 31.2% from 2019. Depending on the structure of the original transaction (i.e. senior secured, first lien/second lien or senior/mezzanine) and what type of incremental debt is being incurred (i.e. debt *pari passu* to the senior secured, first lien or senior facility, debt that is junior to the senior secured, first lien or senior facility but *pari passu* with the second lien/mezzanine facility (if any), or unsecured debt), the type of leverage test will be different (i.e. first lien leverage test *vs.* secured leverage test *vs.* total leverage test).
- The level of the ratios will often be set at the closing date leverage multiple or, in the case of unsecured incrementals, up to 1.00× outside the closing date leverage multiple in larger deals. Historically, the traditional and lower middle market also required *pro forma* compliance with the financial maintenance covenants as a condition to using the unlimited incurrence amount. Our data shows that this has become rare, except in smaller deals. However, this protection is less relevant as financial maintenance covenants loosen and are less likely to step down below the closing leverage level in all but the smaller deals. In larger deals, there may also be an alternative test for the incurrence of incremental facilities used to fund permitted acquisitions. In such instances, the leverage ratio will be the leverage ratio of the borrower immediately prior to giving effect to such permitted acquisition. The upper middle market generally follows the larger deals in terms of how the incremental amount is capped (although the aforementioned alternative test for permitted acquisitions is not widely adopted).
- Data reveals a continuing trend in the traditional middle market to allow for both a starter basket and an unlimited amount, with 90% of traditional middle market deals in 2020 permitting both components of incremental facilities, compared to 85% in 2019. In many lower middle market financings, incremental facilities are still only permitted up to a fixed dollar amount (with no unlimited incurrence amount). In such cases, the incurrence of incremental debt under the fixed cap will be subject to an incurrence leverage test (and less frequently, *pro forma* compliance with the financial maintenance covenants in addition to such leverage test).
- Borrowers prefer to use different leverage tests to govern incurrence of different types of incremental debt (i.e., first lien leverage ratio for the incurrence of first lien debt, a senior secured leverage ratio for the incurrence of second lien debt and a total leverage ratio for the incurrence of unsecured debt) rather than the total leverage ratio test originally used as a leverage governor for all tranches of incremental facilities. This approach allows a borrower to incur a total amount of debt in excess of the total leverage test.

- For example, the indebtedness included in calculating a total leverage ratio would typically include all funded indebtedness of the applicable credit parties and those subsidiaries included in the consolidated financial metrics of the credit parties. The indebtedness included in calculating a first lien leverage ratio would be limited to funded indebtedness subject to a first lien security interest on the assets of the credit parties. As a result, a borrower could (i) first incur unsecured indebtedness up to the total leverage ratio cap, and (ii) second incur additional first lien indebtedness up to the first lien leverage ratio cap. In this example, since the incurrence of first lien incremental facilities is governed by a first lien leverage ratio (rather than a total leverage ratio), that debt incurrence would not be prevented because the first lien leverage ratio does not include the unsecured indebtedness previously incurred by the borrower. However, if the incurrence of first lien incremental facilities was governed by a total leverage ratio, second debt incurrence would exceed the total leverage ratio cap and be prohibited.

- This approach is accepted in the upper middle market but is frequently rejected in traditional middle market transactions. Traditional middle market deals will usually apply a total leverage ratio test for all types of incremental loans (or will apply a total leverage ratio test in addition to the first lien leverage ratio/senior secured leverage ratio tests described above).
- In large cap, upper middle market and traditional middle market transactions, borrowers will also seek the ability to (a) elect to use the ratio-based unlimited incremental amount prior to the fixed amount, (b) reclassify (at their discretion or automatically) incremental debt which was originally incurred under the fixed amount as incurred under the ratio-based unlimited amount (thereby reloading the fixed amount), and (c) in instances where an incremental loan is incurred based on both the fixed amount and the unlimited amount, not take the fixed amount into account when testing leverage under the unlimited amount. These features allow a borrower to incur debt at any time (and from time to time) in an amount that exceeds the ratio-based leverage test by the fixed amount. The traditional middle market has largely accepted these conventions as stacking and reclassification concepts move down market; however, lenders often resist a borrower's ability to automatically reclassify incremental debt originally incurred under the fixed amount as incurred under the ratio-based unlimited amount.
- In large cap, upper middle market and larger traditional middle market transactions, incremental capacity is also increased (over and above the fixed starter basket and ratio-based unlimited incremental amount) by an amount equal to: (a) in the case of an incremental facility that effectively replaces any existing revolving commitment terminated or term loan retired under the "yank-a-bank" provisions, an amount equal to the portion of such terminated commitments or retired loans; (b) in the case of an incremental facility that effectively replaces any term loans that were repurchased by the borrower and immediately cancelled, an amount equal to the portion of such repurchased and cancelled term loans; (c) in the case of an incremental facility that serves to effectively extend the maturity of an existing facility, an amount equal to the amount of loans and/or commitments, as applicable, under that existing facility to be replaced with such incremental facility; and (d) all voluntary prepayments of the existing term loans, previously incurred incremental term loans and incremental equivalent loans and voluntary commitment reductions of the revolving facilities (except to the extent funded with the proceeds from an incurrence of long-term indebtedness (other than revolving indebtedness)) (and sometimes limited in traditional middle market transactions to such loans and commitments that are *pari passu* to the loans/commitments being prepaid or terminated). The incremental amount caps and limitations will also govern incremental equivalent facilities. The establishment of an incremental facility (or the incurrence of incremental equivalent debt) will result in a dollar-for-dollar reduction of the amount of indebtedness that may be incurred pursuant to the other facility. In this regard, the upper middle market is generally consistent with the larger deals. However, the traditional middle market will again differ in that the additional amounts that increase the incremental capacity (over and above the fixed starter basket and ratio-based unlimited incremental amount) will most frequently be limited to the amounts described in clauses (a) and (d) above.

Rate and maturity

- Incremental term loans generally: (a) cannot have a final maturity date earlier than the existing term loan maturity date (and may also require a 91-day maturity setback for subordinated, junior lien and unsecured incremental loans); (b) cannot have a weighted average life to maturity shorter than the weighted average life to maturity of the existing term loans; (c) rank *pari passu* with the existing loans or junior in right of payment and/or security or are unsecured; (d) are not secured by any collateral other than collateral securing the existing term loans or guaranteed by any guarantors not guaranteeing the existing term loans; (e) participate *pro rata* or less than (but not greater than) *pro rata* with the existing term loans in mandatory prepayments; (f) have covenants and events of default substantially similar, or no more favourable, to the lenders providing such incremental term loans than those applicable to the existing term loans, except to the extent such terms apply only after the latest maturity date of the existing term loans or if the loan agreement is amended to add or conform to the more favourable terms for the benefit of the existing term lenders; and (g) if incremental equivalent debt is permitted, such incremental equivalent debt is subject to customary and satisfactory intercreditor arrangements to the extent it is secured. Some borrowers in larger deals have been successful in negotiating a carve-out from the maturity requirement which would allow the borrower to incur incremental term loans with earlier maturities, up to a maximum amount governed by a fixed dollar basket.

  These terms have been adopted in the upper middle market. The traditional middle market does not contain significant variations, but very conservative deals may only allow for the incurrence of incremental debt that is *pari passu* with the existing loans. The traditional middle market may also contain additional restrictions on greater than *pro rata* voluntary prepayments with the existing term loans (but not *pro rata* or less than *pro rata* voluntary prepayments) and will not permit earlier maturities of incremental loans. In some respects, allowing a borrower to incur lien subordinated or unsecured incremental facilities instead of *pari passu* incremental facilities may benefit the existing lenders since those junior and unsecured lenders would not share on a priority basis in the proceeds of collateral in an enforcement scenario. Despite this, the traditional middle market often resists allowing different types of debt due to a desire to maintain a simpler capital

structure (especially in credit transactions where there are no other financings).

- The interest rate provisions applicable to incremental facilities customarily provide some form of pricing protection. Typically, the protections require that the all-in yield of the existing credit facility is increased to match (less 50 basis points) any new incremental facility that is *pari passu* in claim and lien priority to the existing credit facility to the extent that such incremental facility has an all-in yield greater than 50 basis points above the existing credit facility. This differential can be 75 basis points in large cap transactions. These provisions are generally referred to as the "MFN" or most favoured nations provisions. In large cap and upper middle market transactions, the MFN provision often contains a "sunset", meaning that the pricing protection is not applicable to any incremental facilities that are incurred following a period of time. This period ranges from 12 months to 18 months (some with sunset periods as short as six months). The sunset provision, however, may be eliminated altogether or flexed out, depending on market conditions. As the ability to designate incrementals (or incremental equivalent debt) with different payment and lien priorities has become commonplace in large cap, upper middle market and some traditional middle market transactions, borrowers typically push for additional provisions that erode MFN pricing protections. These additional exceptions to the MFN provisions include (i) additional carve-outs to the calculation of all-in yield for amounts that do not clearly constitute "one-time" fees (for example, OID and upfront fees), thereby making it easier to remain below the MFN trigger threshold, (ii) limiting the application of the MFN protection to the term loan facility originally issued under the credit facility (and not any prior incremental loans), and (iii) excluding from the MFN provisions incrementals (or incremental equivalent debt) that (a) are incurred in reliance on the starter basket amount, (b) are utilised for specific purposes (e.g., for permitted acquisitions), (c) are structured as an issuance of notes (whether issued in a public offering, Rule 144A or other private placement) as opposed to loans, (d) mature later than the latest maturity date of any other term loans under the credit facility or which are bridge-financings, and (e) are within a certain capped amount. Of particular concern for lenders is the exclusion in (iii)(a) above. Without adding further protections, this has the potential of eliminating the MFN treatment altogether in deals where the borrower has the ability to redesignate starter basket incrementals as leveraged-based incrementals (subject to sufficient capacity to redesignate borrowings to the ratio-based unlimited incurrence amount) because borrowers are able to effectively reload the starter basket over and over.

  The traditional middle market takes a somewhat consistent approach to the upper middle market's treatment of the MFN provision. For the most part, *pari passu* debt issued in reliance upon the incremental provisions (or the incremental equivalent provisions) is subject to the MFN provisions. However, middle market lenders may also require that the impact of the MFN provisions apply to all debt outstanding under the credit facility, including incremental loans previously funded and typically push back on the multitude of carve-outs and exceptions discussed above. Traditional middle market lenders have had significant success maintaining the MFN provisions without a sunset. 2020 data shows that only 10% of traditional middle market deals with MFN provisions include a sunset period, generally consistent with 9% in 2019.

Use of proceeds

- In large cap, upper middle market and traditional middle market transactions, proceeds from the incurrence of incremental and incremental equivalent debt may generally be used for any purpose not otherwise prohibited by the existing credit documentation. In some more conservative traditional middle market financings, all such uses of proceeds may be permitted, but subject to stricter leverage tests for purposes such as making restricted payments (i.e., dividends) and payments of junior debt. Our data continues to show a clear migration of the large cap and upper middle market flexibility with respect to the use of incremental/incremental equivalent proceeds filtering down to the traditional middle market and even the lower middle market in some cases. As a result, specific limitations placed on the use of proceeds for incremental/incremental equivalent loans are typically only seen in lower middle market deals. In those lower middle market deals, the use of proceeds may be restricted to permitted acquisitions and similar investments and permitted capital expenditures.

Ratio Debt

In addition to the incremental and incremental equivalent facilities described above, large cap, many upper middle market, and a growing number of traditional middle market transactions include "ratio debt" provisions. These provisions, which can be traced back to the high-yield bond market, allow a borrower or any of its subsidiaries to incur additional indebtedness so long as the borrower meets the applicable leverage ratio test (and subject to a cap on ratio debt incurred by subsidiaries that are not guarantors of the existing credit facilities). An interest coverage ratio test may also be applied in place of a leverage ratio for unsecured ratio debt, but this test is typically only accepted in large cap and larger upper middle market financings. If the ratio debt is leverage-based, the leverage rest is typically set at the same level required for incurrence of incremental and incremental equivalent debt. In upper middle market transactions that permit ratio debt, the conditions for incurrence (other than the applicable leverage or interest coverage test) may be looser than the conditions to incurrence of incremental and incremental equivalent debt. However, lenders in the traditional middle market have had some success in standardising the conditions across the different types of permitted debt incurrence. To the extent ratio debt provisions appear in traditional middle market transactions, the incurrence of such debt may be conditioned on such debt being subordinated in right of payment to the credit facility or being unsecured. Additionally, where the traditional middle market allows for ratio debt, it requires that any MFN provisions applicable to incremental and incremental equivalent debt also apply to ratio debt that is *pari passu* to the credit facility obligations. Notably, this protection has migrated up market as upper middle market deals have increasingly adopted MFN protection in respect to ratio debt. Our data shows that 47% of traditional middle market deals permitted ratio debt, compared to 44% in 2019. Lower middle market transactions generally do not provide for ratio debt.

Acquisition Indebtedness

Credit agreements generally allow the borrower to incur certain indebtedness solely to fund permitted acquisitions and similar investments, referred to as "acquisition debt". The terms and conditions discussed above (i.e., conditions for incurrence, etc.)

with respect to ratio debt in a particular credit agreement will also typically apply to acquisition debt in that same credit agreement. Larger deals will commonly allow a borrower to incur acquisition indebtedness in an unlimited amount subject to *pro forma* compliance with a leverage test (typically the same tests applicable to ratio debt). As with ratio debt, an interest coverage ratio test may also be applied in place of a leverage ratio for unsecured ratio debt in the upper market. The upper middle market takes a similar approach to the large cap market (other than allowing an interest coverage ratio test), and the traditional middle market take a similar (but more restrictive) approach to the upper middle market. The traditional middle market may also require that, after giving effect to the acquisition indebtedness, the borrower is in *pro forma* compliance with the financial covenants. It not common for this type of indebtedness to be permitted in the lower middle market. In lower middle market deals, there is still a preference for allowing acquisition indebtedness that is assumed (rather than incurred to finance the permitted acquisition or similar investment) and only up to a fixed dollar cap. Similar to the approach for ratio debt, where the traditional middle market allows for acquisition indebtedness, it requires that any applicable MFN provisions apply to any acquisition indebtedness that is *pari passu* to the existing credit facilities. Upper middle market deals have also increasingly adopted this protection with respect to acquisition debt.

Serta Protections

Allowing a borrower to incur additional indebtedness through incremental facilities, incremental equivalent facilities, ratio debt and acquisition indebtedness creates concerns for existing lenders beyond lending into complicated and highly levered capital structures and sharing in a limited collateral pool in smaller proportions. Many credit documents in the upper middle market and traditional middle market (although less frequently) permit the required lenders (i.e., lenders holding more than 50% of the loans and commitments under an existing credit agreement) to subordinate the payments on and liens securing an existing facility without obtaining the consent of each lender in such existing facility. As touched on above, the required lenders in the Serta financing simultaneously provided additional indebtedness on a senior basis (with both new money and in exchange for existing debt) and subordinated the existing lender debt over the objections of minority lenders that did not receive a piece of the new senior facility. Lenders, especially those that anticipate being a minority holder, may now require a right of all applicable lenders to approve any amendment or other modification of the credit documents that subordinates the payments on or liens securing a class of debt. Another more borrower-friendly formulation of the "Serta provision" requires that a borrower offer on a *pro rata* basis to all applicable lenders the opportunity to participate in any modification in respect of the subordination of the payments on or liens securing a class of debt, and if the lender elects not to participate they will not have any right to consent to any such modification. These provisions have not been widely adopted into credit documents, and lenders do not always push for their inclusion, given that the provisions cut both ways for lenders. They can provide protection or limit a lender's flexibility to provide additional indebtedness with more favourable priority in a particular transaction (depending on whether such lender is a minority or majority holder, respectively).

Limited Condition Transactions

One of the best-known outcomes of the loosened credit markets in 2005 was the introduction of the concept of "certain funds" or "limited conditionality" to US transactions by way of the transaction commonly referred to as "SunGard". This technology was proposed by sellers in order to ensure that potential buyers had financing locked down, although the certain funds concept frequently appeared prior to this in European transactions. "Certain funds provisions" align the funding conditions set out in financing commitment papers as closely as possible to the closing conditions in an acquisition agreement in order to minimise the risk of a lender having a right not to fund upon the desired closing of an acquisition. Specifically, certain funds provisions (or SunGard provisions) provide that, except as expressly set forth in a conditions annex to the commitment papers, there can be no other conditions precedent to the closing and funding of the credit facility in the definitive loan documentation, and it limits the representations and warranties required to be true and correct at closing to certain material representations set forth in the acquisition agreement that give the buyer or its affiliates a right to terminate the transaction (the "acquisition agreement representations") and a narrow set of additional "specified representations". It also limits the actions required to be taken by a borrower pre-closing to perfect security interests in the collateral to certain essential actions, with all other actions to be taken on a post-closing basis. This assures buyers and sellers that, so long as the conditions to closing under an acquisition agreement are met, lenders do not have an "out" beyond a narrow set of conditions in the conditions annex. This is important for both sellers and buyers because a buyer is typically still responsible for funding the purchase price of an acquisition at closing even if its lender refuses to fund.

Acquisition financings, regardless of the market, have generally adopted SunGard provisions. The most typical formulation in upper market transactions, with respect to representations and warranties, are that the only representations and warranties required to be both made and accurate at closing are "specified representations" and certain representations in the acquisition agreement as described above. The other representations and warranties in the credit agreement that are deemed to be less material are not made at closing (so even if the other representations would not have been true, the borrower would not be in default immediately post-closing). In facilities with revolving credit facilities (which require a re-making of representations and warranties in connection with borrowings), the lender is likely to receive the benefit of the full set of representations and warranties soon after closing. However, in financings without revolving credit facilities, these other representations and warranties may not ever be made and would have limited utility to a lender. The upper middle market has generally followed the larger deals in this respect but not without objection, especially in transactions without revolving credit facilities for the reason described above. In smaller or less competitive transactions, the other less material representations and warranties in the credit agreement will also be made at closing, but their truth and accuracy are not conditions to closing. Even if such representations and warranties are not true and correct, the lenders will be required to fund, but with a default immediately following the closing. The traditional middle market has slowly started to adopt the requirement that only specified representations and acquisition agreement representations should be made at close.

As borrowers continued to push for greater flexibility in credit documents, the certain funds provisions continued to evolve. Certain funds is now applicable to the conditions to borrowing incremental facilities, incremental equivalent facilities, ratio

debt and acquisition debt incurred to finance a limited condition acquisition. These features provide a borrower comfort that financing for follow-on acquisitions will be available. In larger deals, borrowers have been successful in extending this "limited condition acquisition" protection to all acquisitions using such financing sources, regardless of whether there is a financing condition in the underlying acquisition documentation. The applicability of the certain funds provisions has been further broadened to include other investments, paydown of indebtedness and restricted payments with features of limited conditionality. Within the middle market, only the lower middle market still shows resistance to the broader applicability of the certain funds provisions.

Customarily, as noted above, conditions to incremental and incremental equivalent debt, ratio debt and acquisition debt incurrence have included material accuracy of representations and warranties, absence of default or event of default, and in certain areas of the market, either a *pro forma* compliance with the existing financial covenant (if any) or meeting a specific leverage test, each tested at the time of incurrence of such additional debt. Limited condition acquisition provisions enable a borrower to elect the signing date (also known as the "effective date") of the acquisition agreement ("acquisition agreement test date") as the relevant date for meeting the required conditions. As a result, if the borrower made such an election then the combined conditions to accessing the additional financing and making the permitted acquisition (which may have included accuracy of representations and warranties, no events of default, and leverage tests) would be tested at the time the acquisition agreement is executed. The borrower would include the financial metrics of the target entity (i.e., EBITDA) at the time of such testing even though the acquisition was not yet consummated. In traditional middle market transactions, a subsequent no payment or bankruptcy event of default test is generally required upon the later consummation of the transaction. However, the requirement for this subsequent test often falls away in larger transactions. Although the middle market has largely incorporated the limited condition acquisition protections, some lenders in lower middle market deals continue to push for a requirement that the relevant acquisition close within a period of time following the execution of the purchase agreement (usually not longer than 180 days), otherwise the limited condition acquisition protections fall away. In this case, in the event the acquisition does not close within the agreed-upon time frame, the limited conditionality is eliminated and the borrower would have to comply with all the conditions at the time of the incurrence of the additional financing and closing of the acquisition.

As discussed above, the limited conditionality provision permits a borrower to elect the effective date of the acquisition agreement (or the date of the agreement documenting the relevant investment, paydown of indebtedness or restricted payment) (instead of the closing date) as the date of determination for purposes of calculating leverage ratios in order to test ratio-based additional debt capacity (as well as other incurrence tests described below). Testing the leverage ratio at signing eliminates the risk of a decline in consolidated EBITDA of the borrower and the target between signing and closing (the period between execution of the acquisition agreement and closing date referred to as the "Intervening Period"), when the ratio would otherwise be tested. This risk is of special concern in deals involving a lengthy delay between signing and closing due to regulatory approvals.

Since the leverage test is intended to include the financials of the acquisition target on a *pro forma* basis, borrowers have further requested that any other incurrence-based leverage test (required in connection with any other investment, incurrence of debt, restricted payment, etc.) that is tested during the Intervening Period include the financials of the acquisition target on a *pro forma* basis. Generally, the markets have responded to this request in three different ways:

- *Most Borrower Favourable*: In large deals, any leverage test required during the Intervening Period will be tested after giving *pro forma* effect to the acquisition. In the event the acquisition does not close, any leverage test applied during the Intervening Period will be deemed to be valid regardless of whether the borrower would have failed to meet the leverage test without giving effect to the acquisition target's EBITDA. The upper middle market has not yet fully embraced this approach, although we are seeing this construct more frequently.
- *Most Lender Favourable*: Any leverage test required during the Intervening Period will be tested on a stand-alone basis. A compromise would be to test all incurrence leverage tests on both a *pro forma* and stand-alone basis. The lower middle market and traditional middle market (but less frequently) will generally take this approach.
- *Compromise*: The maintenance financial covenant and any incurrence leverage test pertaining to the payment of restricted payments (including junior debt payments) are tested on a stand-alone basis, but the remaining incurrence leverage tests are tested giving *pro forma* effect to the acquisition. This application of the leverage test is often seen in the traditional middle market and upper middle market (but less frequently). A more borrower favourable version of the compromise position that is common in the upper middle market and traditional middle market (but less frequently) is to test the maintenance financial covenant on a stand-alone basis but test all incurrence leverage tests on a stand-alone basis.

Available Amount Basket

Once the leveraged financing markets revived following the downturn of the financial markets in 2008–2009, the high-yield bond concept of the "available amount basket" became increasingly prevalent in the upper and traditional middle markets. The lower middle market has not fully embraced the inclusion of available amount baskets. An available amount basket (also commonly referred to as the "cumulative amount") automatically increases a borrower's ability to take actions under negative covenants that generally restrict cash outflow (i.e., investments, dividends and payment of junior indebtedness) to the extent a borrower has built up capacity of the available amount by increasing in profitability and taking other actions that are considered accretive to the business. In some upper market deals, the available amount also creates capacity for debt incurrence.

Lenders are willing to permit this increase in certain baskets in the negative covenants as an attempt to recognize and reward the borrower for increased profitability and for taking such accretive actions. In some cases, lenders require that a borrower de-leverage before it can access the available amount. Our data shows that 77% of traditional middle market deals include the available amount basket concept, compared to 91% in 2019, suggesting that lenders may be more hesitant to incorporate this historically upper market concept into their credit document in view of the uncertain economic climate and recent cases highlighting the inherent risks of the available amount. Most famously, in the PetSmart/Chewy case, PetSmart accessed the available amount basket to (i) distribute 20% of the common stock of its new subsidiary, Chewy.com, to a parent entity outside of the borrower/guarantor group, and (ii) invest 16.5% of the common stock of Chewy.com to a newly formed unrestricted

subsidiary. Lenders were then required to release their liens on Chewy.com, as it was no longer a wholly owned subsidiary of the borrower, and the borrower used the asset to secure new priority debt incurred in exchange for existing debt that was previously subordinated to such lenders.

The available amount basket will be generally constructed to be the sum of the following:

- *Starter Basket Amount*: a starting amount (commonly referred to as a "starter" or "starter basket") generally determined on a case-by-case basis (which amount may be further increased by a grower basket in the larger deals). Unlike the incremental starter basket, this is not necessarily based on a percentage of the borrower's EBITDA. The starter basket amount is often 25%–50% of the borrower's EBITDA but can reach 100% of EBITDA in larger transactions. The available amount basket in upper and traditional middle market transactions (but less frequently in the lower middle market) will often include a starter basket amount. Our data shows that 82% of traditional middle market deals with the available amount basket include a starter basket amount, compared to 92% in 2019.
- *Retained Excess Cash Flow or a Percentage of Consolidated Net Income*: typically in upper market deals, the available amount basket will include a percentage of consolidated net income or retained excess cash flow, at the borrower's election. This is preferable for a borrower because it will have quicker access to the consolidated net income (while excess cash flow often will not be recognised until after the first full fiscal year following the closing date). This is especially relevant in those transactions that close in the first half of a fiscal year since the borrower will not be able to build retained excess cash flow until the end of the following fiscal year. In contrast, the traditional middle market deals will more often include retained excess cash flow which, in addition to having limited accessibility, will most likely be defined in a manner that results in as little actual excess cash flow as possible since the borrower will be required to make a mandatory prepayment in an amount equal to a percentage of such excess cash flow. As a result, the borrower is incentivised to minimise the amount of excess cash flow generated.
- *Contributed Equity*: if the available amount basket is included in the financing, then having it increased by the amount of equity contributions that are not otherwise applied under the credit agreement will be common regardless of the size of the deal. It is also commonly accepted that equity contributions made in connection with equity cures will be excluded from the available amount basket.
- *ROI on Investments Made With the Available Amount Basket*: larger deals and upper middle market deals will commonly permit an increase in the available amount basket by the amount of returns in cash, cash equivalents (including dividends, interest, distributions, returns of principal, profits on sale, repayments, income and similar amounts) or investments. Traditional middle market deals generally include such returns only to the extent they are in cash or cash equivalents, or limit this prong to returns on investments made using the available amount basket.
- *Declined Proceeds*: declined proceeds from mandatory prepayments required to be made by the borrower will commonly be included in the calculation of the available amount basket regardless of the size of the deal.
- *Debt Exchanged for Equity*: in larger deals, to the extent that any debt owed by the borrower is converted into equity, such amount will be included in the available amount basket. The upper middle market will often adopt this formulation while the traditional middle market has not fully accepted the addition of debt exchanged for equity in the calculation of the available amount basket.
- *Redesignation or Sale of Unrestricted Subsidiaries*: in larger deals and often in upper middle market transactions, in the event an unrestricted subsidiary is (i) redesignated as a restricted subsidiary, or (ii) the subject of a disposition, the fair market value (generally determined in good faith by the borrower) of the investments in such unrestricted subsidiary at the time of such redesignation (in the case of clause (i)) or the net proceeds of such sale actually received by a restricted subsidiary or the borrower in excess of the original investment in such unrestricted subsidiary (in the case of clause (ii)), will increase the available amount basket so long as such investments were originally made using the available amount basket. The traditional middle market has not fully accepted this component of the available amount basket.

The conditions around the usage of the available amount basket vary greatly and the traditional middle market takes a very different approach than the upper middle market. As noted, the purpose of the available amount basket was to increase the baskets pertaining to cash leakage such as investments, dividends and junior debt payments. The upper middle market deals often place few conditions around the usage of the available amount basket. Such conditions may be further distinguished as follows.

In most upper middle market transactions, conditions for accessing the available amount basket will usually apply with respect to a dividend or junior debt payment (but not investments). The conditions may include no payment or bankruptcy events of default as well as a specific leverage test set within the closing date leverage level (or at the closing date leverage level in larger deals). In an ever-growing number of cases, the leverage test will apply only to the retained excess cash flow or percentage of consolidated net income component of the available amount basket (and sometimes to the starter basket amount as well). In the more conservative upper middle market transactions and the traditional middle market deals, the approach will be to place conditions for the usage of the available amount basket for all investments, dividends and junior debt payments irrespective of which component of the available amount basket is being accessed. For the most part, these conditions include a no event of default condition and *pro forma* compliance with a leverage ratio test (which, with respect to the payment of dividends or junior debt, is often well within the closing date leverage (by as much as 0.5× to 1.5×)).

Looking Ahead

The Private Credit Group data continues to show that, with each passing year, terms relating to debt incurrence, limited condition transactions and available amount baskets become more prevalent in the middle market as lenders adapt to the inclusion of what were once considered large cap terms. In 2020, our data generally demonstrated a steady pace of adoption as compared to 2019 despite the COVID-19 pandemic and global economic slowdown. However, we did see some retraction in the rate at which lenders incorporated available amount baskets into their credit documents. Consistent with 2019, in many cases lenders achieve some success in flexing out more aggressive formulations of these terms during the primary syndication of transactions. Momentum had historically been supported by evolving markets, the entrance of new capital and institutions into the middle market, and a strong economy. The continued competition among lenders to place capital has helped to keep that momentum strong in 2020. Despite economic uncertainty, lender interest in private credit as an asset class remains strong.

Many economists anticipate growth in 2021, warning of fragility and remaining watchful for contractions in the first half of the year. Lenders are likely to remain cautious about their existing portfolios in the face of this risk and be more selective with respect to investment opportunities and, to some extent, legal documentation. Given these predictions for 2021, we expect a sustained migration of large cap terms into middle market transactions. However, we also expect that lenders will continue to push for conditionality in order to mitigate the inherent risks of such terms. This is expected to continue to occur to varying degrees based on the dividing lines of the lower middle market, traditional middle market and upper middle market.

Our data continues to show that lenders' ability to unwind large cap concepts and provisions from credit documents is, for the most part, limited. As noted above, the continuing trend of borrowers and middle market lenders using credit documents from prior transactions (or precedents with an upper market orientation selected by a borrower) as the basis for the documentation of a new transaction should also continue to drive the adoption of upper market concepts and provisions into smaller transactions.

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Trade Finance on the Blockchain: 2021 Update

Holland & Knight

Josias Dewey

1 Traditional Trade Finance

The Primary Driver of Global Economic Growth

We have updated last year's discussion of blockchain and trade finance to address several projects, joint ventures and other significant advances made toward digitizing the global trade engine. 2019 saw several industry participants move from pilot programs to efforts on commercial projects. There are also discussions about new thoughts on matters of policy and trade that gained traction during the last year. With trade finance accounting for 3% of global trade, it is estimated that the industry is worth nearly $3 trillion a year.[1] The evolution in trade finance is being driven by greater efficiencies and novel capabilities resulting from advancements in the underlying logistics of the global supply chain, all of which are being made possible by the combination of three powerful technologies: (1) blockchain and distributed ledger technology; (2) the Internet of Things ("IoT"); and (3) powerful machine learning capable cognitive tools (e.g., IBM's Watson) that are capable of analyzing vast amounts of data that humans simply cannot do.

The transformation occurring in supply chain management and trade finance is not simply about converting from paper documents, such as letters of credit and bills of lading, to electronic documents. To the contrary, as we will discuss in detail, the changes that are occurring are about new ways that participants in supply chains can share information in a very granular and controlled manner, utilizing novel technology that allows economic participants to trust the outcome of transactions without any need to trust the actual counterparties to a transaction. Equally important is the ability of distributed ledgers to accomplish the foregoing without the need for a trusted third party to act as an intermediary for the transaction – disintermediation has become a key theme of distributed ledger technology, and supply chains and the trade financing vehicles that keep them operating are not exempt from this phenomenon. The industry has come to see the technology as being one that allows for automation on a scale not previously possible.

What is Trade Finance – Basic Mechanics

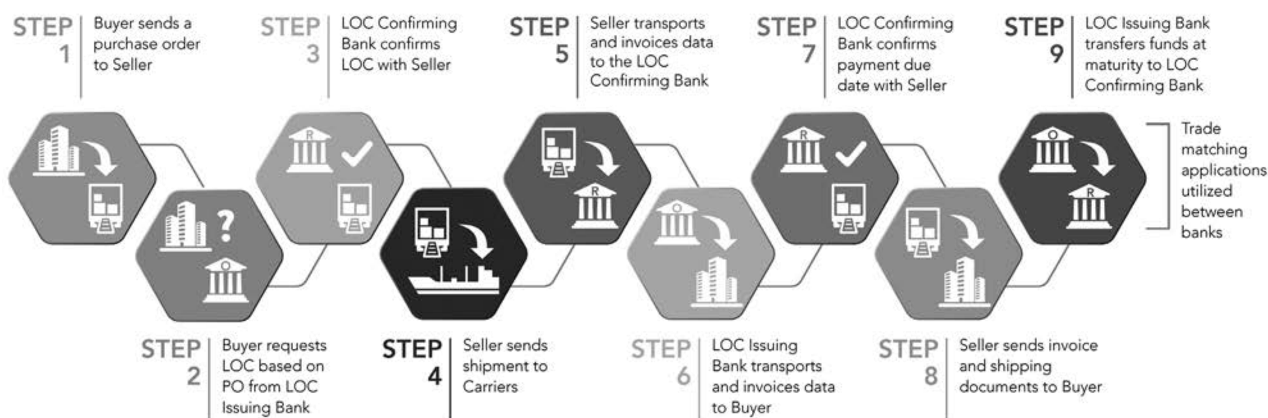
Before discussing the future of trade finance, it is important to understand the current mechanisms used to facilitate the movement of goods and commodities across the globe – much of which has remained static over the last few hundred years. It did not take human civilization long to discover the benefits of specialization and trading resources that might be prevalent in one geographic region for other goods which are scarce in the same region. In the beginning, bartering ruled most forms of trade and even after stores of value, such as gold, allowed for the acquisition of goods for money, marketplaces were often static in terms of point of sale – thus requiring trading groups and companies to venture across long and often dangerous trading routes. With the advent of oceanic shipping, however, it became far easier to move large quantities of goods and commodities from one port to another far more efficiently.

While a superior approach in terms of economic efficiency, "chicken and egg" situations soon arose when sellers did not want to place their goods on a ship for delivery to the purchaser without payment; and likewise, buyers did not want to pay for goods that they had not received – enter trade financing solutions. In its most simple form, trade financing addresses the "chicken and egg" dilemma by effectively creating an intermediary, such as a bank who issues a merchant letter of credit, who can assure the seller of payment if the seller performs and protect the buyer from ever paying for undelivered or non-conforming goods. In most circumstances, this is accomplished by the buyer causing its bank to issue to the seller a merchant letter of credit in the amount of the purchase price for the goods. The bank who issues the merchant letter of credit generally requires that the seller present, together with the merchant letter of credit, documentary proof that conforming goods were delivered to the buyer and that the seller has met the conditions to payment. One of those conditions will be the delivery of a properly executed bill of lading (a document of title) to the buyer, who with that and an opportunity to inspect the goods to ensure conformance, is never at risk of losing his or her capital in the event of the seller's non-performance.

It should be apparent that in many respects, the "finance" transaction described above has less to do with loaning money and extending credit and more to do with facilitating a transaction that might otherwise introduce too much risk for the buyer, seller or both. There are plenty of trade finance transactions that are akin to more traditional extensions of credit. For example, a farmer may need trade finance to acquire seeds and fertilizer and is unable to repay such financing until the farmer harvests his crop. In that case, the transaction could be solely driven by credit considerations. In some cases, trade finance serves both as a transaction facilitator and an extension of credit necessary to provide a farmer or manufacturer with inputs necessary to generate the profits necessary to repay the extension of credit. In the case of the farmer, the seeds and fertilizer may be shipped from a foreign producer, such that the trade finance solution serves both purposes – the role of an intermediary with respect to the exchange between the farmer and the foreign producer and that of an extension of credit because the farmer lacks the liquidity to purchase the inputs necessary to grow his crop.

Trade Finance – Traditional Lifecycle

While there are several forms of trade finance, we have chosen to further illustrate, via graphical illustration (which the author admits is an oversimplification with respect to many transactions), the mechanics of this industry through one of the most conventional types of trade finance facilities – a merchant letter of credit:



As entire books are frequently written on trade finance, we cannot analyze the above transaction from every participant's perspective in a single chapter. So, we will look at some of the most common pain points and areas of "friction" from the perspective of a bank or other financial institution providing trade financing in a transaction following the lifecycle depicted above. In any secured transaction, a trade finance lender will want to ensure that its position:

(i) is adequately collateralized (i.e., the seller has the goods it purports to have or will have when it is required to tender and the value of such goods is consistent with the assumptions made by the lender in underwriting the credit);
(ii) consists of a first-priority security interest (unless providing subordinate financing); and
(iii) is consistent with its understanding of risks posed by acts of god, casualty or other *force majeure* events, and that such risks have been mitigated by insurance or other means to the extent available.

To achieve the above three objectives, lenders often employ the following "controls":

(i) implementing relevant financial controls throughout the trade transaction lifecycle;
(ii) monitoring all material aspects of the transaction; and
(iii) ensuring that the collateral (i.e., the trade goods) are properly stored and transferred.

Using the bill of lading example illustrated above, implementing these controls can be a cumbersome and fragmented process for lenders, which often lead to the following "pain points":

(i) Fraud. Current methods of documentation, and documentation transfer, do not protect against the risk of parties, including lenders, relying on falsified documentation.
(ii) Tracking and Reconciliation Costs. Current fragmented trade lifecycles, which require human involvement and interaction throughout, require constant tracking and reconciliation by lenders and often require that such be done amongst several different platforms.
(iii) Authenticity of Goods. A lack of uniform tracking mechanisms from "source to sale" provides susceptibility for counterfeit goods to enter the trade lifecycle.
(iv) Confidentiality. The current necessity to (humanly) verify and reconcile points throughout the trade cycle make it difficult to ensure the confidentiality of the trading parties and terms.

It should come as no surprise that the above complexities often leave bank customers less than satisfied with the overall experience of obtaining the credit. To make matters worse, there has been a steady increase in transaction costs, in part, due to the increasingly difficult regulatory environment. Fortunately, all participants may soon be receiving relief from all of the above.

Trade Finance – Increasing Number of Stakeholders Means Growing Complexity

It is also worth noting that some of the additional friction in the market today is due to an increase in the overall number of persons involved in the process, including trade finance credit insurers, customs personnel and certification organizations, who – depending on the existence of friendly trade arrangements – may be required to hold the goods at port or other locations for extended periods of time. This increase in participants has led to a corresponding level of complexity. Simply put, supply chain management and trade finance have become more complicated, while innovation was non-existent. Seemingly overnight, the paper documents that remained in use for decades are on the verge of extinction.

2 Emerging Technologies – Blockchain Technology

Blockchain technology is commonly defined as a decentralized peer-to-peer network that maintains a public, or private, ledger of transactions that utilizes cryptographic tools to maintain the integrity of transactions and some method of protocol-wide consensus to maintain the integrity of the ledger itself. The term "ledger" should be thought of in its most simple terms; imagine a simple database (like an Excel spreadsheet) that can store all sorts of information (e.g., someone's name, age, address, date of birth). As you can write an entire book on the topic of blockchain technology and the law (I know because I did), set forth below is a very cursory review of the underlying technology. If

you are not comfortable with the technology itself after reading the below, there are no less than a couple of hundred good descriptions available on the Internet (or you can find my book).

Blockchains tracking the transfer of virtual currency, such as Bitcoin, essentially maintain a ledger that tracks the transfer of Bitcoin from a transferor to a transferee. Perhaps most importantly, such ledgers are considered decentralized because transactions are stored on several thousand computers connected to a common network via the Internet. These computers are known as "nodes". Each node contains a complete history of every transaction completed on a blockchain beginning with the first transaction that was processed into the first block on that blockchain. This network of nodes is connected via the Internet, but in a completely decentralized manner (i.e., there is no single server to which all the nodes are connected). So, when we refer to the network, this describes all the peer-to-peer nodes operating under the same set of rules (commonly referred to as a "protocol"), which are embodied in computer code under which all participants in such blockchain operate. Thus, at the heart of every blockchain is an agreed-upon protocol that ensures that only information upon which the network reaches consensus will be included in the blockchain. In other words, a network of computers, all running a common software application, must come to agreement upon whether a change to the blockchain (again, think "ledger") should be made, and if so, what that change should be.

As a proposed transaction propagates throughout this peer-to-peer network, there is still one last step left to consummate the transaction – the transaction needs to be memorialized into a block on the given blockchain ledger. "Blocks" are simply a convenient way of aggregating transactions into larger groups (or batches) for processing purposes. The perceived immutable nature of the ledger is rooted in the aggregation of time-stamped transactions into linear sequenced blocks. It is the aggregation into blocks that permits us to create links between transactions – the proverbial "chain" in the blockchain. Each block contains a reference to the block before it. This resulting relationship between all the blocks makes it exponentially more difficult to alter a prior entry in the ledger. Certain protocols have been developed which have all the character of a blockchain, but without the block structures – hence the reason all blockchains are distributed ledgers while not all distributed ledgers are blockchains (e.g., R3's Corda Platform is not a blockchain). For the time being, the terms distributed ledger technology and blockchain are generally used interchangeably – the reader should recall the distinction, however, is dealing with the implementation of a distributed ledger system that requires a blockchain-style ledger.

While Bitcoin was the first implementation of blockchain technology (and the only implementation for several years), with the advent of the Ethereum protocol and the subsequent "Blockchain 2.0" protocols, the capability of the technology skyrocketed – as did the potential use cases. The reference to "Blockchain 2.0" generally refers to the development of smart contracts, which is executable computer code that is broadcast to all of the nodes connected to a distributed ledger – the resulting computation being what determines any changes to the ledger. While the term "smart contract" does not necessarily refer to a legally binding contract (but rather any snippet of code), some smart contracts do constitute legally binding agreements. The advent of smart contracts is critically important to its adoption for trade finance – without it, we would not be able to model the functionality and provisions of a letter of credit or bill of lading.

Another recent development that was necessary for distributed ledgers to play an active role in trade finance was the ability for parties to include all the details of a trade in the transmission of a transaction to a distributed ledger – but limit who can see which details with very fine control. For example, if a seller of crops experiences a liquidity crisis and must sell a portion of his crop for below market prices, the seller will want neither his competitors nor other buyers in the market to know the price for those crops. In this example, it is possible to broadcast the transaction with only the buyer and seller seeing the price and needing to validate the terms to the contract. Any other consensus on the network will be limited to the existence of the transaction itself (and most likely a time stamp as well).

While there are no less than a dozen protocols in regular use today, the two most public blockchains are Bitcoin and Ethereum. Anyone is free to connect to either of those protocols. When first launched in 2009, Bitcoin was envisioned to be a global payment system transcending borders and disintermediating financial institutions. However, as governments continue to increase the world's money supply, most recently in response to the COVID-19 pandemic, Bitcoin has become a hedge against inflation and store of value for many people much in the way gold is viewed. As a result, the price of Bitcoin increased more than 300% in the calendar year of 2020. Overshadowed by the price increase, Bitcoin took a step towards realizing its vision of becoming a global payment system with the launch of the Lightning Network on March 15, 2020. The Lightning Network reduces Bitcoin transaction times and fees. This is achieved by reducing the number of transactions that need to be forever stored on the blockchain. Instead, funds are held in smart contract "payment channels," and transactions are exchanged outside of the blockchain between transacting users. The final state of the payment channel balance can be broadcast to the Bitcoin network at any time, securely settling the funds on the blockchain. 2020 also saw the emergence of "DeFi" or decentralized finance. DeFi, mostly built on the Ethereum network, is the next step in the revolution in disruptive financial technology. One area in which DeFi has increased in use is cryptocurrency trading on decentralized exchanges such as Uniswap. These are entirely peer-to-peer, without any company or other institution providing the platform.

Unlike public blockchains, most financial institutions and other enterprise users are not comfortable using public blockchains because of data security and privacy concerns, among other reasons. Instead, these institutions have or intend to deploy permissioned and/or private distributed ledgers, where each member of the distributed ledger knows with whom it is transacting. Again, there are many more protocols that are listed herein, but some of the more popular permissioned protocols are: (1) R3's Corda; (2) Hyperledger Fabric (a Linux Foundation Project); (3) Multichain; (4) Ethereum (permissioned version, Quorum, developed by JPMorgan); and (5) EOS.

3 Emerging Technologies – The Internet of Things

Even alone, distributed ledgers would have a significant impact on supply chains and trade finance, but when coupled with two other technologies – IoT and Cognitive Analytics (including machine learning) – the impact will be nothing short of a paradigm shift. The Internet of Things is one of the other technological advances that will have a major impact on the financial industries. IoT refers to the simple concept that more and more physical devices are becoming connected to the Internet (i.e., networked). Today, the types of devices being connected to the Internet is growing exponentially – both in terms of consumer and industrial products. For example, in January of 2020, BMW and DHL established a joint venture to provide more efficient and secure methods for conducting global trade using blockchain technology and IoT devices. The new venture aims at bringing transparency to the supply chain of auto parts distributed globally

from Malaysia. The joint venture will provide a dashboard that will allow users to monitor data, in real-time via IoT devices, from placed orders, orders in transit and delivered orders.[2]

This trend is expected to continue over the next several years, such that virtually all physical objects in the world will be (or at least have the capability to be) connected to the Internet. These connections will work both ways. Physical objects will transmit information about their internal state and/or information about environmental factors (e.g., temperature, humidity). Many objects will also have physical actuators (i.e., things that interact with physical world such as motors, locks, LEDs). Together with sensors, this means that many physical objects will be able to transmit real-time information over the Internet (whether by ZigBee meshes, cellular or satellite transmissions) to applications that can analyze that data and send commands back to physical devices to interact with the physical world. For example, if the security seal (an IoT device) on a DHL storage container is broken prematurely before the delivery date, that data will trigger an application monitoring that information over the Internet to send a signal back to the container's locks to automatically clamp shut until further instruction.

Driving the emergence of IoT is the advent of 5G, which will usher in a new generation of use cases that will leverage edge computing to make IoT make effective and efficient. It represents a fundamental change in the mobile ecosystem, unleashing a powerful combination of extraordinary speed, expanded bandwidth, low latency, and increased power efficiency that is driving billions more connections in the next five years and changing our world. According to the Global System for Mobile Communications, 5G connections are expected to grow from 10 million at the end of 2019 to 1.8 billion by 2025. In June 2020, the Global Mobile Suppliers Association identified 81 Mobile Network Operators ("MNOs") in 42 countries who had launched 5G commercial services and more than 385 MNOs in 125 countries were investing in 5G development.

Blockchain technology will augment IoT in several positive ways. First, blockchains built in cryptocurrency payment protocols are perfect for interacting with automated payment systems, especially in the context of complex trade cycles that do not necessarily require human interaction. Second, and probably more importantly, the blockchain can add a level of security that no other existing technology can. The distributed ledger is perfect for ensuring that use and ownership rights are adequately tracked. For example, the generation of public/private keys is perfect for ensuring that only an authorized user can authorize the dispatch or acceptance of a delivery of goods.

4 Emerging Technologies – Artificial Intelligence and Cognitive Analytics

Artificial intelligence and cognitive analytics, including applications leveraging machine learning, are the final ingredients needed to radically transform supply chains and trade finance. By combining distributed ledger technology and 5G with IoT devices, such as sensors, real-time data is available to the parties to the transaction and can be recorded on an immutable, tamper-proof ledger. This capability alone significantly improves the overall supply chain and trade finance process, but what about data from one or more business processes that requires intensive calculations or analytics that the human brain cannot do? Artificial intelligence, especially the subsets known as machine learning and natural language processing, have made significant advancements in just the last couple of years. These tools can receive the raw data from the IoT devices, process the data and format it into useful structured data that can be used to monitor contract compliance matters. These tools remove any limitation on human cognition and traditional computing devices that impair our ability to process complicated and voluminous data sets. For example, in Q3 of 2020, Amazon Web Services ("AWS") joined the Mobility Open Blockchain Initiative ("MOBI"), which already includes five major auto manufacturers: Ford, BMW, Honda, General Motors and Renault. MOBI will begin to use AWS's Amazon Quantum Ledger Database, which is a fully managed database that provides a transparent, immutable and cryptographically verifiable transaction log. The infrastructure will utilize AWS's vast cloud-based network to accommodate voluminous and frequent autonomous vehicle data exchange, which may lead to a new generation of smarter self-driving cars.[3]

In addition to real-time compliance oversight, artificial intelligence is also helping sellers and purchasers with business decisions that impact their entire enterprise, especially with respect to supply chain management. For example, price discovery is made possible so that a purchaser can unleash sophisticated algorithmic tools on massive amounts of data available online or through private network data feeds. Price discovery, however, is just the tip of the iceberg – a purchaser's entire inventory management process can be run by artificially intelligent machines, which can contract for supplies when appropriate without any human interaction. Machine learning capabilities are particularly useful because as these systems are used and provided feedback on the decisions they make, its performance or percentage of accurate decisions increases until it performs its function far better than its former human counterpart.

Of course, the real-time data feeds monitoring in-route products and the price discovery and inventory management are ultimately all part of one operation – to ensure the smooth and optimal purchase order and inventory life cycle. We must also keep in mind that these machine capabilities will continue to grow at a rapid pace, especially given the fact that Moore's Law appears to still have some run left in it before humans are no longer capable of fitting more transistors on smaller and smaller pieces of silicon. This assumes, however, that we do not discover entirely new ways to supply ever increasing computational power (e.g., quantum computing).

5 Trade Finance 2.0 – Applying Emerging Technologies and Paradigm Shift

Any lawyer or professional who has practiced transactional law for any length of time knows that the more stakeholders involved in a transaction or series of related transactions, the more difficult it becomes and the more "friction" is involved in the form of higher transactional costs and lost efficiency and output. Often, trade finance and supply chain transactions involve several stakeholders, especially when there is a cross-border aspect to the transaction. The number of participants can grow fast. Possible participants include the buyer, the seller, a letter of credit issuer (i.e., a bank), one or more correspondent banks, customs and revenue (tariff) officials, warehouse owner, logistics companies and a host of other possible involved participants. It is for this reason, that distributed ledgers when combined with IoT devices and cognitive analytics prove to be one of the most powerful uses of distributed ledger technology. The cost savings and reduction in transactional costs and friction in many cases are extreme. For example, the ability to model a merchant letter of credit in the form of computer code (e.g., Solidity, Java, Go); and more importantly, the ability of that code to execute on a distributed ledger using self-implementing conditions to, in the case of a letter of credit, release funds programmatically to the seller without any need for the seller to present a paper letter of credit to anyone. Consider the

reduction in friction afforded by this mechanism. Rather than a paper letter of credit needing to work its way through a series of correspondent banks, each of which must be paid a fee, a digital letter of credit that is self-implementing executes automatically when the conditions to payment are met – resulting in a significant reduction of expenses. In Q2 of 2020, the International Port Community Systems Association ("IPCSA") used blockchain technology to ship cargo from Israel to Ukraine, where an IPCSA member controls Ukraine's Port Community System. A bill of lading was electronically issued by the shipping company and transferred to the exporter and then to the importer in the Ukraine and Spain. During the test, the system constantly provided information as to which party was holding the electronic bill of lading together with the status of the cargo. As a result of the successful pilot, Chinese e-commerce giant Alibaba joined the IPSCA pilot to explore the use of a blockchain bill of lading in its own supply chains.[4]

The inverse is also true, and no less important – meaning that the bill of lading, which evidences the transfer of ownership to the goods to the purchaser, is also transformed into computer code where it resides on a distributed ledger until payment is released to the seller. Upon payment, the bill of lading will automatically be released to the purchaser in digital form. This removes any issues with respect to fraudulently procured or produced documents of title, such as a bill of lading. In Q2 of 2019, breakbulk shipping venture G2 Ocean and blockchain startup Cargo X, completed a pilot that used blockchain technology to carry out paperless bills of lading. During the trial, the two companies transferred ownership of goods with shipments traveling from China to Peru. All participants issued, transferred and received original electronic documents using blockchain technology, which managed the ownership of documents in order to eliminate disputes, forgeries and unnecessary risks. The importer received the electronic bill of lading after only a couple of minutes of delivery. In all, five separate shipments were completed as part of the pilot.[5] As a result of the successful pilot, in February 2020, CargoX, the provider of the CargoX Smart Blockchain Bill of Lading document transfer platform, was approved for use by the International Group of Protection & Indemnity Clubs ("IG"). It was the first provider whose platform operates using the neutral, public Ethereum blockchain. The IG is an unincorporated association of the 13 principal underwriting Protection & Indemnity (P&I) Associations, which between them provide liability cover for approximately 90% of the world's ocean-going tonnage.

In addition to payments and documents of title, many more aspects (in fact, virtually all of them) can be converted to self-implementing code broadcast to a distributed ledger, together with corresponding, real-time contract administration and monitoring, including casualty insurance covering the goods during transit, foreign trade credit insurance and the coordination of any other logistics companies (e.g., last mile carriers).

In addition to what I will refer to as "core logistics," there are a host of other significant benefits to virtually all participants in the lifecycle of an average transaction, including integrity and providence matters. For the consumer, there is certainty that the product is what it says it is, whether that is assurances that a luxury brand is not a cheap counterfeit good, or that a non-GMO food product is in fact not made from genetically altered DNA. For governments, both taxation and import requirements are far easier to enforce when all of the data for products and manufactured goods flowing into and out of a country are monitored in real-time and stored in a tamper-proof, immutable ledger. Governments and regulators can easily require a "master key" with respect to goods and products over which they have some jurisdictional interest. For example, a Chilean berry producer began using SAP Industries' SAP Cloud Platform Blockchain solution to track crates of berries immediately after they have been picked, all the way through the supply chain to delivery at grocery stores.[6] It is for these reasons and many others that so much investment has been spent in supply chain and trade finance. The benefits gained by the number of parties involved in the supply chain far exceeds the potential cost to implement.

It is important to appreciate that the concepts described in this chapter are not mere academic discussions or the thoughts of a futurist. To the contrary, everything has been implemented in real world pilot programs, and some aspects are already in deployed, production systems. In fact, of all the potential use cases generally discussed as appropriate for distributed ledger technology, there is no other use case likely to reach critical mass in deployed, production-ready distributed ledgers. The world's largest participants in all aspects of trade finance and supply chain management are actively pursuing pilots and otherwise moving full speed ahead – these companies include Walmart, BNY Mellon, IBM, HSBC, Bank of America, Microsoft and Barclays, just to name a few. Through 2022, 80% of supply chain blockchain initiatives will remain at a proof-of-concept or pilot stage.[7] To be fair, the transition to Trade Finance 2.0 is not remotely finished and ninety-some percent of supply management and trade finance are accomplished in the same manner as described in the very beginning of this chapter. The feedback, however, received from all the companies involved in pilot or prototype programs has been unanimous – distributed ledger technology (as augmented by IoT and AI) will soon result in a complete paradigm shift.

While the promised land is in sight, there are still obstacles that must be overcome before all the world's trade is completed on distributed ledgers. Payment rails for the distributed systems currently under investigation are still not perfect. More specifically, unlike Bitcoin and Ethereum, Hyperledger Fabric and R3's Corda do not include a native cryptocurrency.

Maybe a more systemic hurdle to overcome is the lack of uniformity in the different distributed ledgers that are currently under active development. As discussed earlier, there are several different distributed ledger protocols under active development. These different ledgers cannot currently communicate with each other, but this may, however, be a temporary impediment. Several development shops are working on interfaces and other strategies to achieve interoperability between these different ledgers. One of the most well known is Cosmos, which aims to act as an ecosystem of blockchains that can scale and interoperate with each other. In addition, systems are being developed to ensure backwards compatibility for each new distributed system with existing legacy systems since it is not possible to transition the world's information technology systems all at one time. Furthermore, given the rather nascent nature of the technology, many companies prefer to overlay their distributed systems atop their legacy system to maintain a level of redundancy (what I refer to as the "training wheels" approach, which I believe to be a prudent approach).

While no one is certain of the exact timing, based on the current pace of advancement, it seems likely that there will be several deployed, production systems in operation within 10 years. Be skeptical of anyone who suggests these systems are 15 or 20 years away from production. In fact, if these systems are not in production before 10 years, that means they are likely never going into production and a newer, better system has surfaced (e.g., quantum computing). The reason for such a statement is that the potential benefits are so fundamental and so enormous when scaled on a global basis, that most major players in every industry imaginable are in a sprint towards implementation. The growing

number of pilot programs and proof of concepts appearing in the general news and economic journals is only further testament to the investment being made around the globe.

This rapid pace of development is likely to continue or even accelerate as industries reach critical mass – which triggers another key benefit of distributed ledgers, which is the mutualization of the cost to implement new systems. Because distributed systems allow all participants to access a common truth, only one distributed ledger system needs to be designed and engineered to a common set of specifications and standards. Today, every participant maintains its own centralized database that is the subject of costly reconciliations with other counterparty records. For example, rather than 10,000 manufacturers in a province of China maintaining their own central database – as they do today – only one decentralized system must be operational; thus resulting in each company paying 1/10,000th of the costs of such decentralized system. It is tempting to think distributed ledger technology is an area limited to the world's megabanks or largest retailers, like Walmart. The headlines certainly reinforce this perception.

For small to midsize banks, suppliers, manufacturers and others involved in supply chain management and trade finance (or any other industry for that matter), distributed ledger technology is an opportunity to level the playing field and eliminate certain competitive advantages held by their larger competitors, especially with respect to the banking industry in the United States. Anti-money laundering ("AML"), OFAC and other compliance costs represent a disproportionate amount of expenses for small and midsize banks. Distributed ledger technology also can permit banks to mutualize the cost of compliance, and in doing so, improve the effectiveness of their overall programs. This is just one of the many potential benefits (others include participation trading platforms) available to small and midsize banks. The choice seems simple. For those institutions willing to be innovative and to take some risk, there is an opportunity to be a trailblazer with potentially market-changing innovative solutions. For those who remain complacent and willing to allow the world's largest banks to maintain a monopoly on the future, their own future does not seem bright.

Perhaps the one force that can derail the implementation of distributed ledger technology across the globe is regulations or other policy enforcement that is too restrictive, and ultimately smothers out the innovation needed to reform our existing and inefficient processes. Fortunately, many jurisdictions, including the United States, already have existing legislation that, while passed years before distributed ledger technology existed, is broad enough in scope because of their origins out of the original Internet revolution. So, electronic or digital signatures, including public key infrastructure, are already accepted practice. While there will almost certainly be a need to tweak commercial laws here and there, especially in the cross-border context, those efforts should be easy to accomplish given the mutual benefits for all involved, including governments. The policy decisions that will impede distributed ledger technology are those too myopic on counterbalancing issues, such as consumer protection. Any policy that says no to any risk, is a policy that will shutter innovation. Going forward, it is important that the regulators and policymakers in the United States, the UK, continental Europe, China and the rest of the world's global trade powers, implement regulations and rules that foster innovation and encourage institutions to take chances to achieve potentially game changing results. That is not to say that financial institutions need a license to engage in reckless activities, but rather enough flexibility to innovate by taking calculated chances and risk. There is a balance that can be found where consumer safety and the soundness of the economic environment is maintained, while innovation fosters much-needed economic growth and employment growth around the globe.

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Financing Your Private Debt Platform

Dechert's Global Finance Group

Over the last several years, financing options for private debt platforms have become increasingly diverse. There is now a broad range of products available to managers seeking to leverage their investment portfolios. These products serve different purposes and are provided by different investor groups. In this chapter, we explore some of the different financing options that private debt fund managers have utilized in recent years. Such products include senior secured facilities, unsecured notes and structured credit products. Common senior secured facilities include asset-based loans (ABLs), loan-to-SPVs (special purpose vehicles), hybrid subscription and ABL lines, collateralized loan obligations (CLOs) and hybrid variants. Unsecured notes include rated notes, baby bonds and convertible notes. Available structured credit products include repurchase agreements, total return swaps and forward contracts.

I Senior Secured Facilities

A. Asset-Based Loans

What is an asset-based loan facility?

ABLs at the fund level are one method of obtaining platform-wide financing. ABLs advance against a borrower's portfolio of investments based on the value and classification of each eligible investment held. ABLs are generally provided by banks and other financial institutions and, depending on total commitments, may take the form of club or syndicated deals. ABLs are also one of the most flexible types of secured financing – a borrower's ability to purchase assets is generally only limited by its own investment policies and compliance with applicable law. Portfolio managers may otherwise distribute cash throughout the system with relative ease, subject in some circumstances to certain borrowing base cushions and other specified conditions, and may purchase and sell assets and otherwise conduct day-to-day business with little involvement of the lenders.

What are the common features that distinguish ABLs?

- **Tenor**. ABLs generally provide for a three- to four-year revolving credit line, with some recent funds opting for a small term loan piece to optimize pricing. During the availability period, there are generally no prepayment penalties or make-whole premiums, and mandatory prepayments are limited to those needed to cure borrowing base deficiencies. Following the availability period, there is often a one- to two-year term out period during which the outstanding loans amortize, most commonly either evenly on a monthly basis through the scheduled maturity date or contingent upon the receipt of net cash proceeds in connection with the occurrence of certain events (for example, sales not in the ordinary course, returns on investments, incurrence of debt, issuance of equity and receipt of insurance proceeds).
- **Cash Flow**. Loan proceeds may be used for general corporate purposes, including purchases of assets that do not receive credit in the borrowing base. Furthermore, cash generated from the business is not required to be sent to a lockbox or to be paid subject to a payment waterfall. Instead, a borrower retains its rights to direct use of cash from its various accounts until a default occurs, at which time the secured parties may exercise authority over any cash or securities held in accounts governed by a control agreement. Cash may also be freely moved up and down the capital structure, in some cases subject to no default and a borrowing base cushion, including to make distributions and prepay other debt. ABLs for registered investment companies (RICs) also frequently permit certain distributions notwithstanding the existence of a default, typically in an amount equal to the higher of the net investment income or the amount of required tax distributions estimated by a borrower, in each case subject to a cushion.
- **Borrowing Base**. Borrowing bases for ABLs comprise the following primary components:
  - **Eligibility Criteria**. Although eligibility criteria vary borrower-to-borrower and, in some cases, provider-to-provider, a consistent feature is that they are predetermined and not subject to subsequent agent or lender review or consent. In addition, although eligibility criteria determine whether any given asset may contribute to the borrowing base, they do not limit whether an asset may be purchased in the first instance (unlike many loan-to-SPV facilities discussed below that require lender consent to purchase an asset).
  - **Advance Rates**. ABLs give credit to a wide variety of assets, including first-lien loans (which may be subject to prior working capital liens), second-lien loans (which may include first-lien loans in excess of certain leverage ratio thresholds), high yield securities, mezzanine loans, last out loans, covenant-lite loans, loans that permit interest to be paid in kind (PIK loans), and debtor-in-possession (DIP) loans. Some facilities will require minimum EBITDA thresholds for certain assets to be deemed eligible, but recent trends have provided managers with the added flexibility for portions of the borrowing base to be based on assets whose performance is measured by metrics other than EBITDA, including, for example, recurring revenue, loan-to-value and late stage lending loans. Credit may also be given to preferred and common equity investments, both

performing and non-performing assets and investments in foreign portfolio companies. Advance rates given to quoted, first-lien loans may be as high as 85%, and vary depending on factors such as credit quality, seniority, tenor of a specific type of asset, overall fund performance (for example, stepping up as the most recently calculated asset coverage ratio increases above 1.50×) and a manager's track record.

- **Concentration Limitations**. Counterbalancing the flexibility granted to a borrower in its acquisition strategy, secured parties enforce diversity and cap non-core assets through concentration limitations. Common concentration limitations include issuer and industry concentrations, minimum percentages of first-lien and/or second-lien loans, and maximum percentages of non-performing assets, PIK loans, DIP loans, equity investments and/or foreign assets. However, a borrower does still maintain control over the application of such concentration limitations – to the extent more than one concentration limitation may apply, a borrower may choose which assets to move in and out of the borrowing base in order to satisfy the concentration limitations, and thereby optimize its borrowing base availability.
- **Value**. The value of assets in an ABL are marked to market on a periodic basis, typically requiring both a level of internal and external review. Internal valuations may be required as frequently as weekly, though some managers seek to limit to quarterly, and a negotiated percentage of the assets are to be valued externally at least on a quarterly basis. Secured parties also reserve the ability to perform supplemental valuations at any time, though borrower reimbursement obligations are often capped to the extent no default exists. Valuation dispute mechanics are negotiated, including the value that controls while any dispute is ongoing.

- **Structuring Considerations**. ABLs are secured by substantially all assets of the fund and its subsidiaries. Such grant is subject to certain exceptions, which may vary based on a given fund's investment strategy and profile, but assets are typically included in the security package irrespective of whether such assets are included in the borrowing base. Representations, warranties, covenants and defaults may extend to all subsidiaries as well. For a manager considering a combination of the financing options described in this chapter, of particular importance to note is the extent to which the ABL agreement will apply to "subsidiary" investment vehicles controlled by the fund, including SPVs, CLOs, small business investment companies (SBICs) and their related assets. Generally speaking, there are two principal challenges a manager faces in this regard. First, there may be limitations on moving investments held by the fund and its other subsidiaries into these vehicles, including the absence of a default and a borrowing base cushion. Second, ABLs commonly cross-default, or at a minimum cross-accelerate, to the third-party debt facilities incurred or expected to be incurred by such vehicles.
- **Other Notable Features**. It is also common for ABLs to be available to provide borrowings in foreign currencies and to issue letters of credit on behalf of a credit party or an underlying portfolio investment company.

Recent developments

- **Consolidation**. The business development company (BDC) segment of the permanent capital space, in particular, has seen an increase in the rate of consolidation in the past few years. ABLs have accommodated by not only permitting an existing borrower to acquire third parties, but even providing for limited representations and conditionality in certain circumstances – for example, in connection with acquiring another BDC sharing a common advisor. A related permutation has been the availability of "umbrella" facilities, which provide for uniform borrowing mechanics and other terms for multiple BDC co-borrowers under one shared facility, subject only to several (and not joint) liability. Such facilities simultaneously ease loan administration and prebake in merger mechanics and the ability to port over commitments from the non-surviving borrower to the surviving borrower, allowing for more seamless streamlining and scaling.
- **Access to Other Capital**. Historically, various forms of debt have been permitted, including uncapped (other than by statutory and, in some cases, more stringent contractual asset coverage ratio compliance) unsecured debt maturing outside a preference period, baskets for unsecured shorter-term debt, and secured *pari passu* debt. Finance providers at the fund level are recognizing the potential benefits of greater flexibility in fundraising, and are working with funds to allow easier access to other capital when opportunities arise. There has been greater flexibility to incur shorter-term debt maturing earlier than the ABL, as well as to structure bankruptcy-remote vehicles to leverage pools of assets and securitizations via SPVs and CLOs highlighted later in this chapter. Increased flexibility in this area has been important in allowing funds to react in real-time to developing trends.

On balance, what are the pros and cons for managers of ABLs?

Pros

- Flexibility: ABLs are versatile and flexible, providing for liquidity at all levels of the capital structure and strategic leveraging of a diverse range of assets. Such flexibility also extends to concurrent access to other capital – ABLs are frequently set up in contemplation of and providing for easy-to-exercise mechanics for assuming or issuing many of the other types of financings discussed herein.

Cons

- Overcollateralization: All assets coverage and financial covenants can be restrictive, making lenders overcollateralized, and if breached can put real stress on "fund" structure and ability to support other facilities.

B. Loan-to-SPVs

What is a loan-to-SPV facility?

A loan-to-SPV facility is a financing to a bankruptcy-remote special purpose vehicle (SPV) that is secured by and with recourse only to a portfolio of assets held by the SPV. The bankruptcy-remote nature of the vehicle is a key feature of this type of financing – although the SPV is typically a wholly owned subsidiary of the parent fund, these facilities by nature are expressly non-recourse to the fund, and credit underwriting is instead based on the portfolio of assets owned by the SPV. As a result, there are often meaningful limitations on the nature of the assets that may be held at the SPV level, and managers will have comparatively less flexibility with respect to the portfolio in comparison to fund-level revolvers and other asset-based financing products (including on their ability to purchase and sell assets and make distributions). However, these facilities are often priced attractively in comparison to other products,

and can be a valuable resource for managers both as a long-term leverage solution and as short-term warehouse financing in advance of a CLO.

In contrast to securitizations backed by different tranches of notes issued to investors, or the broad syndications seen in certain fund-level financings, many loan-to-SPV facilities are structured as single-tranche, bilateral loan facilities between a single bank (or a small syndicate of banks) lending directly to the SPV. Although the SPV is often a wholly owned subsidiary of a parent BDC or other investment vehicle, the parent fund typically does not provide direct credit support beyond a limited indemnity for bad acts and other limited exceptions. The parent fund is also often party to the transaction documents as the "Collateral Manager" responsible for the management of the portfolio held by the SPV (this is often true even if the parent fund is managed by an external adviser, meaning that the adviser is not required to be party to the transaction documents).

What are the common features that distinguish loan-to-SPV facilities?

The composition of the portfolio in a loan-to-SPV facility is often tightly restricted. It is not uncommon for lenders to have an up-or-down right to approve the inclusion of any asset in the portfolio, whether or not funded with advances under the facility. Eligibility criteria and concentration limits for inclusion of assets in the borrowing base tend to be narrower than those governing fund-level revolvers, and are often curated to a pre-determined strategy (e.g. a portfolio exclusive to broadly syndicated loans (BSL)). Advance rates for different asset categories also tend to be lower than at the fund level (for example, a liquid, performing first-lien loan, which might receive an advance rate of 75–85% in an ABL revolver, might receive an advance rate of only 65–75% in an SPV facility). It is rare for equity to receive any credit in the borrowing base. Many facilities require a standing equity cushion to the borrowing base as well.

Asset valuation is a critical component for managers to evaluate when considering a loan-to-SPV facility. Certain facilities, particularly those backed by a liquid portfolio, permit the lender to mark any or all of the assets in the portfolio to market at their discretion at any time. Another common approach is for assets to be valued at their initial purchase price (with near-par trades or loans issued with original issue discount treated as being acquired at par), and with the lender having the right to mark down the asset only after the occurrence of one or more specified "value adjustment events" (often including a wide range of triggers such as payment defaults, increases in leverage, declines in EBITDA, and "material modifications" of the underlying loan documents). In many cases, a manager may dispute a lender's valuation, either by obtaining firm bids for liquid assets or by retaining an approved independent valuation firm to value an illiquid asset. However, it is often the case that the lender's valuation will apply during the pendency of a dispute, which can result in the need to cure a borrowing base deficiency in the short-term before the dispute is resolved (this is especially true in an economy-wide crisis like the COVID-19 pandemic in which lenders may mark down assets across the portfolio simultaneously).

Another typical feature in loan-to-SPV facilities is that the borrower's access to cash collections on the portfolio is restricted, with cash proceeds flowing into a controlled collection account and distributed through a periodic (often quarterly) waterfall. Payments to the equity are generally last in the waterfall, subject to re-direction during the reinvestment period to acquire additional assets, or as may be required to cure a borrowing base deficiency (though there is often a scrape at the top of the waterfall to permit collateral management fees to be distributed to the parent fund). SPV facilities sitting below a BDC or other registered fund generally include less flexibility than at the fund level to permit cash to be used for distributions by the parent fund to maintain treatment as a RIC, with distributions to the parent fund for this purpose often subordinated in the waterfall and/or subject to a payment block during an event of default. To avoid cash being trapped at the SPV level between quarterly distribution dates, managers often push for flexibility to elect to run the waterfall on an interim basis, and/or to make interim distributions to the parent fund subject to certain criteria (including *pro forma* borrowing base compliance and sufficient cash to cover the next upcoming waterfall distribution).

What are the implications of the bankruptcy-remote structure?

Structuring a facility as a bankruptcy-remote financing requires a two-pronged analysis: one, that the sales and contributions of assets from the parent fund into the SPV portfolio are "true sales," meaning that if the parent fund were to file for bankruptcy, a court would not recharacterize the sale of the assets as a secured financing from the SPV in which the assets remain part of the parent fund's bankruptcy estate; and two, that a bankruptcy court would not use its equitable powers to "substantively consolidate" the SPV and its assets into the bankruptcy estate of the parent. It is customary for borrower counsel to deliver legal opinions on a reasoned basis that these bankruptcy-remote aspects of the transactions would be respected in a bankruptcy court in the event of a bankruptcy of the parent fund.

While both the true sale and substantive consolidation analyses are detailed and fact-specific, they have structuring implications for bankruptcy-remote financing facilities. For example, the existence of recourse to the parent fund for the performance of the underlying portfolio is a bad fact for the true sale analysis, which operates as a significant limitation on the ability of the parent fund to guarantee or backstop the obligations of the SPV. In addition, true sale considerations limit the ability of the parent fund to repurchase assets that have been contributed to the SPV, though market participants have got comfortable with some flexibility for such trades within a modest cap. From a substantive consolidation perspective, key considerations include ensuring that the parent fund and the SPV conduct their operations separately, with no commingling of cash and with clear records demonstrating ownership of assets available to satisfy respective creditors' claims. Additionally, bankruptcy-remote SPVs are expected to have at least one independent director whose consent is required for the SPV to file for bankruptcy or take certain other actions including dissolution and liquidation of the portfolio.

What are some other basic terms that can be expected in a loan-to-SPV facility?

Certain other core terms of SPV facilities are driven by the purpose of the facility, including whether it is a short-term facility for a CLO warehouse or a longer-term leverage facility. In the CLO warehouse context, the expectation is typically that the facility will be outstanding on a shorter-term basis (six to 18 months), and the economics may reflect the expectation that an affiliate of the warehouse provider will place the CLO (for example, the facility may include a margin step-up to incentivize CLO execution, and there may not be an unused fee or a make-whole unless the CLO fails to occur and no placement agency fee is paid). By contrast, a longer-term facility often includes a reinvestment period of between two and four years, with a term-out period of one to three years, often with an unused

fee and/or a minimum utilization fee during the reinvestment period (sometimes after a short ramp-up period). It is not uncommon for longer-term facilities to include a make-whole or other call protection in the first 12 to 24 months of the facility.

On balance, what are the pros and cons for managers for loan-to-SPV facilities?

Pros

- Specificity: Facilities can be structured as bespoke vehicles for different strategies (BSL portfolio, CLO warehouse, etc.).
- Economics: Bankruptcy-remote structure and extensive lender control rights lead to more attractive pricing than other comparable products (though make-wholes are more prevalent than at the fund level).
- Insulation: A problem at a bankruptcy-remote portfolio will not necessarily cross-default to the rest of the fund structure, and the fund often retains the ability to step in and cure a default or a borrowing base deficiency before foreclosure or liquidation of the portfolio.

Cons

- Lender Discretion: Lenders often have significant rights (in their "sole and absolute discretion") with respect to the portfolio, including whether to lend against individual assets and how those assets should be valued, meaning relationships between lenders and borrowers and the "trust factor" is an important consideration.
- Call Protection: Make-wholes are prevalent in longer-term facilities, which can complicate efforts to refinance facilities that are not working as intended (e.g., a lender that is no longer approving asset acquisitions or who is aggressive on marking down asset values).
- Trapping of Assets: As a result of the waterfall construct and the limitation on sales to affiliates from a bankruptcy-remoteness perspective, there can be significant limitations on getting cash and assets out of the SPV and up to the parent fund.

C. Hybrid Subscription and ABL Lines

Another common type of fund-level facility not discussed in detail in this chapter is a subscription facility, which leverages the capital commitments of investors in a fund. Subscription facilities are often used in the early stage of funds as they begin to ramp up in order to bridge the period of time necessary to call capital for investments. In order to maximize leverage and terms, one alternative used by managers is a hybrid facility that includes both investor capital commitments and portfolio investments of the fund in the borrowing base. A hybrid facility may take a myriad of forms. Some hybrid facilities have separate interest rates for each borrowing base, while others have blended interest rates that may adjust depending on which portion of the borrowing base is being more heavily utilized. Certain hybrid facilities may be used when there is a weaker investor base or if the investor base lacks the necessary diversity. Other hybrid facilities start off as subscription lines, providing for varying advances linked to the strength of the investors supporting the fund, and set forth a series of benchmarks that, as met, will ease the primary source of credit support toward a more traditional all-assets ABL. Under this latter type of financing, as the capital commitments are called and the fund matures, the hybrid facility evolves into an ABL – investor restrictions and reporting obligations loosen and the collateral focus shifts to the robustness of the asset portfolio. Including all phases and growth mechanics in one facility guarantees consistent access to liquidity, eliminates timing and refinancing uncertainty, and thereby minimizes potential business interruptions (at the risk of leaving all financing options in the hands of one lender or a group of lenders).

D. Collateralized Loan Obligations

What is a CLO?

Collateralized loan obligations (CLOs) are private funds that raise money by issuing varying classes of investment-grade and slightly below investment-grade secured notes and subordinated notes, preferred equity or other first loss positions. Managers apply the money raised by CLOs to invest in a pool of non-investment grade corporate loans, including loans in connection with leveraged buyouts and recapitalizations. CLOs are structured to provide protections and credit ratings that debt investors find appealing, while maintaining the ability to provide attractive risk adjusted returns to equity investors. Most, but not all, CLOs are actively managed vehicles. The manager (typically called a Collateral Manager) receives a fee for managing the CLO. A Collateral Manager's duties include asset selection, disposition and acting on behalf of the CLO issuer in its day-to-day functioning. Although overall CLO issuance decreased in 2020 due to uncertainty around the global COVID-19 pandemic, volumes are expected to return to pre-COVID levels in 2021.[1]

What are the different types of CLOs?

The two most common types of CLOs are balance sheet CLOs and arbitrage CLOs. Specialty finance/lending firms tend to use balance sheet CLOs as a means of financing the origination of middle-market loans (Middle Market CLOs). Comparatively, arbitrage CLOs are managed with the goal of producing returns in excess of the borrowing costs of the notes issued by such CLOs. Arbitrage CLOs are generally collateralized by pools of BSL acquired in the secondary market by CLO issuers (BSL CLOs). BSL CLOs make up the vast majority of CLOs, but the last several years have seen significant growth in the issuance of Middle Market CLOs.

What is the typical lifecycle of a CLO?

The typical lifecycle of a CLO includes a warehouse period prior to launching the CLO, a three- to six-month ramp-up period after the CLO closes and a three- to four-year reinvestment period followed by amortization to maturity or call. During the warehouse period, one or more banks will provide financing in the form of a credit facility (such as a loan-to-SPV facility described above) or total return swap (as described below) so as to allow the Collateral Manager the ability to build the initial pool of assets that will back the CLO. Generally, asset accumulation is not complete at the time a CLO closes, and after the CLO closes, the CLO will continue to build its collateral portfolio until an effective date. During this ramp-up period, the CLO will have some relaxed testing standards so as to provide the manager with greater flexibility to finalize the portfolio. CLOs generally allow for reinvestment of principal collections in additional loans during the first three or four years. Reinvestment is subject to compliance with certain transaction tests, as described below. After the reinvestment period, the CLO will enter into amortization, during which the manager has less ability to actively manage the portfolio as the deal winds down. BSL CLOs generally offer more flexibility for managers to invest during the post-reinvestment period than do Middle Market CLOs.

What are the common features that distinguish CLOs?
One attractive feature of CLOs is that the cash flows on the underlying loans of the CLO are the source of payment for the CLO's liabilities, and thus repayment is only required to the extent such cash flows are available to make such payments. This makes CLOs advantageous as compared to funds with market value-based repayment triggers, as such triggers can be extremely punitive in periods of high volatility, particularly when the pricing of underlying loans is declining.

As noted previously, CLOs include key protections that make them attractive to debt investors seeking to invest in a structured finance product. These protections include overcollateralization and interest coverage requirements, which if not satisfied, result in the diversion of excess interest on junior classes of notes to pay down the principal of senior classes of notes. CLOs also provide for collateral quality tests to ensure the underlying loan portfolio meets certain quality standards. If these standards are not generally satisfied, the manager's ability to trade assets on behalf of the CLO during the reinvestment period could be restricted. Finally, the underlying loans in a CLO are required to meet various eligibility and concentration criteria. Such eligibility criteria, protections and other key terms are highly negotiated with both equity and debt investors. Further, the rating agencies providing the ratings to the rated debt issued in a CLO all have their own specific methodology and requirements that are stipulated prior to closing a CLO.

Who invests in CLOs?
CLOs largely attract a wide array of institutional investors. Insurance companies, domestic and foreign banks (including U.S. regional banks), pension funds and the investment arms of large companies typically invest in AAA-rated and other senior CLO note classes. Hedge funds, credit arms of private equity firms, insurance companies and other credit opportunity funds typically invest in mezzanine and junior CLO notes, as well as in the equity issued by CLOs. Subject to applicable regulatory laws, foreign investment is generally permitted in CLOs, with much of such foreign investment deriving from Europe, Japan and South Korea in recent years.

On balance, what are the pros and cons for managers of CLOs?
Pros

- Fees and Returns: Managers can use BSL CLOs to generate management fee revenue and to provide investors in other funds managed by it with returns on equity in its CLOs (to the extent its managed funds invest in CLO equity).
- Cost Effective Financing: For firms with middle market lending operations, Middle Market CLOs are attractive financing vehicles for such lending operations because the cost of borrowing through CLO vehicles is generally lower than through other forms of financing and Middle Market CLOs create opportunities for their managers to form long-term relationships with debt investors that invest in the manager's CLOs.
- Investor Protections: CLOs provide protections and credit ratings that debt investors find appealing.
- Ramp-Up Flexibility: Ramp-up periods allow managers to continue to build the underlying portfolio as they take advantage of CLO financing.
- Reinvestment: CLOs allow for reinvestment so that experienced managers can trade loans and generate higher returns for equity investors.
- Cash Flow: Cash flows on the underlying loans of the CLO are the source of payment on CLO notes and therefore repayment is only required to the extent of available cash flows.
- Interest Rates: As most of the liabilities issued by a CLO are floating rate-based (as are the underlying assets), CLO liabilities are not as sensitive to rising interest rates. Alternatively, in a low interest rate environment, the coupons offered on CLO liabilities are traditionally more attractive than the return in many asset classes.

Cons

- Limitations in Workouts: Although CLO reinvestment criteria are intended to provide a certain amount of flexibility for the Collateral Manager, they do have their limits. In particular, such criteria have historically limited the ability of CLO managers to maximize value when underlying loans undergo workouts, restructurings or other distressed scenarios. In fact, recently, distressed debt investors have utilized these inherent restrictions against CLOs so as to intentionally structure workout transactions in a manner largely benefiting the non-CLO lenders in the lending group. However, the CLO market over the past year has begun to coalesce around certain strategies to level the playing field in the workout/restructuring context. Further, Collateral Managers have been able to negotiate better flexibility (by historical standards) in regard to this issue in their recent vintage CLOs.
- Rating Agency Requirements: Because CLOs are rated, Collateral Managers have to structure CLOs to satisfy rating agency requirements in addition to investor stipulations, which places additional limitations on flexibility to manage the portfolio.
- Ratings Volatility: The underlying collateral of CLOs is required to have ratings or credit estimates, which subjects CLOs to potential ratings volatility. As we recently saw in the second quarter of 2020, sharp downgrades in ratings on underlying loans can cause haircuts to the valuation of these assets (which can in turn make the valuation of the asset more sensitive to its market value at a given time). Thus, even though CLOs are cash flow-based, in a period of high volatility in the leveraged loan markets, the various tests and triggers imbedded within a CLO expose it to broader market and credit risks.

In sum, the unique structure of CLOs coupled with debt investor protections make CLOs a useful and cost-effective tool for asset managers. Even taking into account the turbulence of 2020, CLOs in aggregate remain the largest lender to the leveraged loan market and this is likely to be the case for the foreseeable future.

E. CLO/ABS Hybrid Transactions

What are Hybrid Structures?
A relatively niche product in the securitization space that we are seeing employed more routinely is the hybrid CLO/ABS structure (Hybrid Structures). Based on more traditional asset-backed securitizations (ABS) that initially emerged after the credit crisis, these transactions offer attractive yields to debt investors while at the same time offering sponsors in the middle market space better flexibility to finance loans that are viewed as niche products relative to regular-way middle market corporate loans. In particular, these Hybrid Structures have been utilized to finance loans to venture-backed obligors in the technology, software and healthcare sectors, which are seen as carrying a higher risk profile than traditional middle market loans backing private equity-sponsored buyouts. More recently, the Hybrid Structures have become a preferred method of financing recurring revenue loans and late stage lending loans.

How are Hybrid Structures structured?

From a structural and legal documentation perspective, Hybrid Structures are relatively straightforward. Typically, one or more funds managed by the sponsor will sell assets down to a special purpose entity issuer. The issuer finances the acquisition through the issuance of debt and the equity is retained by one or more of the selling funds. Although older transactions in this space utilized a Delaware statutory trust for the issuer, more recent deals have used Cayman domiciled entities (again, similar to a CLO). Importantly, Hybrid Structures are cash flow-based and utilize a borrowing base approach versus the coverage test features typically seen in CLOs.

What are the common features that distinguish Hybrid Structures?

One looking at the older vintage of these transactions might be surprised at their recent growth. The portfolios were often static with some limited availability for substitution, so the sponsor/manager was relatively constrained in its options regarding management of the portfolio. Further, certain triggers based on the amount of delinquent and/or defaulted assets in the portfolio would trigger early amortization of the portfolio. Generally speaking, although a securitization, they looked more akin to a traditional loan-to-SPV financing. However, recent incorporation of traditional CLO mechanics (such as reinvestment periods and greater flexibility for the acquisition and disposition of assets), have provided attractive flexibility for middle market sponsors of various stripes. Further, the assets securitized in these transactions are not required to have a rating or credit estimate, which, when combined with a borrowing base approach that does not utilize haircuts to the assets such as what one sees in the overcollateralization tests in a CLO, helps to safeguard the transaction from market price risk. Finally, these Hybrid Structures have often employed a revolving loan tranche (something relatively rare in post-credit crisis CLOs). This revolving tranche provides the issuer greater flexibility to manage unfunded commitments and/or the acquisition of additional assets into the portfolio.

Who invests in Hybrid Structures?

Historically, investors in this space were largely insurance companies, pension funds and banking institutions. Although that largely remains the case, more recent transactions have seen an increase in primarily traditional CLO investors (hedge funds, credit funds and other non-bank credit investors).

What is the outlook for Hybrid Structures?

As credit platforms targeting all spectrums of the middle market continue to grow, we expect to see further growth in the Hybrid Structure space. Many traditional Middle Market CLOs are not designed to hold the assets that are primarily financed in Hybrid Structures for one or more reasons. Various lenders will provide financing for such assets, but the Hybrid Structures provide an overall better cost of funding and flexibility. It would not be surprising to see regular issuance of Hybrid Structures from many of the current leading Middle Market CLO managers in the years to come. Further, we expect this particular product will continue to be attractive amongst large investors seeking higher yield opportunities in this current low interest rate environment.

On balance, what are the pros and cons for managers of Hybrid Structures?

Pros

- Attractive Yields: Hybrid Structures provide attractive yields to debt investors and offer middle market sponsors flexibility to finance niche finance loans.
- Ease: Straightforward from a structural and legal documentation perspective.
- Flexibility: Recent incorporation of traditional CLO mechanics have provided Hybrid Structures with attractive flexibility.
- No Asset Ratings or Borrowing Base Haircuts: Underlying assets are not required to have a rating or credit estimate and the borrowing base is not haircut, all of which help to insulate the transaction from market and credit risk.

Cons

- Niche: Application is limited to niche assets such as loans to venture-backed technology and healthcare sectors, recurring revenue loans and late lending stage loans. These types of loans are generally considered to have a higher risk profile and are fairly illiquid.

II Unsecured Notes

A. Rated Note Structures

What is a rated note?

A rated note is a type of security issued by investment funds that allows insurance companies to invest in those funds on a more capital-efficient basis. Managers offering interests in their private funds to domestic and foreign insurance companies will often structure these offerings as rated note issuances. Insurance companies are typically required to hold regulatory capital against investments in debt and equity securities. When investing into a fund as a limited partner, shareholder or other equity investor, insurance companies are required to hold higher amounts of regulatory capital against that investment than they would against debt issued by the same fund. A rated note may allow an insurance company to characterize a portion of its investment as a debt investment, and incur a lower regulatory capital charge, while obtaining a return that is linked in part to the performance of the underlying fund by also holding the equity in the fund.

How are rated notes structured?

The terms of a rated note offering will usually reflect the terms and structure of the underlying fund. For example, investors in rated notes typically are required to fund the principal amount of the note over time, *pro rata* with capital called from the equity investors. Investors in rated notes may also have the ability to reduce the outstanding principal amount of the notes in the same manner in which equity investors may be able to redeem from the underlying fund.

A rated note structure will typically have at least two tranches, a senior or debt tranche that will be rated and a junior or equity tranche that provides the subordination required to support the senior tranche rating. In some structures, depending on the type of assets in the underlying fund portfolio, the note may include a mezzanine tranche. While the mezzanine tranche will have a lower rating than the senior tranche, it may still allow the insurance company to treat this tranche as debt rather than equity. Usually, but not always, the debt, mezzanine and equity tranches will be "stapled" – that is, issued together as a single investment unit that will not allow for the separate sale or transfer of any individual tranche.

A rated note structure allows for a significant amount of flexibility for both managers and insurance companies. The senior tranche, like other debt securities, will have a fixed maturity and interest rate. However, the senior tranche may pay a supplemental distribution that captures additional investment returns of the fund during a particular interest period. Alternatively, particularly in stapled structures, the excess returns may go to the related equity. To address potential underperformance by

the fund, the interest payable on the senior tranche typically allows for PIK interest. Rated notes are usually not secured, although in some structures the feeder fund issuer may pledge to noteholders its investment in the master fund.

What type of vehicles issue rated notes?
A rated note can be issued by a dedicated feeder fund, established for the sole purpose of issuing the notes. This feeder fund would be established as another feeder fund to invest alongside traditional domestic and offshore feeder funds into a master fund. This approach allows managers to offer a rated note structure if, for example, demand for this type of investment arose after the underlying fund's initial close. In other cases, managers may establish a single feeder fund as part of the initial launch of the underlying fund to issue both limited partnership interests and rated notes. This approach can reduce the cost and expense associated with administering and operating a separate dedicated feeder fund. Other managers use a parallel rated notes fund that invests *pro rata* with the other parallel fund(s).

How does the NAIC view rated note offerings?
The National Association of Insurance Commissioners (NAIC) is currently reviewing these types of structures, including collateralized fund obligations (CFOs), which are similar to rated notes but include collateral support for the principal and interest payments on the debt tranches. The NAIC is concerned that certain types of CFOs, rated notes and other similar structured securities may be repackaging an equity investment into a debt security that attracts a lower capital charge. The NAIC has been in extensive dialogue with industry participants on the matter and a formal NAIC response to address these concerns is expected by the end of 2021.

On balance, what are the pros and cons for managers of rated note offerings?
Pros

- Potential for Optimized Capital Treatment: Rated notes may allow insurance companies to invest in private funds in a manner more efficient than investing directly as a limited partner or other equity investor.
- Ease of Execution: Rated notes can be issued from a feeder fund that has been established for this purpose without interfering with the operations of existing feeder funds.
- Flexibility: Rated note structures allow insurance companies to invest substantial amounts in securities with a fixed return, with the potential for upside from the notes themselves or the related equity. In addition, the required interest payments on the senior and mezzanine tranches may be PIK.

Cons

- Regulatory Review: The NAIC is currently reviewing rated notes, CFOs and other similar types of structured securities. The outcome of this review could result in the elimination in whole or part of the regulatory capital benefits available to insurance companies investing in rated notes.
- Formal Securities Offering: An issuance of rated notes is substantially similar to other issuances of debt securities, which will require a private placement memorandum, indenture and other customary documentation.
- Negotiation: Because rated notes can be structured in a variety of different ways depending on the investment objectives of the prospective purchasers, additional time may be required to negotiate and structure each separate rated note offering.

B. Baby Bonds

In contrast to private placement notes under the American College of Investment Counsel's Model Note Purchase Agreement (the Model NPA)[2] and rated note issuances discussed above, which are marketed and sold to insurance companies and other institutional purchasers, registered funds such as BDCs may seek to issue debt instruments that may be marketed and sold to both institutional and retail investors. "Baby bonds" are designed to access this pool of potential debt investors.

Baby bonds – key terms

- **Small minimum denomination**. Unlike conventional or institutional bonds, which are typically sold in minimum denominations of $1,000 or more, baby bonds are sold in small denominations such as $25. This smaller minimum investment in notes facilitates public trading and broadens the pool of potential purchasers, such as retail investors, who may not be comfortable buying and selling securities in $1,000 increments.
- **Senior unsecured notes**. Baby bonds are typically structured as senior unsecured notes, ranking *pari passu* with other unsecured and unsubordinated debt of the fund. As with the other fund-level unsecured debt, baby bonds are effectively subordinated to any secured debt (for instance, senior secured revolver or term loan debt) and structurally subordinated (with respect to assets below the fund level) to any subsidiary debt.
- **Fixed interest rate**. Baby bonds are issued with a fixed interest rate, which may be higher than the rate on other debt available to the fund such as senior secured credit facilities or convertible notes discussed below. In recent years, it has been common for BDC baby bonds to be issued with a coupon between 5% and 7%.
- **Quarterly interest**. Baby bonds are often structured to pay interest quarterly, unlike the typical semi-annual interest payments in higher-denomination institutional bonds.
- **Relatively long maturity**. Baby bonds provide a relatively long-term source of debt capital, with maturity extending out five to 10 years, and in some cases longer.
- **Issuer right to call**. The relatively long maturity may be unattractive to the issuer in a declining interest rate environment, and funds can mitigate this risk by including an optional redemption feature in baby bonds. Baby bonds are often callable at par, with a no-call period significantly shorter than the maturity date. By way of example, a seven-year note may be callable at par after three years, a 15-year note after five years.
- **Limited negative covenants**. Unlike, for instance, private placement notes under the Model NPA, which include extensive and often heavily negotiated covenants, baby bonds are typically issued pursuant to an indenture that includes few covenants restricting the fund going forward, often limited to key concerns of debt investors such as leverage restrictions.

Baby bonds – manner of sale

- **Registered underwritten offering**. To permit wide marketing and sales to non-institutional investors (unlike private placements, which are limited to certain institutions or in some cases sophisticated accredited investors), baby bonds are sold in an underwritten offering that is registered with the Securities and Exchange Commission (SEC). This requires the filing of an N-2 registration statement and clearing SEC review and comment prior to going

effective. The offering is marketed by the issuer's underwriters using a prospectus supplement that includes, or incorporates by reference, extensive disclosure regarding the issuer, the offering and the notes.

- **Exchange listing**. To facilitate trading, baby bonds are listed on a national securities exchange. As with other features, exchange listing and convenient trading enhances the attractiveness of baby bonds to potential retail and other smaller investors.

C. Convertible Notes

As another alternative available to registered private debt vehicles considering the issuance of senior unsecured debt, convertible notes can provide access to capital from investors seeking the seniority of a note along with the potential upside available through future conversion into equity.

Convertible notes – key terms

- **Senior note**. Convertible notes are typically senior unsecured notes and are often structured with a fixed interest rate over several years to maturity (though there are also convertible notes structured with no coupon or yield to maturity), providing investors a current yield along with the downside protection afforded senior debt instruments. The interest rate on convertible notes will typically be lower than comparable instruments that lack potential conversion into equity (such as baby bonds or $1,000-par senior unsecured notes).
- **Conversion features**. Convertible notes provide for the potential conversion into equity. The conversion price is typically set at a premium to the then-current market price of the underlying equity security, typically at or in excess of 10%.
- **Anti-dilution**. The initial conversion rate is subject to adjustment for dilutive events, such as stock splits, stock dividends or the payment of cash dividends or distributions above a negotiated threshold.
- **Complex instruments with many variables**. Convertible notes offer a wide variety of features and are subject to complex tax and accounting considerations (for instance, to maintain treatment as debt). Key variables include the extent of any covenants included in the governing indenture (which may be limited), change of control or fundamental change protections, call protections and redemption terms, settlement methods on conversion (cash, shares or a mixture thereof) and whether conversion is fixed or contingent.

Convertible notes – manner of sale

- **Rule 144A offering to QIBs**. While other mechanics, such as a registered underwritten offering, are available, a convertible note issuance is often conducted as an unregistered offering under Rule 144A under the United States Securities Act of 1933, as amended (the Securities Act). Under Rule 144A, initial purchasers (analogous to underwriters in a registered offering) acquire the convertible notes from issuer in a private placement and immediately resell to Qualified Institutional Buyers (QIBs). QIBs are generally institutions that own or invest at least $100 million of unaffiliated securities on a discretionary basis.
- **Fungibility under Rule 144A**. Convertible notes issued in a Rule 144A offering must not be fungible with the listed equity security, requiring a conversion price premium of at least 10% (note that this is the lower limit and there are many Rule 144A issuances with greater conversion premiums).
- **Registration rights**. While senior notes issued in a Rule 144A offering are often subject to registration rights requiring the issuer to conduct a registered exchange offer to issue freely tradable securities, convertible notes are typically not subject to registration rights. Instead, QIBs may trade with other QIBs pursuant to Rule 144A and the issuer may agree to take steps to allow holders to sell under Rule 144 and remove the restrictive legend from notes held by non-affiliates after satisfaction of the relevant holding period.
- **Offering memorandum**. Rule 144A offerings are conducted using a confidential offering memorandum including disclosure similar in scope to what would be required in a registered offering.

D. Private Placements under the ACIC's Model NPA

What are 4(a)(2) Notes?

We use the term "4(a)(2) Notes" to describe unsecured notes issued in private placements pursuant to Section 4(a)(2) of the Securities Act, and documented using the Model NPA. Investors in 4(a)(2) Notes are typically insurance companies and other large institutional investors, which may be domestic and located outside of the United States.

How is the Model NPA Structured?

The Model NPA contains many of the necessary deal terms and mechanics that would be included in a note purchase agreement and an indenture. In particular, the Model NPA includes standard closing mechanics, conditions precedent, representations and warranties of the issuer and the purchaser, information delivery requirements, payment provisions (including prepayments with payment of a make-whole amount), affirmative and negative covenants and events of default. This allows for relatively quick and cost-effective negotiation. However, parties may also negotiate additional provisions that are not included in the Model NPA. Of particular note, the Model NPA does not contain any financial maintenance covenants, so these will need to be negotiated between the parties if desired. It is also common for parties to focus their negotiation on the prepayment and make-whole provisions. In addition, parties often add mechanics that allow the issuer to issue additional notes under the same agreement, much like an "add-on" or "re-open" of a traditional indenture.

How do 4(a)(2) Notes differ from Rule 144A notes or registered notes?

Unlike in a traditional notes placement, an issuer using the Model NPA delivers physical notes to noteholders and makes interest payments directly to noteholders. There is no need for an underwriter or initial purchaser (although a placement agent is sometimes engaged), nor is there a need for an indenture trustee or a separate indenture. In placements where notes are issued to a large number of holders, however, the issuer may choose to engage a paying agent to handle interest payments and communications with noteholders. There is often no offering document or, if one is used, it is typically much shorter than a traditional private placement memorandum or prospectus. 4(a)(2) Notes are sold only to large institutional investors that typically hold the notes until maturity. Accordingly, a resale market does not develop, which may result in the issuer obtaining less favorable pricing terms than it would have obtained in a Rule 144A placement or registered offering. 4(a)(2) Notes may be secured or unsecured.

Can the Model NPA be used for loans from private credit managers to its investment vehicles?

Yes. The standard terms and user-friendly mechanics make the Model NPA an effective way to document these loans in a quick and cost-effective manner. Also, it is not uncommon to supplement the Model NPA with affirmative, negative and financial covenants similar to those found in a fund-level revolver.

On balance, what are the pros and cons for managers of 4(a)(2) Notes?

Pros

- Ease of Execution: Relative ease of documentation results in lower costs and faster execution.
- Ease of Administration: A small noteholder base and absence of indenture trustee simplifies consent process and other communications with noteholders.

Cons

- Less Favorable Pricing: Resale restrictions and absence of trading market may result in less favorable pricing terms than in a Rule 144A private placement or an underwritten offering.
- Difficulty of Administration: If 4(a)(2) Notes are sold to a larger number of noteholders, interest payments and noteholder communications can become burdensome and the issuer may need to engage a paying agent to assist.

III Structured Credit Products

A. Product Types

1. Repurchase Agreements

What is a repurchase agreement or repo?

A repo is a bilateral contract pursuant to which the borrower, acting as a "seller," sells to the lender, acting as a "buyer," a portfolio of assets that would ordinarily be pledged to the lender as collateral in a traditional secured financing. The purchase price for the portfolio is effectively the "principal amount" of the financing. Usually, the purchase price is some percentage of the initial value of the portfolio – e.g., 60–70% – which equates to an advance rate. At maturity, the borrower repays the financing by repurchasing the portfolio. Interest payments can either be made periodically or at maturity, where the repurchase price would be increased to account for accrued interest. During the term of the repo, the parties will typically exchange margin periodically to reflect changes in the value of the portfolio of assets.

In situations where it may be too difficult or time consuming to transfer the portfolio of assets, a repo can also be structured so that the assets are retained by the borrower (or a financing subsidiary), and notes can be issued backed by those assets. In this structure, the notes themselves would be sold to the lender under the repo. In addition, the parties may negotiate what rights, if any, the borrower may have in respect of the assets subject to the repo. Repos are typically, but not always, evidenced through industry standard documentation called a Master Repurchase Agreement (MRA) under New York law or a Global Master Repurchase Agreement (GMRA) under English law.

The parties expressly state in the repo documentation that the transactions under the agreement constitute sales and purchases. Nevertheless, the MRA provides for a back-up security interest granted by the borrower as the Seller under the agreement. The MRA states that in the event that the repurchase agreement is recharacterized as a secured loan, the borrower is deemed to have pledged to the lender the portfolio of assets as security that was intended to be sold under the repo.

2. Total Return Swaps

What is a total return swap?

In a total return swap (TRS), a lender agrees to provide to the borrower the investment returns on a portfolio of loans or other assets in exchange for (or "swapped" for) periodic interest payments. A TRS is often referred to as a "synthetic" financing because the borrower does not directly receive any loan proceeds from the lender and does not hold or acquire the assets subject to the financing. Instead, under a TRS the borrower instructs the lender to acquire certain assets, and the lender agrees to make periodic payments to the borrower based on the distributions received from those assets. The borrower may also instruct the lender to dispose of some or all of the assets in the portfolio. In that case, the lender will pay to the borrower any realized gains, and the borrower will pay to the lender any realized losses. The "total return" of the swap means both the distributions on the portfolio, together with any gains or losses on that portfolio, accrued to the borrower. Generally, parties will enter into a TRS on a net basis, where the parties' payment streams are netted against one another with the borrower receiving or paying, as the case may be, only the net amount of those streams.

The borrower will also usually be required to pledge in cash a certain percentage of the initial value of each portfolio asset subject to the TRS, often 20–25%. The inverse of this margin percentage is effectively the advance rate in a TRS. As with a repo, the parties to a TRS will typically exchange margin periodically to reflect changes in the value of the portfolio of assets.

As with repos, the parties will negotiate any rights, particularly voting rights, that the borrower may have in respect of the assets under the TRS. A TRS can also be structured to require that the lender deliver the portfolio of assets to the borrower at maturity. To facilitate this type of physical settlement of the TRS, the lender will often form an SPV to hold the portfolio. At maturity, rather than transferring each individual portfolio asset, the lender will transfer to the borrower its equity interest in the SPV.

The TRS and the related collateral requirements are usually documented on an ISDA Master Agreement, a Schedule that allows the parties to modify the ISDA Master Agreement and a Credit Support Annex that sets forth the key terms of the collateral arrangements.

3. Forward Contracts

What is a forward contract?

In a forward contract, one party (here, the borrower) directs another party (here, the lender) to acquire a portfolio of assets on or after the closing date that will be sold to the borrower for a fixed price at maturity. The purchase price of the portfolio is effectively the principal amount of this type of financing. Interest payments can either be made periodically or at maturity, where the forward purchase price would also take into account accrued interest.

As with a TRS, the borrower will usually be required to deliver an upfront margin amount to the lender, which reflects the borrower's equity position in the portfolio. Similar to both a repo and TRS, during the term of the forward, the lender may mark the portfolio to market and the parties may be required to exchange margin on a periodic basis. In some cases, the lender will also pledge the portfolio to the borrower to secure the delivery of the portfolio at maturity. As with TRS contracts, forward contracts are usually documented on form ISDA documentation.

B. Structural Benefits

Why do borrowers enter into repos, TRSs and forward contracts?

Market participants structure financings as repos, TRSs and forward contracts for a variety of reasons. These transactions

are entered into on industry-standard documentation that can reduce the required time and effort for negotiation and drafting. In some cases, legal opinions may not be required.

In addition, the "lender" in these types of contract enjoys preferential treatment under the Bankruptcy Code in the event of a borrower's insolvency. These contracts can be structured to qualify as protected contracts under certain applicable sections of the Bankruptcy Code. As such, a lender's contractual right to cause the "liquidation," "termination" or "acceleration" of the relevant contract generally may not be stayed, avoided or otherwise limited by operation of any provision of the Bankruptcy Code. This safe harbor from the automatic stay will also typically allow the lender to set aside less regulatory capital against these types of financings.

In addition, in each of a repo, TRS and forward contract, the lender obtains an ownership interest over the portfolio rather than a security interest in pledged collateral. The lender does not have to be concerned with obtaining a perfected security interest over the assets or with a foreclosure process in the event of a default. These structural features of repos, TRSs and forward contracts address a number of credit and market risks inherent in traditional secured financings, and together with the regulatory capital benefits for the lender, often provide borrowers with materially better financing rates.

On balance, what are the pros and cons for managers of repos, TRSs and forward contracts?

Pros

- Cost Efficient Financing: these types of products generally allow lenders to provide more attractive financing rates due to reduced capital charges.
- Ease of Execution: these products are often documented on industry standard forms that can reduce the time needed to negotiate and draft the documentation. In some cases, particularly with TRSs, legal opinions may not be required.
- Follow on Financings: once the parties agree to the documentation for an initial repo, TRS or forward, this documentation can be used for additional similar financings between the parties even in situations when the underlying assets being financed may differ.

Cons

- Ability to Manage Assets: with these products, the lenders will acquire and hold the assets being financed through the term of the transaction. Borrowers will need to negotiate what rights (e.g., voting rights) they may exercise with respect to those assets prior to the maturity of the transactions.
- Margining: each of these products will typically require periodic mark-to-market margining, which may present challenges to borrowers with liquidity needs during stressed market conditions.
- Abstruse Terminology: the standard documentation for these products, particularly TRSs and forward contracts on ISDA documentation, includes terms and provisions that may be difficult initially to understand and navigate.

As described above, there are many financing options available to a manager and each has its advantages and disadvantages. Many of the managers we advise have been able to successfully utilize several of these structures, often simultaneously, to leverage their investment portfolios and finance their private debt platforms at all levels. The availability of these structures permits managers to pursue a flexible and diversified leverage strategy that aligns with their overall investment strategy and that can adapt to evolving market conditions.

Endnotes

1. Robin Armitage, Creditflux, *CLO 2021 outlook: back to the 'old' normal with volumes, spreads and structures to revert to pre-covid levels* (Dec. 18, 2020), available at https://www.creditflux.com/CLOs/2020-12-18/CLO-2021-outlook-back-to-the-old-normal-with-volumes-spreads-and-structures-to-revert-to-precovid-levels.
2. The ACIC currently publishes four forms of model NPAs. The appropriate model depends on whether the issuer is a U.S. or non-U.S. issuer and the issuer's credit rating.

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An Overview of Debtor in Possession Financing

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Introduction

When companies with existing credit facilities are in financial distress, whether as a result of adverse market forces, covenant or other defaults under their debt facilities or unexpected business interruption, they may lose access to liquidity under their credit facilities or face the potential exercise of remedies by lenders under such credit facilities. In such circumstances, since a leveraged company's assets are typically pledged to secure its existing indebtedness, it is nearly impossible to attract new capital to continue operations or to refinance existing debt. A chapter 11 bankruptcy can provide such a distressed company with an opportunity to obtain financing in the form of debtor in possession financing ("DIP Financing"). With the uptick in chapter 11 filings over the past year resulting from the COVID-19 pandemic, DIP Financing is more relevant than ever.

DIP Financing provides a lifeline to companies that would otherwise run out of cash and have no ability to satisfy near-term obligations, including payroll, rent and other operating expenses. Lenders may be willing to provide DIP Financing to otherwise non-credit-worthy companies because they receive lender protections that are not available outside of a chapter 11 process, including the ability to prime existing liens, court approval of the financing terms to avoid future challenges by other creditors and strict controls on how the borrower spends the funds.

While the benefits to the debtor are obvious, creditors and lenders have strategic incentives to provide or consent to the DIP Financing. As a simple economic matter, DIP Financings typically have higher interest rates and fees than lenders can obtain outside of chapter 11 for similar loans, and are a relatively safe investment due to the protections afforded by the Bankruptcy Code and the Bankruptcy Court. As a result, DIP Financing is a relatively safe high yielding investment.

In addition, the debtor's existing pre-bankruptcy lenders frequently use the various mechanisms available to DIP lenders to help protect their existing investment in the debtor and, in some cases, make a play for ownership of the reorganised entity post-emergence through the DIP Financing. An understanding of the basics of DIP Financing and how the various and often conflicting interests of the debtor, its DIP lenders, and creditors are addressed within a chapter 11 case provides a crucial insight into one of the driving forces of the reorganisation process.

Further, investors may seek to provide DIP Financing to better position themselves for a subsequent bid to acquire the debtor. However, as is discussed below, there is a limit to how much the financing can lock up the debtor for the financing source as the DIP Financing cannot be used as a sub rosa chapter 11 plan.

DIP Financing Under the Bankruptcy Code

DIP Financing, like other aspects of chapter 11 bankruptcy, is governed by chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code").[1] Specifically, section 364 of the Bankruptcy Code authorises DIP Financing arrangements by allowing the "debtor" to obtain post-petition (i.e., post-bankruptcy filing) credit.[2] It also incentivises both new and existing lenders to make loans by offering them special protections.

If the debtor needs to incur unsecured debt outside the ordinary course of business during the pendency of the chapter 11 case, it must obtain approval of the Bankruptcy Court under section 364(b) of the Bankruptcy Code. To encourage lenders ("DIP Lenders") to extend unsecured financing to a debtor, the Bankruptcy Code provides DIP Lenders with an administrative expense priority under section 503(b) of the Bankruptcy Code. Being granted a priority as an administrative expense means that a DIP Lender's claim for repayment of the unsecured DIP Financing will have priority over all other pre-petition unsecured claims, which must be paid in full, in cash in order for the debtor to emerge from bankruptcy, unless otherwise agreed to by the lender.

Often, a simple administrative expense priority is insufficient to induce lenders to provide unsecured DIP Financing. If the debtor is unable to obtain unsecured financing, the Bankruptcy Court may authorise a debtor to obtain secured financing under section 364(c) of the Bankruptcy Code. Under section 364(c), the DIP Lender's DIP Financing will be given a superpriority over any and all other administrative expenses of the estate along with a security interest in any unencumbered assets, or a junior lien on already encumbered assets. Credit obtained under section 364(c) not only requires the approval of the Bankruptcy Court, but also requires the debtor to prove to the court that it could not obtain financing on an unsecured basis.

If the debtor is still unable to obtain sufficient funding secured only by previously unencumbered assets and a junior lien on already encumbered assets, the debtor can obtain secured financing under section 364(d) of the Bankruptcy Code. Under that section, a debtor can also offer a priming lien, which is a lien on collateral senior to existing, pre-petition liens on such collateral and requires the DIP Lender's claims to be paid prior to the payment of claims by the existing lenders secured by the same collateral, regardless of whether the source of payment is the sale of proceeds of the common collateral. Financings under section 364(d) are similar to financings authorised under 364(c) in the sense that this section is only available to the debtor if the debtor proves to the Bankruptcy Court that, without a priming lien, it could not otherwise obtain such financing. This ability to offer a priming lien on already encumbered assets is not

available outside of chapter 11 and is one of the primary reasons that debtors can attract DIP Financing in chapter 11 when access to credit, even secured debt, was unavailable outside of bankruptcy.[3]

While the ability to prime liens is of great benefit to DIP Lenders, because of the impact such liens have on the interests of the existing secured lenders, the Bankruptcy Code provides significant protections to the existing lenders whose liens are being primed. If the debtor seeks to prime existing liens, the debtor must either obtain consent from the lenders being primed or it must ensure that the interest of such lenders in the collateral is adequately protected against diminution of value resulting from the priming. Adequate protection, as defined in section 361 of the Bankruptcy Code, may include:

1. a cash payment or periodic cash payment by the debtor to the creditor to the extent that the value of the creditor's collateral depreciates or otherwise decreases;
2. an additional or replacement lien to make up for any decrease in the value of the creditor's collateral; or
3. granting such other relief as will result in the realisation of the "indubitable equivalent" of the creditor's interest in the collateral.

Existing lenders will typically resist getting primed and will challenge the adequacy of the protections being offered. Insofar as a contested priming fight can be a very difficult, highly contentious, and destabilising proceeding for the business, debtors typically try to avoid a "priming fight" in the early stages of its case and will seek consent from the existing lenders or negotiate with them to provide the DIP Financing. As a result, the priming DIP Financing is generally provided by existing lenders who prime their own existing liens as well as the liens of the co-lenders who do not participate in the DIP Financing.

Additional DIP Lender Incentives

There are a number of other reasons why a lender would be interested in providing DIP Financing. First, DIP Financing typically provides lenders with relatively higher rates of interest than they would otherwise receive outside of chapter 11. In 2020, there were 42 chapter 11 cases in which the debtor sought approval of DIP Financing that had interest rates of at least 10%, and 16 which had interest rates of at least 12%. Such facilities were dominated by the consumer discretionary sector, including True Religion's 18% DIP loan. Other consumer discretionary DIP Financings with high interest rates included those from Punch Bowl Social with an 18% rate on its Tranche B DIP loans and Lucky Brand with a 17% rate. The highest rate for the year was utilities sector company CEC Development, whose DIP interest rate was proposed at 20%.[4]

In addition, DIP Financing is a way for the debtor's existing lenders to safeguard the value of their existing loans to the company. In many cases, were the debtor forced to liquidate precipitously after running out of funds, such lenders would almost certainly be faced with significantly lower recoveries on their loans. DIP Financing signals to vendors and customers that the debtor has sufficient capital to continue operations during the bankruptcy process or to conduct an orderly sale or liquidation process that can help maximise the existing lender's recovery.

Furthermore, existing secured lenders may provide the DIP Financing as a defensive measure, as they may not want outside lenders to obtain junior or priming liens on the collateral that is already securing their loans or senior liens on unencumbered assets. Given their existing investment in the company, existing lenders often want to control their own destiny by providing the financing and dictating the direction and timeline of the chapter 11 proceeding. They risk losing such control if a third-party lender comes in and provides the DIP Financing.

Outside of bankruptcy, lenders are always able to exert some control over their borrower's financial activities through negotiated covenants in loan documents. However, for companies that had strong credit prior to financial distress, the covenants typically allow the business to operate without restriction in the ordinary course. Additionally, there can be a concern outside bankruptcy that micromanaging the business might invite lender liability claims or cause disputes with other creditors, thus resulting in less control by the lender. In contrast, DIP Loans have tight covenants and impose strict control over disbursements, and the cost of the requisite monitoring is paid by the debtor. Moreover, the terms of DIP Financing and the controls placed up on the debtor are approved by the Bankruptcy Court, and thus DIP Lenders are insulated from lender liability and similar claims. Therefore, DIP Lenders typically exert significant control over the debtor by requiring, among other things, strict compliance with an agreed-upon weekly budget and financial and non-financial covenants, detailed and frequent reporting, appointment of a chief restructuring officer acceptable to the DIP Lenders, and compliance with milestones for a condensed chapter 11 timeline.

While these controls keep a tight rein on the debtor's expenditures and provide the lender with early warnings if the company deteriorates further, the DIP Financing milestones also provide the DIP Lender with significant control over the timing and direction of the case. For example, the DIP Financing may require the debtor to obtain court approval of a chapter 11 plan on an expedited timeline. The DIP Financing may also require a sale of substantially all of the debtor's assets under section 363 of the Bankruptcy Code if the plan milestones are not met.[5]

Where the DIP Lenders do not believe that a reorganisation of the debtor will be feasible or where they believe such reorganisation would be too costly or time-consuming, the DIP Lenders may require the debtor to engage in a sale process quickly at the outset of the case. For example, given the current market pressures in the retail space, it is not uncommon for DIP Lenders providing financing to retailers to require a sale to occur within the first 30 to 60 days of the bankruptcy case.

A Bankruptcy Code 363 sale may be required by the DIP Financing (either from the outset or due to the debtor failing to meet a milestone). In such event, the DIP Lender has the advantage of being able to credit bid its secured claim under section 363(k) of the Bankruptcy Code. With a credit bid, a DIP Lender can use the amount of its secured claim to pay all or a portion of the sale price in an auction for the assets being sold, which protects the DIP Lender's interest in its collateral and ensures that its secured claim will not be undervalued.

Finally, existing pre-petition lenders that provide the DIP Financing may also negotiate for other special protections such as roll-up and cross-collateralisation provisions to ensure that their pre-petition claims are given priority over the claims of other pre-petition creditors. Roll-up provisions typically require the debtor to draw on the DIP Loan to pay off either some or all of the lender's pre-petition claims. In other words, the lender's pre-petition debt is "rolled up" into post-petition debt, which improves the lender's prospect of receiving a recovery on its pre-petition investment by elevating its pre-petition claim to a post-petition secured claim with a superpriority administrative expense status.

Cross-collateralisation is another avenue the parties may take to achieve the same result. Those provisions grant a debtor a security interest in otherwise unencumbered assets of the company for both the DIP Lender's pre- and post-petition claims.

It is worth noting that neither roll-ups nor cross-collateralisation are expressly authorised under section 364 of the Bankruptcy Code. Further, the improvement of the status of a

DIP Lender's pre-petition claim over that of similarly situated pre-petition claims also conflicts with the general bankruptcy equitable principle that members of the same class of pre-petition claims receive equal treatment. Nevertheless, if the debtor has no other source of financing and lenders will not otherwise extend credit to the debtor without such provisions, Bankruptcy Courts frequently approve these provisions.

Lenders in syndicated credit facilities often take advantage of these benefits, as well as the ability to prime liens, to advantage their position over the other lenders within their credit facility. It is not unusual for several of the largest lenders under the existing facility to propose a DIP Financing that rolls up the pre-petition debt of the participating lenders and primes all of the liens securing the credit facility held by the non-participating existing lenders. If this group of lenders comprise the "required lenders" under the credit agreement, they may be able to direct the agent to consent to the priming of the liens and thus through the roll-up. Upon the roll-up, both the new money as well as their existing loans will become senior to the other lenders with whom they were previously *pari passu*. Of course, the minority lenders often object to such financing and may be afforded the opportunity to participate in the financing to resolve their objections.

As mentioned above, DIP Financing may be used by third-party investors to improve their chances of leading the debtor's reorganisation. If their approach is too aggressive, however, the court may refuse to approve the financing as a sub rosa plan of reorganisation. For example, in *In re LATAM Airlines Grp., S.A.*, 2020 Bankr. LEXIS 2405, 2020 WL 5506407 (Bankr. S.D.N.Y. September 10, 2020), the court refused to approve a DIP Financing. In this case, the original DIP Financing included a proposed Tranche C loan from two of the debtor's largest shareholders. The debtor would be permitted to require the Tranche C lenders to convert their loan to equity at a 20% discount to plan value in a plan of reorganisation. Although the debtor argued that this discount was a valuable asset, in a lengthy opinion the court rejected the DIP Financing as a sub rosa plan – a transaction that circumvents the chapter 11 requirements for confirmation, insofar as the Tranche C Lenders' rights would give them an advantage over other plan sponsors. Subsequently, the DIP Financing for this debtor was approved without the discounted equity provision and with the inclusion of a third-party investor into Tranche C.[6]

Negotiating DIP Financing

Negotiating the DIP Financing is often undertaken during a compressed period of time, while the company is under significant financial strain and on the verge of running out of money. Given that the debtor is *in extremis* and often has no other options, DIP Lenders have significant leverage. Nevertheless, the Bankruptcy Court approval process helps to balance the leverage as the Bankruptcy Court may ultimately not approve provisions that it views as too onerous.

When negotiating the DIP Financing, as an initial matter, the parties must agree on the type of chapter 11 case, such as whether the case will involve a quick liquidation, an organised sale process or a lengthier reorganisation proceeding. Based on that, the parties must negotiate and agree upon the amount of financing needed and the structure of the loan. Depending on the anticipated length of the chapter 11 case and the agreed use of proceeds, the DIP Financing may be comprised of a term loan and/or a revolving credit facility (including asset-backed facilities). The parties also must negotiate the economic terms, the collateral securing the DIP Financing, including the interests to be primed, affirmative and negative covenants and other special protections like roll-ups and cross-collateralisation.

Determining the amount of DIP Financing required for a chapter 11 process is more complicated than simply determining the amount of money needed to keep the business' operations running at the status quo and pay for the chapter 11 case. It also involves a strategic analysis of how new financing might impact the perception of the company among its vendors and suppliers. Often, by the time a company has filed for bankruptcy, all trade credit has dried up and the company is operating on a cash-on-delivery basis. A key assumption in any DIP Financing budget is whether and how quickly trade credit will return. Given the strict budget compliance requirements, wrong assumptions on issues such as trade credit can quickly lead to a default under the DIP Financing.

DIP Financings are evidenced by loan documents that can be based on the loan documents for the debtor's existing debt. Even though the Bankruptcy Court order is sufficient to constitute a perfected priority security interest on collateral, DIP Lenders will typically document their security interests in collateral and take actions otherwise required by law to perfect those security interests. While it is generally the case that DIP Financings are made pursuant to executed loan documents, the Bankruptcy Court has the ability to approve DIP Financing terms, including priming liens, based on a term sheet which it may do under exigent circumstances, and the debtor and DIP Lenders will subsequently negotiate and execute loan documents.

Court Approval of DIP Financing

In any situation requiring court approval for DIP Financing, the debtor will need to file a motion with the Bankruptcy Court for authorisation to obtain post-petition credit ("DIP Motion"). The DIP Motion will be accompanied by the proposed order to be granted by the court ("DIP Order"), the underlying loan documents, as well as affidavits by the debtor explaining the process by which the financing was obtained and the need for the financing. Frequently, due to the short time frame before the filing, the parties are still negotiating the loan agreement when the motion is filed, so they may only attach to the motion a commitment letter or drafts of the loan agreement.

Approval of the DIP Financing is often a two-step process. As the DIP Motion is often filed on the first day of the bankruptcy case without the opportunity for the creditors of the debtor to receive more than a day or two's notice, the Bankruptcy Code only permits the bankruptcy judge to grant interim approval of the amount of the DIP Financing necessary to avoid irreparable harm to the debtor. The Bankruptcy Court will then hold a hearing during the first few days of the case to consider approval of disbursal of a portion of the DIP Financing on an interim basis. Thereafter, notice of the financing will be provided to all of the debtor's creditors and the court will hold a hearing at least 14 days later to consider final approval of the DIP Financing.

Because of the bifurcated hearing process, it is fairly common for creditors and creditors' committees to raise objections to the financing at the final hearing. Often, these objections will focus on the milestones and other controls placed on the debtor by the lender, the roll-up and/or cross-collateralisation and other protections and benefits built into the DIP Financing. Whether the court will approve these provisions despite the creditors' objections will often depend on the court's perceptions as to whether the lenders would still make the financing available even if the court cuts back or eliminates such protections and benefits.

Conclusion

With the continued need of chapter 11 restructuring for large and complex businesses, the importance of understanding the role that DIP Financing plays in such restructurings remains

crucial to debtors and lenders alike. Financially distressed companies should allow as much time as possible to investigate the terms of all available sources of financing, and the challenges that each potential lender presents to its restructuring efforts. Lenders, on the other hand, should evaluate and weigh the benefits available as the provider of the DIP Financing. To do this, they must understand the full array of available protections and strategic control they may be able to exert on the debtor's case to best position themselves and protect their pre- and post-petition investments.

Endnotes

1. During a chapter 11 case, the debtor generally continues operations and restructures its debt under the Bankruptcy Court's protection and oversight, or can otherwise conduct an orderly liquidation or sale process. This is different to a chapter 7 case where a trustee is appointed to conduct a liquidation process.
2. A company operating under chapter 11 is referred to as the "debtor". Because the debtor remains in possession of its assets and its board remains in place, it is referred to as the "debtor in possession".
3. There are many factors that may affect a lender's decision not to extend credit to a financially distressed company that has not yet filed for bankruptcy protection, such as potential avoidance actions or the impact of the automatic bankruptcy stay of creditor remedies.
4. Reorg Research, *2021 Year in Review* (Jan. 19, 2021).
5. Section 363 of the Bankruptcy Code provides, among other things, for the sale of a debtor's assets free and clear of all liens, claims, encumbrances and interests of third parties.
6. Rich Archer, *LATAM Gets Approval for Revised $2.45B DIP Plan*, Law 360 (Sep. 18, 2020), https://www.law360.com/articles/1311652/latam-gets-approval-for-revised-2-45b-dip-plan.

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Developments in Midstream Oil and Gas Finance in the United States

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Growth of Private Equity in Midstream Oil and Gas

The Midstream Sector at a Glance

The United States midstream oil and gas sector did not escape COVID-19's wrath in 2020, as it witnessed a decrease in total enterprise value from $770 billion in 2019, to $665 billion in 2020. This drop in value coincided with a 47% decrease in energy M&A activity from the previous year. Nonetheless, midstream continues to be a large component of the oil and gas sector in the United States.[1]

In terms of pipelines, the U.S. network is the largest in the world, extending about 3 million miles.[2] This network contains an extensive sub-network of gathering lines, extending from main pipelines into regional producer areas.[3] For crude, this sub-network extends over nearly 75,000 miles. For natural gas, whose development is a more recent phenomenon, the gathering line sub-network is less extensive, but growing quickly. Shipment of crude, natural gas and other related products by pipeline in the United States quite simply dwarfs all other means of transport. This sector is predicted to grow even more in coming years, despite regulatory uncertainty predicated on the Biden administration's public commitment to a focus on climate change regulation and a corresponding transition away from fossil fuels. The reasons for this growth are multiple.

Growth Factors

The extensive pipeline infrastructure in the United States has allowed the oil and gas industry to thrive, connecting regional markets to other regional markets, power plants, refineries and export facilities across the United States. This has been a decade-long process, leading to a situation in which 70% of all crude, natural gas and related products are shipped by pipeline. This also means that the pipeline infrastructure in some cases is ageing, leading to leaks, ruptures and spills. Over the past decade, there have been over 3,000 pipeline spills in the United States.[4] Nearly half of the pipelines are over 50 years old. Combined with the growth in the need for natural gas pipelines and gathering line networks stemming from growth in regions such as the Bakken, Eagle Ford, Marcellus, Permian and Utica shales, the need to replace ageing mainline pipeline infrastructure only points to increased capital needs for the foreseeable future.

Furthering this trend, the United States is predicted to account for more than half of worldwide growth in oil production capacity over the next five years. Fuelling this are a number of factors such as increases in oil output and the mismatch between U.S. crude production and U.S. refiner demand, discounts in U.S. crude prices relative to other producers driving export demand, and an increased demand expectation for so-called "sweet" crudes with lower sulphur content (the predominant type produced in the United States) due to international requirements and limitations on many refiners' ability to remove sulphur from crude, further driving export demand.[5]

On the natural gas side, it is predicted that more than $150 billion in midstream assets are needed over the next decade to reduce bottlenecks and move shale gas from its various basins to demand centres, ports and refineries. Operators in the Marcellus, Permian and Utica shales are already investing in regional projects to provide capacity.[6] In addition, the liquefied natural gas (LNG) facilities on the U.S. Gulf Coast are in need of pipelines to feed exports. Over the coming two decades, nearly $800 billion is expected to be required, given these trends.

In addition, there is continued build out of natural gas, natural gas liquids (NGL) and oil pipelines to demand centres in the South Gulf Coast, such as South Texas and Louisiana. Much of the pipeline capacity added in 2019 through 2020 was built to provide such capacity. These pipeline projects include Kinder Morgan's Gulf Coast Express Pipeline (which is expected to transport hydrocarbons to the Gulf Coast), El Paso Natural Gas Pipeline's Northern Delaware Basin Expansion Project, Cheniere's MIDSHIP Pipeline (which will deliver natural gas from Oklahoma to the Sabine Pass LNG Facility), Texas East Transmission Company's Stratton Ridge Expansion (which will deliver gas to the Freeport LNG facility), TC Energy's Alberta Xpress expansion project (which is expected to deliver natural gas from Westdale, Louisiana to Starks, Louisiana), Phillips 66 and Trafigura's joint venture Bluewater Texas Terminals (which includes pipelines that are expected to transport crude to offshore export terminals from onshore storage terminal in Taft, Texas that will be fed with crude from the Permian and Eagle Ford basins), and Kinder Morgan's Permian Pass Pipeline (which is expected to deliver gas from the Permian basin to the Gulf Coast).[7] The expansion of delivery pipelines to the Gulf Coast is expected to spur further development of new downstream facilities and storage terminal projects over the coming years, including methanol, ethylene, ammonia and LNG export facilities. As a result, new greenfield industrial facility developments would also require significant capital investments over the coming years.

Despite the continued development of pipelines and demand for long-term investments in 2020, the gathering and processing sector (i.e., midstream infrastructure closer to the wellhead) was impacted heavily by COVID-19 and the economic downturn it ushered. With the North American oil and gas producers having

to cut back on output, most of the proposed pipeline and infrastructure projects in the South Gulf Coast came to a halt in 2020. A measurable recovery appears to be in the offing, but it remains to be seen whether additional regulations will be imposed on the pipeline industry by the Biden administration following the issuance of several executive orders affecting midstream markets (e.g., the planned revocation of the Keystone XL pipeline permit), potentially hampering an otherwise faster recovery.[8]

Private Equity's Search for Assets

The growth of the midstream oil and gas sector as a financeable infrastructure asset is largely the product of a number of simultaneous developments.

The first development is on the private equity side of the equation. Private equity's overall capital pool has continued to grow over the past decade, and for infrastructure-focused funds, the pool of available traditional (or "core") infrastructure assets in need of capital – or more accurately, in need of capital in exchange for rates of return sufficient to justify certain types of private equity investment – has steadily decreased. These core infrastructure assets have most traditionally encompassed toll roads, airports, rail and electric power plants. In respect of electricity generation, the plants of the base load long-term contracted variety (e.g., natural gas and coal) were eventually joined by quick-start peaking plants as well as, over the past decade, renewable projects, such as wind and solar. Beyond just the expansion of the asset class to private equity and lenders, once routine features underpinning their bankability on a non-recourse basis (such as long-term contracted offtake agreements) have become rather rare – these assets more often than not now are "merchant", though revenues are backstopped somewhat by energy commodity hedges. But the returns for such assets have continued to move downward (absent a unique risk profile for a particular plant or a particular power market).

As the asset class has continued to mature and the inherent risks thereof have become more predictable, the market has driven down the return profiles. These developments have resulted in a search for infrastructure-focused private equity for new assets, the search for the next so-called "core plus". Commercial lenders and long-term institutional investors that focus on infrastructure have seen the same developments over the past decade – more competition for bankable assets, driving lower yields and leading to stores of capital in search of deployment.

Midstream Assets in Search of Capital

The assets that Master Limited Partnerships (MLPs) would typically acquire are of a largely midstream variety: pipelines and logistics facilities – stable income-generating assets which, while beholden to swings in commodity prices and wellhead production (given their reliance on utilisation by producers sending product to market or storing it), were not as directly at risk (usually as a result of producer diversification and minimum volume commitment (MVCs) capacity charges). Although, like the developments in the "core" power infrastructure space, the types of assets treated as "midstream" have evolved over time, moving closer and closer to the wellhead. Today, while pipelines, terminals and storage facilities would still be quintessential "midstream" assets (as well as LNG facilities), the class now also includes assets much closer to the wellhead and upstream activities: gathering and processing (G&P) systems that bring crude, natural gas and NGL to the pipelines and water gathering and disposal systems. It is this value chain that private equity has stepped into in recent years, and with it, private equity has brought along its commercial banks and institutional investors, many of whom had seen first-hand the developments in the power sector (and the expansion of that asset class).

On the commodity front, the crude oil price downturn that began about seven years ago led a number of corporates to pull back from equity markets due to capital cost increases resulting from share price decreases. The commodity prices may have risen in the last three years, but there remains a continued desire for restraint on the part of the corporates and their MLPs. This has further contributed to an environment in which private equity has been able to make inroads. While these investments were negatively impacted in 2020, as previously mentioned, there is still a need for long-term growth in the asset class.

Another development is on the corporate and tax side of the equation. Over the past several decades, oil and gas-focused corporates have binged on MLP structures, separate investment vehicles that would steadily acquire income-producing oil and gas assets (primarily midstream-style logistics operations). The payment streams from acquisitions by these MLPs would fund further development capital for the corporates, and the corporates would continue to see ongoing revenues (and maintain control over the assets) by virtue of their management interests in the MLP. MLPs have, over the past few years, seen many corporates opting to fold the vehicles back into the corporate, or have the MLP itself convert into a C-corp. And many of the remaining MLPs have begun acting much more like private equity untethered from their parent corporates, acquiring new assets from outside their corporate structure. Furthering this trend is the fact that a very attractive feature of MLPs was the tax pass-through nature of the MLPs (the MLPs themselves remained untaxed, while such taxes were passed through to the ultimate investors). Where corporate tax rates were the same or higher than corporate tax rates, a tax pass-through structure could reliably provide greater tax efficiencies. However, in addition to other tax law changes, the federal income tax changes in 2018, which have seen corporate tax rates fall considerably below individual tax rates, have created an environment where, when a corporate intends to keep captive its assets, electing S-corp rather than C-corp treatment may not have as much value, particularly when weighed against other considerations inherent in MLPs (such as the administrative burden of establishing and maintaining an MLP). Furthermore, private equity generally has a lower cost of capital (thus lowering the hurdle-rate for returns) as compared with MLPs. Additionally, private equity investors can take time to see investments through, while MLP investors tend to be quarterly result- and distribution-focused. These factors have given private equity an ever-increasing opportunity to gain ground in the sector.[9]

Private Equity Growth in the Years Leading to 2020

In the years leading to early 2020, private equity steadily increased its foothold in various key midstream regions (a trend that began in earnest in 2017), such as the Permian Basin and the Marcellus and Utica shales, competing with public corporates as they target existing assets and build new infrastructure.

For example, linking assets in West Texas, Ares-backed EPIC is developing a 700-mile y-grade (i.e., NGL) pipeline connecting the Permian and Eagle Ford basins to refineries and export terminals in Corpus Christi, Texas. UBS and Deutsche Bank led a $650 million TLB and $40 million super-priority revolver to finance the project.[10] A parallel crude pipeline project is also being developed by Ares-backed EPIC.[11] Later on in 2018, the

Salt Creek Midstream G&P system was expanded to include additional cryo processing facilities, crude and natural gas gathering lines and water gathering and disposal infrastructure. Deutsche Bank arranged an additional $300 million for the upsized project, bringing the total financing to $650 million.[12] In respect of other midstream asset sub-classes, ArcLight Capital Partners in late 2018 acquired from Targa Resources assets including a refined products and crude oil storage and terminal facilities in Tacoma, Washington and Baltimore, Maryland.[13]

2019 witnessed continued growth in private equity investments in the midstream sector, driven somewhat by the downward-trending equity prices of midstream companies. Leading examples are Blackstone Infrastructure Partners' acquisition of the general partner of Tallgrass Energy (TGE) and 44% interest in TGE for $3.3 billion.[14] Credit Suisse arranged a $1.155 billion senior secured facility to fund a portion of the transaction consideration.[15] Funds managed by Blackstone Tactical Opportunities and GSO Capital Partners purchased a 45% interest in Targa Badlands for $1.6 billion.[16] The Williams Companies (WMB) and the Canada Pension Plan Investment Board (CPPIB) announced a JV in the Marcellus and Utica shales, with CPPIB investing $1.34 billion for a 35% interest in WMB's now wholly owned Ohio Valley Midstream and Utica East Ohio Midstream systems.[17] Stonepeak Infrastructure Partners acquired Oryx Midstream, the largest privately held midstream crude operator in the Permian Basin, for $3.6 billion.[18] Following the acquisition, Oryx Midstream announced that an affiliate of Qatar Investment Authority acquired a significant stake in Oryx Midstream from Stonepeak Infrastructure Partners.[19] S&P reported that of the eight announced deals in excess of $1 billion for which transaction value was reported in the first half of 2019, only two involved MLPs (MPLX LP and EQM Midstream Partners LP).[20]

The Field Today

As the world economy slowed down considerably during 2020, so did the demand for oil and gas products. Such decline accelerated a downward demand trend already in existence prior to the pandemic, primarily galvanised by countries' responses to climate change. Such compounded disruption has resulted in several bankruptcies and restructuring across the oil and gas industry. Notable among them is the Salt Creek Midstream restructuring. In July of 2020, Salt Creek Midstream, one of the largest privately owned gas gatherers and processors in the Delaware basin in Texas, developed by Ares Management and ARM Energy Holdings' joint venture, closed on a comprehensive recapitalisation with additional investments from both its existing lender groups and funds managed by Ares Management. The recapitalisation was consensual and approved by 100% of the lender group. The new capital structure provides Salt Creek Gas with increased financial flexibility, improved cash flow generation capacity, and the ability to seek to raise additional capital for growth projects and other funding needs.[21]

Despite the above-described challenges engulfing the midstream oil and gas sector, several impressive private equity investments crossed the proverbial finish line in 2020. Among the many private equity investments this year, in February, EQM Midstream's announced its acquisition of Equitrans Midstream, a natural gas gatherer in the Appalachian Basin, for a value of $1.84 billion. In March, Encap Flatrock Midstream announced its $500 million investment in Tatanka Midstream, a newly launched independent energy company focused on acquiring and building midstream assets in North America. In July, Berkshire Hathaway announced its acquisition of Dominion Energy's natural gas transmission and storage business, for a total value of $8 billion; and CNX Resources announced its acquisition of CNX Midstream, an operator, developer and acquirer of natural gas gathering and other midstream energy assets, for a total value of $357 million. In August, Brookfield announced its acquisition of a 40% stake in Cheniere LNG, an LNG infrastructure company headquartered in Houston, Texas, for a total value of $6.8 billion.

Private equity firms, along with midstream developers, are keeping an eye on the U.S. regulatory landscape. Several of the many executive orders issued during the first week of the Biden administration were focused on a federal response to climate change. These executive actions, among which was a pause on oil and gas leasing on federal lands, are part of a broader administration policy of development of renewable energy projects that creates additional uncertainty to the near-term midstream outlook. Notably, however, these recent actions do not affect oil and gas activity on private lands, State lands or tribal lands, where the vast majority of U.S. oil and gas development (and midstream infrastructure) is located.

While inevitably slower moving than an executive order, midstream developers will be keen to stay on top of federal rulemakings that could impact permitting of future linear projects as well as potential changes to leadership at the Federal Energy Regulatory Commission. In addition, anticipated changes to the U.S. Army Corps of Engineers' nationwide permitting program or the Clean Water Act's water quality certification process could challenge timelines (and capital budgets) of desired midstream projects.

Growth of TLB Facilities on a Project Financing Basis

Development of Project TLBs

Until the 2008 financial crisis, projects benefitting from high-quality contracted revenues were financed on a single-asset or small portfolio basis by European commercial banks utilising project finance structures. In brief, project finance structures (usually term loan As (TLAs)) are characterised by substantial amortisation payments, lower, if any, balloon payment at maturity, significant lender oversight of project contracts (such as construction, operations/maintenance and revenue contracts) and direct arrangements between counterparties and lenders, control over cash flows (through a depositary-controlled waterfall), robust notice and reporting regimes and tighter covenants. A traditional project financing sees lenders financing an asset on the basis of stable contracted cash flows with credit-worthy entities to ensure the project succeeds and the loan is repaid, which is the reason that project financing structures are often utilised to support under-construction projects where no project sponsor operational track record has been established. Domestic projects, such as electricity generation facilities and liquefied natural gas facilities, typically benefitted from such long-term fixed-price offtake agreements. TLA lenders (typically European commercial banks) were able to lend against a constant stream of cash flows, which covered operations and maintenance costs of the project and debt service.

Following the 2008 financial crisis, European commercial banks became subject to stricter capital and liquidity requirements, which resulted in diminished availability of such capital. Additionally, the abundance of low-cost natural gas in the U.S. market resulting from the rapid development of hydraulic fracturing technology and horizontal shale drilling drastically lowered fuel-supply costs for the power sector, but with

it came declines in the price of electricity. With such lower fuel costs, natural gas power plant projects, which historically relied on revenues from long-term offtake agreements to underpin project financings, now faced a changing landscape as a result of utilities and other traditional offtakers no longer needing to lock in long-term power purchase agreements, making such assets less appealing to European commercial banks. Such banks continued to invest in high-quality contracted assets, such as large capital-intensive liquefied natural gas projects benefitting from offtake contracts with highly rated counterparties, including Osaka Gas Co Ltd. and Chubu Electric Power Co. Inc. In 2014, Freeport LNG raised approximately $11 billion, making it the "largest fully non-recourse construction project financing in history".[22] However, natural-gas power projects (some of which had been under development for years), were required to find alternate sources of capital. Commencing in 2012, Panda Power Funds was one of the first sponsors to tap the institutional investor TLB market to finance a series of greenfield limited-recourse construction financings for gas-fired generation facilities in the ERCOT and PJM power markets. By adopting structural protections typically included in project finance transactions, but retaining the repayment and covenant flexibility of traditional TLB transactions, institutional TLB investors were able to absorb the relatively higher risk of an uncontracted or partially hedged asset, while enjoying the relatively stable returns afforded by an electricity generation facility and the lower default risk profile of a project financing. In March 2020, Moody's published its study, "Default Research: Default and Recovery Rates for Project Finance Bank Loans, 1983-2018" which reconfirmed, as reported by one co-author of the study, that "structural features, underwriting disciplines and incentive structures that characterise the project finance asset class have proven effective".[23]

Syndicated leverage finance TLBs, on the other end of the spectrum from project finance TLAs, rely heavily on the borrower and its ability to operate its business to drive revenues, with less oversight and control over the borrower; the key protections of lenders being excess cash flow sweeps, leverage ratios and covenant thresholds tied to the relative size of the business.

Power sector TLB financings vary, but as of 2019, they are characterised most commonly by light covenant controls over key project contracts (the number of which is fewer than a traditional project financing given the lack of revenue contracts) and the ability to replace them easily, the maintenance of an account waterfall (though in some cases permitting the borrower to itself manage the waterfall rather than a depositary bank) and the inclusion of leveraged finance-style EBITDA-based financial covenants, with excess cash flow sweeps at varying percentages. Construction-stage TLBs typically contain additional features that are more common to TLA financings, while operational power projects benefit from significant flexibility in the loan documentation.

In 2017, following the controversy surrounding the Dakota Access construction project financing involving a syndicate of TLA lenders, pipeline sponsors found the TLB market an attractive funding source. Equity investors in the Rover Pipeline, which was designed to transport 3.25 billion cubic feet per day of domestically produced natural gas from the Marcellus and Utica Shale production areas to markets in the United States and Canada, closed separate TLB financings in close succession, including the approximately $1.2 billion TLB to fund ongoing capital requirements associated with Traverse's 35% interest in the Rover Pipeline and the approximately $1.2 billion TLB to fund Blackstone's acquisition of 32.4% (net) interest in the same Rover Pipeline. In addition, in 2018, Traverse closed a $150 million term loan add-on to fund additional project costs incurred to complete the pipeline which did not impact ratings. Access to the TLB market at leverage exceeding 7× debt-to-EBITDA (projected to 5× debt-to-EBITDA by 2023) was available, in part, due to "long-dated, take-or-pay contracts having a weighted average tenor approximating 15.5 years".[24] While power projects may now access the hybrid TLB market on a "merchant" or "quasi-merchant" basis, the presence of shipper contracts representing a steady stream of revenues has remained integral to a midstream project's access to the hybrid TLB market (though the level of "take-or-pay" required is evolving).

Given the robust acquisition finance market commencing at the end of 2017 for midstream assets and the lack of capital in the public markets, a further evolution of the hybrid TLB financing structures accommodated the particularities of the midstream acquisition finance market.

Unique Considerations in Midstream O&G Finance Transactions

Debt financing in the oil and gas industry is one historically consisting of EBITDA-driven leveraged financings and reserve-based lending (RBL) financings, the former supporting existing operational concerns with earnings capable of repaying debt, the latter with projected oil and gas reserves providing the support for riskier upstream construction and development. In addition, Master Limited Partnerships afforded sponsors access to readily available public capital. In the past decade, with declining commodity prices, many borrowers of RBLs having become overextended, became insolvent. This resulted in an industry-wide reduction in RBLs, and while such financings continue for certain oil and gas players, they are less common. In addition, private equity money and commercial lending has shifted away from any significant new investments in the upstream sector. This pulling back from oil & gas by financial institutions and investors is a trend that is expected to accelerate during the coming years, particularly in light of recent commitments by 130 international banks to support implementation of the Paris Climate Agreement by signing the "Principles for Responsible Banking", which was launched at the UN General Assembly in September 2019.[25] Thirty banks led the development of the Principles for Responsible Banking, including Barclays, BNP Paribas, Citigroup, ING, Natixis, and Société Générale. Additionally, on October 1, 2020 the Equator Principles IV came into full effect. Equator Principle Financial Institutions, of which there are 116, including the entities above mentioned, are required to implement such principles in any future project.

With the coming of investment by private equity into the midstream sector, beginning with a wave of acquisitions of existing operational concerns, such as Blackstone's acquisition of EagleClaw in 2017 and GIP's acquisition of Medallion in 2017, both noted above, the TLB market, which has developed alongside private equity in the power infrastructure sector, followed.

Midstream TLBs

The midstream sector has taken the hybrid TLB structures, and adapted the structures to meet the needs of the asset class. For some midstream assets, the structures largely fit well from the beginning. A pipeline is a project very similar in many respects to a power project. A set amount of capex is required to reach completion. Prior to completion, no revenues will flow. Cost overruns are possible but are largely a known quantum; however, the sheer length of pipelines, the various terrains to be overcome, the property rights to be acquired and the fact that the

production in the area serviced by the pipeline will eventually decline does create a higher level (or at least a marginally varied type) of risk as compared to a power project built on a single plot. It is no surprise then that project finance-style TLBs have been utilised to fund construction of pipelines, just as they have for construction of power projects.

In addition, by utilising project finance structural protections, sponsors seeking financing for midstream assets have been able to utilise project finance methodology to obtain higher ratings in respect of higher closing date leverage than would be available using leverage finance methodology. At a very high level, Standard & Poor's Methodology for Project Finance Ratings requires four basic characteristics to rate a project's debt using such methodology, including limited purpose entities, senior ranking of the debt, a covenant package that limits debt, security and assets sales, insurance requirements and a traditional cash-management covenant package that governs the priority of cash payments.[26] In addition, key credit factors outlined by S&P's Key Credit Factors and Assumptions for Energy Projects take into consideration the project's customer mix, value proposition, scale scope and diversity, and its value added offerings.[27]

Private equity sponsors have, however, run into issues where they have attempted to access the TLB market too early in the construction, particularly where significant portions of property rights of way are not yet locked in. Alternatives to such a scenario, where capital is needed very early in construction, have been in the form of underwritten construction-stage bridge financings; in those transactions, bridge lenders rely on the ability of the project to, upon reaching certain milestones, be capable of accessing the TLB market for takeout financing.

Further tracking the developments in the power TLB market, which has seen a trend toward "merchant" or "quasi-merchant", there has been a move in the midstream TLB market from MVC-structured shipper contracts (the early-process midstream iteration of a "take-or-pay" contract) toward shipper contracts that rely primarily on field-wide dedications (either exclusively or with reduced MVC components) whereby all of the production from a specified geographic area (or, less commonly, a specified set of wells) will flow through a particular G&P system and/or pipeline. Some basins are more likely to be capable of supporting this structure than others. For example, where a basin's decline curves are less steep and there is a history of continued production in commodity downside scenarios (for example, West Texas' Permian Basin, and particular sub-basins therein), there tends to be a greater willingness to accept a level of production risk resulting from such structures.

One aspect of midstream TLBs that has proven interesting is that, given the size of certain pipeline projects (and the relative lack of commercial project finance availability), sponsors can tap the TLB market for leverage of JV interests. This is seen in the Traverse Midstream TLB described above.

Acquisition Financings and Construction Financings in the Midstream Sector

The TLB market has also supported acquisitions of large operating G&P assets. These assets are already operating, show historic EBITDA and are relatively straightforward to finance under a TLB structure.

As noted above, Blackstone's acquisition of EagleClaw in 2017 for $2 billion with a $1.25 billion acquisition TLB arguably began the trend. This was shortly followed by GIP's acquisition of Medallion for $1.8 billion with a $725 million acquisition TLB. ArcLight's acquisition of storage and terminal facilities in Tacoma, Washington and Baltimore, Maryland also saw acquisition financing round out the capital stack.

While there may be certain aspects of these G&P TLBs that are somewhat critical given the asset-class, for example, a need for future development and acquisition flexibility, they are not altogether unique to the sector. This additional flexibility is nonetheless worth mentioning in brief. A feature in certain midstream TLB structures is an ability on the part of the borrower to, subject to certain conditions, account for a portion of revenues of material projects under construction in EBITDA calculations. This unique accounting may be of interest in a pipeline or G&P transaction in which the business case relies heavily on continued growth and investment of the pipeline or G&P asset. As the types of transactions among midstream players continue to evolve, including in respect of joint ventures, sales of capacity on pipelines and G&P assets and trading of interests on pipelines, financing structures have and will continue to adapt to the realities of this dynamic business.

Unlike a pipeline (or a power plant), a G&P system, while it may have construction phases and growth milestones, does not necessarily achieve "completion" in the traditional sense. There is no final point at which the project is complete and revenues start flowing. It will grow to track wellhead production – expanding toward active wells as they come online – growing to suit. And as such, revenues will start trickling into the project relatively early in the construction process, which ramp up over time as the system grows. And perhaps most importantly as a structural consideration, the construction and ongoing development of the system must be nimble; project contracts will need to be entered into and revised constantly, with constant re-evaluations and re-workings of the overall design and development of the system as it develops, as new shipper contracts are obtained.

As such, a traditional project finance-style product will not provide the level of flexibility that is necessary for a G&P system undergoing construction and/or continued development. Even a project finance-style TLB might be too restrictive for the long-term; and, in any event, early-stage G&P systems rarely support the level of debt quantum typically needed to access the TLB market. While one option would be to arrange a short-term bridge-to-TLB financing, there are risks to both borrowers and lenders in such a scenario – namely certainty of access to the TLB market for takeout financing.

Recent financings of G&P companies have innovated to develop a loan structure very well suited to the asset class, taking a project finance-style TLB structure, with its excess cash flow sweep, and adding early-stage tight controls over project contracts, account waterfalls and reporting, all of which deactivate after certain financial metrics are met as demonstrated by the growth of the project via increased EBITDA. Essentially, once the overall debt-to-EBITDA of the project is reduced below certain pre-agreed thresholds (such that from a credit-perspective the financing looks and feels more like a leverage finance loan rather than a project finance loan), the project finance technology turns off and the borrower can act more freely without lender approval and oversight, since at that point the lenders' protections are the maintenance of EBITDA; in short, the loan and corresponding credit looks and smells much more like a leveraged financing rather than a project financing at that point, and the loan is structured with built-in flexibility to accommodate that reality.

On the Horizon

The developments in the TLB market (and TLB-adjacent markets, such as commercial bank TLA and bridge loan markets that target similar assets) in recent years demonstrate an ongoing evolution in financial structuring and a willingness (perhaps even an eagerness) of the market to adapt, accommodate and absorb new types of asset classes and credit profiles.

The rise of the hybrid midstream TLB, and its evolution within the midstream sector to accommodate varying asset profiles, has proven it to be a stalwart source of capital where the traditional project finance market and the equity markets have been unable to provide sufficient funds. From pipelines to G&P systems to terminals and from crude, to natural gas, to NGLs and water, the asset base continues to grow, and the need for financing with it. And many of these assets beget a need for more assets to service them, as the infrastructure matures. By 2022, it is expected that new pipelines to the U.S. Gulf Coast will carry an additional 2.5 million barrels per day (bpd) of crude.[28] The expansion of prolific G&P systems throughout the Permian, and in other basins, eventually give rise to significant water gathering and disposal needs. Private equity appears poised to acquire and develop these assets, as the examples of ArcLight's acquisition of Targa's terminal assets and Macquarie's investment in water service provider Lagoon demonstrate, and with that follows a need for additional leverage.

If the story of the TLB market holds, the evolution from power financings to midstream financings is unlikely to be the last chapter in the story. As the definition of infrastructure continues to expand, from "core plus" to "core plus" and so on, the instances where infra-focused private equity investors move into those spaces will increase, and along with them, the TLB market and related financings. Increased activity in the downstream sector as a result of recent midstream buildout will likely require access to non-traditional pockets of capital, particularly given the focus of traditional project finance lenders on seeking sustainable energy investments, as laid out in the Principles for Responsible Banking. While downstream projects traditionally have been project financed, the evolution of midstream finance structures may change how downstream and other oil & gas assets are financed. In addition, one other industry where private equity is steadily taking greater ground is the telecommunications industry, and in particular the broadband sub-sector. This process has already occurred in Europe and in the United States and is now accelerating in the United States; and as PE-backed networks grow, consolidate and densify (due to 5G demands), their value may increasingly tempt the TLB market. As private equity moves into this space and others, lessons learned in the power and midstream TLB markets will prove invaluable in creating financing structures that can adapt to meet the unique needs of new asset classes.

The COVID-19 global pandemic continues to take a toll on the midstream oil and gas sector, increasing previous trends of demand downturn and market uncertainty. Expected stricter regulatory policies by the new federal administration may present yet additional challenges. However, the midstream oil and gas sector has demonstrated resilience amid past tumultuous times, and senior executives remain confident that it will weather current storms as well.[29]

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LIBOR – The End is Near(er)?

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Introduction

2020 proved to be an unprecedented year, with many new challenges. Most importantly, a global pandemic, and governments, industries and the market had to quickly adapt. Despite 2020's challenges, the market continued to take steps to prepare for the transition away from LIBOR. The U.S. Alternative Reference Rates Committee ("ARRC") and organisations like the Loan Syndications & Trading Association ("LSTA"), International Swaps and Derivatives Association ("ISDA") and others continued to publish recommended fallback language and model provisions for SOFR-based contracts while also educating the market about the transition, next steps, risks and what to expect. The past year has seen many new developments in the transition away from LIBOR.

Legislative Developments[1]

Although market participants have increasingly been adopting language with LIBOR fallback provisions, state or federal legislation would minimise litigation and basis risk across US LIBOR contracts and provide stability and uniformity to the financial markets on this very important issue.

New York

In March 2020, the ARRC proposed legislation for New York that would, among other things, protect parties that adopt SOFR as a replacement for LIBOR under financial contracts governed by New York law.

On October 28, 2020, New York State Senator Kevin Thomas (D-Nassau County) introduced legislation substantially similar to the proposed legislation from the ARRC related to LIBOR's transition. The bill (S.9070)[2] provides fallback benchmarks for US LIBOR legacy contracts governed by New York law that lack fallback provisions.

As New York's last legislative session for 2020 came to an end, it was not clear if, or when, New York State would take up S.9070 in the first legislative session of 2021. However, a few weeks into 2021, New York Governor Andrew Cuomo included in his New York State Executive Budget Proposal proposed legislation related to the cessation of LIBOR.[3] The proposed legislation provides fallback benchmarks for US LIBOR legacy contracts governed by New York law that lack fallback provisions and is substantially similar to the proposed legislation from the ARRC related to LIBOR's transition. The New York legislation could prove to be a model for other states and its adoption could encourage the introduction of LIBOR transition legislation across the country.

With the LIBOR cessation date looming, market participants are closely monitoring Congress and the New York state legislature for any developments on the legislative solution front.

Congress

With the LIBOR cessation date looming, there was some hope that Congress may enact a legislative solution. In late October, a draft bill was circulated to members of Congress for discussion that mirrors New York's S.9070. As federal legislation, it would provide for a legislative solution in all states, including New York.

Among other things, the draft bill would:

- prohibit a party from refusing to perform its contractual obligations or declaring a breach as a result of a LIBOR discontinuance or the use of the legislation's recommended benchmark replacement;
- establish that the ARRC-recommended benchmark replacement is a commercially reasonable substitute for, and a commercially substantial equivalent to, LIBOR; and
- provide a safe harbour from litigation for the use of the ARRC-recommended benchmark replacement rate.

If presented to the floor and ultimately enacted, the proposed bill would provide clarity and protection to parties as contracts transition away from LIBOR. It remains to be seen whether Congress, reshuffled after November's elections, will take action on LIBOR-related legislation, but the financial markets are keeping a close eye on any developments.

Key US Dollar LIBOR Maturities Will Extend to June 2023

On November 18, 2020, ICE Benchmark Administration ("IBA"), the FCA-regulated and authorised administrator of LIBOR, announced that it will consult on plans to cease euro, sterling, Swiss Franc and yen LIBOR at the end of 2021. US Dollar LIBOR, however, was noticeably excluded from such announcement. Some news outlets and market participants rightly speculated that the omission of US Dollar LIBOR from the announcement may be a sign that cessation of US Dollar LIBOR may be postponed or delayed, especially given the slower pace of transition away from US Dollar LIBOR and concerns over SOFR as a replacement benchmark.

No doubt in response to the speculation, the Federal Reserve Bank of New York, however, continued to express its support for a transition away from LIBOR, encouraging the market to move forward with its transition plans. ISDA also issued a statement that the announcement from the IBA does not "constitute an index cessation event under the IBOR Fallbacks Supplement or the ISDA 2020 IBOR Fallbacks Protocol. Therefore, these statements will not trigger the fallbacks".

The speculation proved correct, and on November 20, 2020, the IBA announced its upcoming consultation to extend most US Dollar LIBOR tenors for legacy contracts. New one-week and two-month US Dollar LIBOR rates would cease being published after December 31, 2021, but all other US Dollar LIBOR rates would continue being published until June 30, 2023. Referencing the announcement by the IBA, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation issued a statement[4] encouraging banks to shift away from using US Dollar LIBOR. Although the publication of certain US Dollar LIBOR tenors may extend until June 30, 2023, the statement noted that the purpose of the extension is to allow most legacy US Dollar LIBOR contracts to mature before disruptions to US Dollar LIBOR are to occur. In connection with the IBA's announcement, the agencies encouraged banks to start using reference rates other than US Dollar LIBOR or to provide a clear alternate reference rate in new contracts by no later than December 31, 2021. While the agencies did acknowledge a brief list of circumstances in which it is appropriate for new bank contracts to use US Dollar LIBOR rates after that date, they advised that a quick transition by banks from US Dollar LIBOR is critical for an orderly LIBOR transition.

The IBA's consultation closed on January 25, 2021 and on March 5, 2021 the IBA announced[5] that 1-week and 2-month US Dollar LIBOR settings would cease to be published after December 31, 2021 and Overnight, 1, 3, 6 and 12-month US Dollar LIBOR settings would cease after the publication on June 30, 2023. The FCA confirmed the IBA's announcement.[6] No successor administrator was identified in the IBA's announcement. Each announcement noted that the FCA, under new proposed powers, could require the IBA to publish certain US Dollar LIBOR tenors on a synthetic basis. Such "synthetic LIBOR" settings will, if published, likely be limited to select legacy contracts and would no longer be representative or available for use in new contracts. The FCA will consult on the use of any proposed new powers in the second quarter of 2021.

The IBA and FCA Announcements – Trigger Event?

The IBA and FCA announcements may have implications for those transactions with fallback provisions. For transactions that adopted ARRC recommended fallback provisions, the ARRC confirmed on March 8, 2021[7] that the announcements constitute a "Benchmark Transition Event" with respect to US Dollar LIBOR under the more robust recommended ARRC fallback language for new floating rate loan, securitisation, syndicated business loans and bilateral business loan contracts. As a result the applicable transaction party may be required to notify other transaction parties that a trigger event has occurred. It is important to note that, under ARRC recommended language, although a notice requirement may be triggered, such trigger event would not require a transition away from LIBOR. Such a transition would not occur until LIBOR ceases to be reported permanently.

Market participants, if they have not already, should review their transaction documents and fallback provisions to determine whether a trigger event may occur and what steps are required following such a trigger event. Particular attention should be paid to those transactions with alternate fallback provisions or modified ARRC fallback provisions to ensure that the terms are complied with should a trigger event occur and to understand the next steps transaction parties may need to take under such provisions. Transaction parties should note which party is responsible for determining when a trigger event has occurred, what are the trigger events and what are the implications for a trigger event. Specifically, parties should be aware of any notice requirements and which transaction party is responsible for delivering such notice. Parties should also review their transaction documents to understand whether there is an amendment requirement that is triggered as well.

In the loan market, the LSTA, together with its Primary Market Committee, prepared a generic form of notice that market participants across loan platforms may use upon a trigger event. Parties that choose to use the LSTA's form should review their transaction documents to ensure that the form is appropriate for their particular transactions. On the swaps and derivatives front, ISDA separately confirmed[8] that as a result of the FCA's announcement the "spread adjustments" used in its IBOR fallbacks will be fixed as of March 5, 2020, and Bloomberg published a technical notice on the fixing of those spread adjustments.[9]

Legacy Contracts

Despite developments over the last year, legacy transactions continue to be a possible challenge in the transition away from LIBOR. Longer term financial products, and in particular, structured finance transactions with maturity dates that exceed 2021 or June 2023, as applicable, and which may be further complicated by the use of globally held notes through a depositary, may prove the greatest challenge for transition to a replacement benchmark. In those transactions, it is not typical, even for the most non-controversial and mundane amendments, to expect to receive 100% noteholder consent, which is typically the threshold of investor consent required in order to amend interest rate provisions; therefore, accomplishing an appropriate transition will need to be carefully thought out. Although amending the transaction documents to incorporate fallback provisions could be the answer, given that such an approach likely requires unanimous investor consent, amendments would prove administratively and practically challenging, if not impossible. If most LIBOR tenors are extended through June 2023, a portion of these challenging transactions may mature before LIBOR reporting ceases, obviating the need for such amendments. For those transactions that do not mature – and remain challenging to amend – a legislative fix may be the only path forward for implementing a replacement benchmark. As noted above, legislation on LIBOR transition has been included in the New York State Executive Budget Proposal, and may very well be adopted by April 1, 2021, and would provide a solution for New York law-based contracts.

For those contracts without fallback provisions and for which an amendment or legislative solution are not available, there may be judicial or other mechanisms that transaction parties can explore in order to amend their transaction documents and implement a replacement benchmark without obtaining the unanimous consent of the investors. How legacy transactions ultimately will be addressed still remains to be seen, but as we head into 2021 we are starting to see the light at the end of the tunnel. As possible solutions are made manifest, market participants must remain vigilant and informed and be prepared to act in advance of a benchmark discontinuation event.

Fallback Provisions

Considerations on the Amendment Approach *vs.* the Hardwired Approach

If parties have not already adopted fallback language in their contracts, they should do it now (run don't walk!). In older

transactions, parties may have seen the cessation of LIBOR and replacement fallback provisions addressed in one of two ways, an amendment approach or a hardwired approach. Prior to the publication of final ARRC fallback provisions, the amendment approach was often adopted, which essentially provides an amendment process by which parties can amend the transaction documents to implement a replacement benchmark at such time that a benchmark discontinuation event occurs. Given some of the uncertainty that existed as the market settled on a likely replacement benchmark, it provided optionality and flexibility, allowing deal parties to select replacement rates and spreads in the future when more information would become available. Given that LIBOR cessation is now imminent, the amendment approach which provides no certainty as to what the replacement benchmark will be when LIBOR ceases, is not the best option. With more certainty in the market as to a SOFR-based replacement benchmark, for those market participants still choosing to enter into LIBOR-based transactions between now and the end of 2021, a hardwired approach would be the more appropriate solution. A hardwired approach which provides parties with either a determined fallback rate or a waterfall of fallbacks provides economic and operational certainty, neither of which can be underestimated and would prove less disruptive to the market.

Operational Challenges

Not to be underestimated or overlooked, operational challenges should be closely examined and addressed by market participants as the transition to SOFR begins and picks up steam. Since SOFR is a secured, risk-free rate, and many of the SOFR-based benchmarks operate much differently than LIBOR, implementing a new SOFR-based benchmark continues to present certain operational challenges for the market. The operational challenges are greater for those rates not known in advance, such as SOFR compounded in arrears, a rate which will not be known until the end of the period. Therefore, a borrower on a loan facility could not be invoiced until the day the payment is due, which is not practical. These rates will likely include some type of look back period, for example three days or five days, permitting the borrower to be invoiced in advance of the payment date. The spread adjustments that SOFR-based rates will require add another layer of complexity for calculating and operationalising these rates. Systems will need to be updated to operationalise SOFR, which will take some time. Beginning on March 2, 2020, the New York Fed began publishing three daily compounded averages for SOFR – 30-, 90- and 180-day averages. These published averages along with a daily SOFR index also published by the New York Fed should ease the operational burden of calculating compounded SOFR-based rates. Market participants will need to be educated to understand the operational aspects of SOFR and SOFR-based rates since they will function much differently than LIBOR. Market participants should also continue to adopt systems and practices to operationally implement SOFR, particularly as SOFR-based transactions replace LIBOR-based transactions.

A Look Ahead

While 2020 was certainly an unprecedented year, in the midst of the global COVID-19 pandemic we saw many important LIBOR developments and the market took active steps to prepare for the transition away from LIBOR. From the publication of SOFR-based averages to the introduction of LIBOR transition legislation to address legacy contracts, in the last year the market has taken big steps toward replacing LIBOR. The ARRC and organisations like the LSTA, ISDA and others continued to educate the market about the transition, next steps, risks and what to expect. Banks and other market participants should remain vigilant and informed on market developments in the LIBOR transition space and continue establish protocols for implementing and operationalising replacement benchmark rates. Market participants should also continue to review their existing contracts for exposure to LIBOR and review fallback provisions, mindful of the implications of any trigger event. In addition, market participants should take steps to mitigate risks by evaluating LIBOR exposure and the steps required to implement a replacement rate, and the impact on portfolios, reporting, trading and valuation. Great progress was made in 2019, but much work remains to be done. SOFR-based transactions are now becoming a reality and market participants must work to familiarise themselves with SOFR. The global pandemic has proven how quickly market participants can pivot and adapt to a new normal, and a time where SOFR, not LIBOR, is the norm is one the market has been preparing for.

Endnotes

1. Please note that the below is correct as of 15 March 2021.
2. https://legislation.nysenate.gov/pdf/bills/2019/S9070.
3. https://www.budget.ny.gov/pubs/archive/fy22/ex/artvii/ted-bill.pdf.
4. Board of Governors of the Federal Reserve System Federal Deposit Insurance Corporation Office of the Comptroller of the Currency, Statement on LIBOR Transition November 30, 2020: https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20201130a1.pdf.
5. https://www.theice.com/publicdocs/ICE_LIBOR_feedback_statement_on_consultation_on_potential_cessation.pdf.
6. https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf.
7. https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/ARRC_Benchmark_Transition_Event_Statement.pdf.
8. https://www.isda.org/2021/03/05/isda-statement-on-uk-fca-libor-announcement/.
9. https://assets.bbhub.io/professional/sites/10/IBOR-Fallbacks-LIBOR-Cessation_Announcement_20210305.pdf.

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2021 Private Credit and Middle Market Update: Pandemic Priming Shifts Debt to Defence

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Introduction

The COVID-19 pandemic shifted middle market lending to the defensive in 2020 as the main goal of many debtors was to find liquidity, delay maturities, relieve covenant pressure and take other measures to bridge a return to normal operations.

The main themes of private credit and the middle market in 2020 were borrowers looking to buy time and investors protecting the value of their positions. The combination resulted in an increase in aggressive lending practices with many turning to using super-senior secured debt to gain a priority claim over existing debt obligations.

These transactions, commonly called "priming", were accomplished through a number of techniques, including using existing loopholes or "trapdoors" in agreements or having a cooperative majority of lenders modify the existing debt. Some priming transactions even took the extra step of stripping covenants, defaults, and other lender protections from the old debt to ensure the new super-senior tranche would be in the driver's seat for any future restructuring.

Legal challenges to these transactions are ongoing in many instances, but priming and covenant stripping are likely to be a feature of the middle market lending landscape for the foreseeable future. Understanding how these transactions work and what steps, short of litigation, investors left outside the tent may consider to protect the value of their loans are important issues as we go forward into 2021. It is also important to balance investor value protection with the ability of borrowers to protect their business and stakeholders. These transactions can be instrumental in preventing a free-fall of credit that would be detrimental to all.

The Basics of Priming

For many borrowers, priming transactions are a last resort to stave off bankruptcy. To that end, borrowers will enter into direct priming transactions or drop-down structurally senior financings to keep the business running by increasing liquidity, extending maturities, restructuring covenants or taking other steps to preserve equity and seek a bridge to normalised operations. For the lenders participating in these transactions, the goals are to provide a financial fix while protecting the return on its new investment by lending at a senior position to existing debt. For lenders already in the debt, the transaction may protect their existing positions, but exchanging, refinancing, or otherwise abandoning their existing positions to move up the capital structure may also help increase their blended returns on their aggregate exposure to a borrower. It also has the advantage of preventing other investors from grabbing the "high ground" above them. For the lenders not participating in the transaction, whether due to limits on their investment criteria, dissatisfaction with the credit terms, or the opportunity to participate in the transaction not being offered to all lenders, the result is that their original investment is devalued as it is pushed down the capital structure.

Priming transactions are typically accomplished by (1) taking advantage of existing loopholes and "trapdoors" to permissibly shift collateral out of the existing lenders' credit box to support new structurally senior financing, (2) directly priming minority lenders by obtaining majority lender consent to modifications of the credit documents that permit the majority to exchange their debt for, or participate in, an improved priority position on shared collateral, or (3) a combination of the foregoing.

When priming through existing loopholes and trap doors, a borrower will typically utilise existing investment, restricted payment baskets, and other carve-outs to the negative covenants to move collateral away from existing loan parties to unrestricted subsidiaries, non-guarantor subsidiaries, or affiliates, thereby removing it from the scope of the exiting lenders' collateral, so that such assets can then serve as the primary source of security for new money – often from third parties – and/or restructuring existing debt. The new facility then enjoys a structurally senior position over all of the existing lenders and does not require existing lender consent. Examples of priming transactions that have been successful in this manner include *J.Crew*, *Travelport*, *Neiman Marcus* and *PetSmart*.

When priming with the consent of a majority of lenders, borrowers will amend the credit documents to permit the priming debt, as was done in *Serta* and *Murray Energy*. In a majority priming deal, the lenders who are left out of the new tranche of debt are usually investors who do not approve of the credit changes or, like many CLOs, are limited in their investment options to agree to the new terms. In some cases, however, the minority lenders are not even given the option to participate in the majority deal. By issuing additional permitted debt (through incremental equivalent debt baskets or amending the existing credit documentation to approve new third-party debt), the majority can use provisions for debtor debt buybacks and open market purchases of outstanding loans to effectively exchange their existing debt for the new tranche with superior collateral and payment rights. These structures avoid having to share the improved debt position *pro rata* with all existing lenders.

As a sign of the times, borrowers and lenders have even become more aggressive in how they achieve the lender consent threshold needed to effectuate direct priming transactions. In *Revlon*, some lenders increased their revolving commitments to create a technical majority that would then consent to the priming position, without ever funding the increased commitment. While some lenders have objected to these "sham revolvers" and have legally challenged this technique, there is

usually nothing in express terms of standard credit documentation that would disqualify an increased, undrawn revolver commitment permitted by the credit agreement from being included in the majority vote. Indeed, they may be expressly included – such vote is customarily calculated including both outstanding loans and undrawn commitments.

Priming Advanced: Stripping Lender Protections

Recently, some majority groups have taken things a step further and modified the existing debt to not only permit the priming position, but to also remove covenants, defaults, and other customary lender protections. Taking the extra step of stripping covenants further ensures that the new priming debt is in the driver's seat for any further restructurings of the borrower's balance sheet. While this priming/stripping "two-step" is understandable from the view of the priming lenders, it leaves minority lenders holding what is essentially a bare promissory note secured by a structurally or directly junior lien – an investment far from the one they originally made. Two examples of this priming/stripping "two-step" that occurred in 2020 were the *TriMark USA* and *Boardriders Inc*. transactions. In addition to using majority vote to roll-up into new priming debt, the lenders modified the credit facility they were exiting to remove most of the covenants, defaults, and other lender protections.

Although this priming/stripping "two-step" has been relatively unheard of in the private debt sphere, it is worth noting that stripping covenants in connection with bond exchange offers is nothing new. But bondholders have the Trust Indenture Act requirement that any exchange has to be offered to all holders on an equal basis. As credit agreements are private transactions, what can and cannot be done as far as priming, covenant stripping, and other modifications depends on the terms of each credit agreement. Consequently, as has happened in recent transactions, the "inside" participating majority lenders did not offer the deal to the "outside" minority lenders, leaving the latter stranded with lien-subordinated and stripped debt. Even where offered, some creditors, such as CLOs, may not be able to participate in the new debt. This priming/stripping "two-step" changes the playing field for investors in distressed credits trying to assess risks to their positions.

What Can Investors Do to Protect Their Loans?

In response to priming transactions, investors have attempted to protect themselves with various changes to credit documentation. Whether it be tightening specific investment or restricted payment baskets (i.e., capping the aggregate value of investments in non-guarantor subsidiaries and unrestricted subsidiaries or prohibiting the transfer of intellectual property to them and limiting restricted payments), attempting to close each loophole can be a cat-and-mouse game and as one trapdoor is closed, others will open. Further, absent revisions to standard amendment provisions, majority lenders can still open any closed trapdoor.

Aside from the lender "sacred rights" – specified modifications that require the consent of all lenders or all affected lenders – the borrower may amend the credit documents with just the consent of a majority of lenders. In most credit documents, the "sacred rights" are limited to changes extending maturity, delaying scheduled payments, reducing interest margins, changing *pro rata* payments, releasing all or substantially all of the collateral, and changing amendment provisions related to sacred rights. The sacred rights often have exceptions for indirect modifications resulting from transactions permitted by the credit such as the incurrence of incremental tranches, open market debt purchases, and borrower debt buy-backs that might otherwise appear to run afoul of *pro rata* provisions and other sacred rights. As a result of the narrow definition of sacred rights or the exceptions thereto, in many deals, the majority lenders can make significant amendments and adjustments that can materially modify the rights and payment priority of non-consenting lenders.

There is no one magic bullet that can prevent all possible priming and stripping transactions. However, certain macro-level changes could be made to credit documentation that can provide investors some protection from being primed. Some possibilities include:

- **Release of Collateral Sacred Right**. In majority lender priming transactions, the credit documentation is often amended to permit senior debt and leaves the minority lender groups with a subordinated lien position. While releasing the lenders' lien on substantially all collateral is a sacred right, subordination of that lien – even where it has the practical effect of rendering the credit fully underwater – is not. Changing the sacred rights to cover lien subordination (or require a supermajority for lien priority changes) in addition to lien releases would limit direct priming by majority lenders. It would also be consistent with the bond markets where first lien bond documentation usually requires all holders to approve an adverse change in lien priority. This revision, however, would not prevent priming through drop-down structurally senior priming transactions such as in *J.Crew*.
- **Required Lender Thresholds**. Increasing the Required Lender voting threshold from a majority to 66⅔% would make it more difficult to use "sham revolvers" or otherwise get a consensus on the changes needed to effect direct priming transactions. Such a change, however, is completely counter to credit trends over the last several decades and likely would make normal-course administration and adjustment of a credit more difficult. Using a supermajority for specified changes (such as modifications to the incremental and key baskets) might get more traction. Still, changing thresholds for even specific issues could have unintended consequences and make it easier for a minority to have "hold-up" value over the majority for many transactions that do not involve priming. Like using a hammer instead of a scalpel, changing "Required Lender" thresholds may be too heavy a tool for the job.
- **Required Lender Voting Mechanics**. Modifying the manner in which "Required Lenders" or "Requisite Lenders" is calculated may limit exit consents or sham revolver voting. This modification runs counter to bond markets where documents typically expressly permit exit voting and exchange offers. A key difference, however, is bond documents usually require the exchange offer to be made to all holders. Changing the majority voting mechanics to prohibit "interested party" voting at the expense of an excluded minority could help close direct priming transactions. It would not, however, address third-party priming through drop-down structurally senior financings. This is a more narrowly focused path than a wholesale change to the Required Lender threshold for all purposes as it would only come into play if a group of lenders are trying to adjust terms to benefit themselves as opposed to all lenders.
- ***Pro Rata* Changes**. The sacred right prohibiting changes to *pro rata* sharing provisions could be expanded to include modifications that indirectly negatively impact *pro rata* provisions, in addition to the customary language directly crossreferencing the *pro rata* sharing provision. This

approach could have unintended consequences, including preventing otherwise legitimate transactions such as incurring additional debt under the incremental and other baskets and incurrence tests. It also would not prevent priming through drop-down structurally senior financings. A more practical alternative approach may be to strengthen the *pro rata* sacred right provision to pick up value capture outside of the credit documents. Most *pro rata* provisions pick up setoff and other self-help remedies against collateral as recoveries that are used to adjust equitable sharing in the debt waterfall. These concepts could be expanded to require *pro rata* sharing among the lenders in any transaction where existing collateral is used for any lender to take a position that is senior to other existing lenders. This sharing provision would not apply to any priming transaction that is equally offered to all lenders. While this would not stop third-party priming, it would be a strong disincentive to majority priming of the minority.

- **Additional Incurrence Tests**. Credit documents typically require that many of the mechanisms used for priming, including baskets and the use of incremental debt, are subject to *pro forma* compliance with a specified leverage ratio, interest coverage ratio, or fixed charge coverage ratio. While these incurrence tests can be useful restraints, none address the issue of the sufficiency of the collateral remaining after the transaction. Addition of a collateral coverage ratio would be similar to the guarantor coverage ratio, which used to be more common in European transactions (where lien coverage is more difficult to obtain). Such a collateral coverage ratio would be an incurrence test that requires the borrower to show the value of remaining collateral (either book value or fair market value as determined in good faith) is at a pre-agreed multiple of total debt or first lien debt at the time a basket is used or other transaction is consummated. Of course, the collateral valuations could be susceptible to inflation, but including such a test imposes an additional hurdle on the borrower and another foothold for excluded lenders to challenge the priming. The test could also be limited to include only collateral in which the remaining lenders have a first lien priority. This would make it more difficult to inflate values in a priming move or move significant assets outside the credit group to support new, structurally senior debt. The general trend in credit documents over the last couple of decades has been to limit the use of maintenance tests, making this a more difficult path. The change would also not protect against the use of "free and clear" and other baskets and exceptions that do not require any incurrence tests as a condition to use.

A broad-brush approach is challenging with changes to limit the stripping of covenants by majority lenders looking to move up the capital structure. It would not be helpful to the markets to over-cure the problem and create new ones for amendments and modifications that are necessary for businesses to perform. There are changes that could be sought to the calculation of majority lenders and prohibiting exit consents by up-tiering lenders, but these changes run the risk of causing unintended consequences in the ability to amend or modify a credit in the ordinary course. It is important to note that priming is the core intent of these transactions, and stripping is secondary to moving up the capital structure on the new debt. Further, these transactions tend to take place in times of distress if participating lenders see room for a priming position to have value. Therefore, while changes that would limit stripping are certainly possible, closing the priming door is likely the best protection for minority lenders in all of these scenarios.

Any of these changes go against the general trend in credit documentation to be more borrower-friendly, which includes greater majority control and easier amendments. Given the competition for deals, it is also not likely there will be any widespread changes in credit documentation to address these issues. This is good news for borrowers looking to preserve wiggle-room in distressed situations and priming lenders looking to preserve value and overall return on their investment. For minority lenders on the outside, however, it means they will have to pick their battles as to where they can change the terms of credits they are investing in, particularly if the credit is already, or likely to become, distressed.

Further changing standard credit documentation may not be in the best interests of all lenders, or the borrower and its stakeholders. Priming is often the best life-line for a credit in distress and can make the difference between recovery and bankruptcy. There is no right or wrong approach to these issues; an investor being primed today may well be priming tomorrow. The tension between protecting minority investors and permitting the borrower to fashion out-of-court solutions with the majority or other lenders is a delicate balance. Giving hold-up value to a small group of stakeholders often does not benefit the whole.

All of this proves the adage that the terms of any credit, no matter how tight, cannot replace good old-fashioned diligence and credit analysis. As always, in the debt marketplace, buyer beware.

Conclusion

As 2020 came to a close, US election issues resolved, the promise of global vaccines emerged, and private equity and initial public offering activity increased dramatically, indicating that 2021 should see a resurgence across markets, including private debt and middle market lending.

The economic impact of the pandemic, however, will continue through most of 2021, and there are a lot of financing fixes put in place in 2020 that will need to be reworked. Priming and stripping have become a part of the distressed lending playbook. Even if markets largely return to normal, debt investors need to factor subordination risks into their decisions. Credit agreement covenant schemes are a complex matrix and, in times of stress, borrowers, lenders and their advisors will be creative and continue to find solutions. A key lesson of 2020 is that not all solutions treat *pro rata* investors equally.

The good news is the debt markets usually find a way to strike a balance among competing interests and standard documentation evolves to a norm that most, if not all, stakeholders accept. Priming and stripping are no different from other majority/minority/borrower issues that eventually balance out and become "market". Finding that balance will be a key feature of the deals ahead as we go into 2021.

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Bankruptcy Asset Sales & Acquisition Financing Process: Key Considerations from a Buyer's Perspective

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I Introduction

While sale processes under chapter 11 ("**Chapter 11**") of the United States Bankruptcy Code (the "**Bankruptcy Code**") may seem similar to any other asset sale or acquisition processes outside of bankruptcy, executing a successful deal in the bankruptcy context is anything but simple. Indeed, acquisition financings in connection with a section 363 sale under the Bankruptcy Code (a "**363 Sale**") or a sale of estate assets pursuant to a Chapter 11 plan contain all of the same elements as financings of typical acquisitions outside of bankruptcy, but the bankruptcy process raises additional issues and makes these transactions uniquely challenging.

In this chapter, we focus on acquisition financing in connection with 363 Sales and sales pursuant to a Chapter 11 plan from a buyer's perspective. We begin with an overview of the bankruptcy asset process, which provides important context for thinking about negotiating and executing acquisition financing transactions. We highlight practical considerations with respect to acquisition financings in the context of bankruptcy asset sales, including the dynamics of negotiating with prospective lenders when the target is a distressed business, navigating bankruptcy court processes and their impact on deal timelines, managing lenders' enhanced due diligence demands and limiting concerns regarding conditionality.

Chapter 11, broadly speaking, is a form of bankruptcy that allows a distressed company to reorganise its business affairs, assets and debts, through a plan of reorganisation, a sale of some or all of its assets, or a combination of both. For potential buyers, there are two methods for acquiring assets from a distressed company in Chapter 11: a buyer can acquire certain assets and liabilities through a 363 Sale, or it can complete the acquisition through a plan of reorganisation. There are benefits and risks to each approach, and the decision as to which path to pursue depends on a variety of factors, including:

- the size and complexity of the case;
- the financial condition of the debtor;
- whether the debtor has made progress in negotiating with its creditors;
- whether the debtor believes there is a clear path to file a viable plan of reorganisation that is confirmable by its creditors;
- the assets and the industry of the debtor;
- whether secondary considerations (such as the preservation of tax attributes) may be furthered by a particular transaction structure; and
- whether there is any competition among potential bidders for the debtor's assets or business.

Section 363 of the Bankruptcy Code authorises a trustee or a debtor to sell all or a portion of the debtor's assets and is designed to allow such sale to take place expeditiously. The sale of a significant portion of a debtor's assets or business operations is likely a non-ordinary course transaction and requires approval from the bankruptcy court. In order for a bankruptcy court to approve the sale of a debtor's assets outside the ordinary course of the debtor's business, the court must find that there is a "good business reason" for the proposed sale. The court may find a "good business reason" exists in a variety of situations, such as when the value of the relevant assets is declining such that any value for the creditors would be lost or greatly diminished if the debtor continued to operate the business (i.e., the "melting ice cube") and/or where the debtor lacks funding to continue to preserve its assets or operate its business for an extended period of time absent a quick sale. In each such situation, it is in the best interest of the creditors to permit the debtor to pursue and complete a sale transaction early in the case rather than to allow significant value leakage while the debtor attempts to develop and confirm a plan of reorganisation or force the debtor to wind down and liquidate its assets on a non-going concern basis.

Whether a buyer and a debtor decide to move forward with a 363 Sale or a sale consummated through a plan of reorganisation, the debtor and its creditors will value certainty that a deal will close when comparing bids that otherwise have similar value to the debtor's estate. As with any leveraged acquisition, if one potential buyer's bid has more certainty than another, the bid with more certainty is more appealing to the seller – in this context the prospective buyer's plans with regard to financing the transaction and of the debtor's level of confidence with respect to the buyer's ability to obtain such financing are critical factors. These considerations become even more important if the sale process is competitive.

II Practical Considerations in Bankruptcy Sale Acquisition Financings – A Buyer's Perspective

a. Deal Dynamics: Negotiating with Prospective Lenders

In a bankruptcy sale process, a buyer should expect that negotiations with its potential lenders may be more challenging compared to negotiations in connection with a standard leveraged buyout. There are many reasons this may be the case, including: (i) the actual or perceived financial distress of a debtor; (ii) the prospective buyer's lenders may potentially have less familiarity with bankruptcy and, in particular, 363 Sales or sales consummated through a Chapter 11 plan; (iii) the actual

or perceived risk of purchasing assets from a business in bankruptcy or investing in a business that will be emerging from bankruptcy and the risk that such business can remain a "going concern" after closing; (iv) residual "hard feelings" that certain lenders may feel if they are current creditors of the debtor; and (v) the uncertainty of whether the debtor's business will be sold as a going concern through a bankruptcy auction process or whether the debtor's assets will be liquidated.

A potential buyer should understand that, depending on the projected financial condition of the acquired business after the conclusion of the 363 Sale, the buyer may have minimal leverage to negotiate further amendments to the debtor's existing financing. As such, it is essential for the buyer to have a clear understanding of the flexibility the business requires to operate successfully post-closing. When negotiating with prospective lenders, a buyer should develop a clear list of priorities with respect to deal terms or "must haves" up front. To that end, developing a viable business plan will be an important element of structuring the post-bankruptcy capital structure and may be a requirement by the lenders (one that goes beyond a typical sponsor model and quality of earnings report). As buyer's counsel, it is important to understand the business plan to ensure that the definitive documentation for the financing permits the required degree of flexibility to implement the plan.

One way to evaluate the go-forward needs of the acquired business is to refer to the debtor's prepetition financing agreements, which in most cases will be used as the basis for the post-bankruptcy financing documentation. As a general matter, the post-bankruptcy financing documentation will have similarities to the prepetition financing agreements, but because the debtor went through bankruptcy, will generally have more restrictive terms, including potentially more onerous reporting covenants, more restrictive negative covenants (especially with respect to permitted debt, liens, investments and restricted payments), less generous cure periods for certain events of default and tighter financial covenants with less favourable definitions.

Lastly, unlike standard asset sales, 363 Sales and sales consummated as part of a Chapter 11 plan are approved by a bankruptcy court. 363 Sales are conducted in accordance with court-approved bidding and auction procedures, which may add a level of complexity to the transaction and enhance the need for coordination between teams representing the buyer to further a successful transaction. At this stage, it can be helpful to involve the buyer's M&A and bankruptcy advisors directly in conversations with the lenders and their counsel. Such conversations can help the lender's team become comfortable with the transaction structure and the elements imposed on a 363 Sale by the Bankruptcy Code and a bankruptcy court.

b. From Bidding to Closing: Bankruptcy Court Processes and Deal Timelines

The stages of reaching an agreement in a 363 Sale scenario are generally similar to the stages of reaching an agreement in a standard leveraged acquisition: (i) a buyer submits a bid to the target; (ii) if the buyer's bid is appealing to the target, the parties will work to finalise the acquisition agreement and the buyer will work to sign financing commitments simultaneously with the signing of the acquisition agreement; and (iii) once signing takes place, the parties will work toward closing (which will include the definitive financing documentation).

In a leveraged acquisition outside of bankruptcy, the deal timeline may largely be driven by the need for regulatory approvals for the acquisition and marketing requirements for syndicated debt. Lenders and their counsel are familiar and comfortable with these processes. In a 363 Sale, the path from bidding to closing can be more fluid and subject to change as a result of specific elements of the Bankruptcy Code that determine when and how a transaction can proceed.

- **Sale Motion and Bidding Procedures**. The bankruptcy sale process is commenced by the debtor filing a motion to approve the sale of its assets and the assumption and assignment of its designated executory contracts and unexpired leases (if any). The sale motion also typically will seek approval of bidding and auction procedures. The bidding procedures will impose the conditions for potential purchasers to become "qualified bidders", which will generally include a requirement that such bidder provides evidence of its financial ability to consummate the transaction. The bidding procedures will also set out the conditions under which potential bidders undertake their due diligence process, provide a deadline for bidders to submit a binding bid for the assets (including an asset acquisition agreement) and set the rules for an auction if multiple bids are received. If the debtor is able to negotiate an acquisition agreement with a purchaser prior to the approval of formal bidding procedures, the debtor may in its sale motion seek approval of that agreement as a "stalking horse" agreement, subject to the receipt of higher and better bids at an auction. The stalking horse bidder's bid serves as a price floor during the auction and typically the debtor will seek bankruptcy court approval to provide certain benefits to the stalking horse such as a breakup fee (in case of a higher or better bid) and/or the reimbursement of certain expenses.
- **The Sale Hearing**. In order to complete a 363 Sale, the bankruptcy court must approve the sale to the buyer selected by the debtor, including the winning bidder at an auction. The bankruptcy court will conduct a sale hearing and, if the bankruptcy court is satisfied that the sale is consistent with the Bankruptcy Code, it will enter a sale order approving the transaction. Generally, the bankruptcy court will be deferential to the debtor's business judgment with respect to the debtor's selection of the highest and best bid.

  There are two types of sale hearings: an uncontested sale hearing and a contested sale hearing. Where all creditors and parties in interest support a transaction, and no other objections have been filed with the bankruptcy court to the proposed sale, the approval of the sale is fairly straightforward and usually involves a single hearing at which the judge approves the sale and enters a sale order. The simplicity and predictability of an uncontested sale hearing makes the transaction easier from a financing perspective because the sale terms are unlikely to change and the parties can plan for a closing on a predictable timeline. On the other hand, a contested sale hearing can be much more unpredictable and may require additional time and preparation. A contested sale hearing occurs when one or more parties object to the sale. Potential objectors may include the unsecured creditors' committee appointed in the case or another *ad hoc* committee of creditors, contract counterparties (if the sale order includes the assumption and assignment of their contract) and counsel to various landlords (if leases are involved), among others. Because bankruptcy court approval of the sale order will be a condition to funding under the financing agreements, the resolution of objections to the sale, whether by the bankruptcy court following one or more hearings or by negotiation among the parties, is key to keeping the financing intact. Since the lenders will have agreed to finance the transaction

on its negotiated terms, the buyer may have to engage in further negotiations with its lenders if certain negotiated terms in the deal change based on parties' objections.

- **The Sale Order**. In addition to the acquisition agreement that governs the sale transaction, the sale is consummated through the bankruptcy court's entry of a sale order. The sale order approves the sale transaction and specifically memorialises the bankruptcy court's approval and authorisation of (i) the acquisition agreement, as well as any ancillary documents, such as any transition services agreement or any employee lease agreements, (ii) the acquisition consideration (including the method (i.e., cash and/or credit bidding,[1] if applicable) and whether it is being allocated among specific assets), (iii) the sale of the assets to be purchased free and clear of liens, claims, interests and encumbrances of the debtor, and (iv) the assumption and assignment of certain executory contracts and leases (if any) to the purchaser at closing. Entry of the sale order by the bankruptcy court is essential for a 363 Sale to close and the entry of a sale order satisfactory to the purchaser is normally a closing condition in the acquisition agreement and under the financing documents.

c. Enhanced Scrutiny: Lenders' Due Diligence

In every acquisition financing, the lenders will conduct due diligence on the target company – the amount of due diligence will vary depending on the lenders' existing knowledge of the target company, the financial condition of the target company and the type of transaction (i.e., an asset deal may require more due diligence by the lenders since the structure is inherently more difficult than a stock deal). The due diligence of the lenders in connection with a 363 Sale is often very extensive. Some of the points that lenders will want to understand include:

- which assets are being acquired and which assets are being left behind (if any);
- any liabilities the buyer is assuming;
- the consideration used to purchase the assets and whether any cash equity contributions (as opposed to proceeds of debt) will be injected into the targeted company once it emerges from bankruptcy;
- the substance of the sale order;
- any additional debt that will be incurred by the buyer at or after closing;
- the projected cash flows and *pro forma* financial statements of the buyer;
- any working capital needs; and
- any letter of credit or other credit support requirements.

While some of these items are similar to diligence a lender would conduct in a leveraged acquisition outside of bankruptcy, the first four items above are particularly important in the bankruptcy context:

- **Assets**. In 363 Sales, a buyer often has the ability to purchase "designation rights". Designation rights allow a buyer to cherry pick through the debtor's assets for a certain period of time after closing and receive such assets without paying any additional consideration. Any assets of the debtor can be the subject of designation rights, but designation rights most frequently apply to leases and executory contracts that can be assigned to the buyer or rejected by the debtor. The benefits of designation rights include the ability to renegotiate contracts with landlords and other counterparties for more favourable terms and the opportunity for the buyer to conduct additional post-closing diligence. Designation rights are important to lenders because the ability to acquire additional assets has implications for the pool of collateral securing the lenders' debt. The specific assets subject to designation rights can also have implications with respect to the operation of the debtor's business. If designation rights are included in a transaction, it will be important to keep the lenders apprised of any changes in the collateral and the assets that are ultimately acquired, which may involve sharing updated schedules to the acquisition agreement or other transaction documents on an ongoing basis.
- **Liabilities**. Lenders will be focused on understanding which liabilities the buyer plans to assume at the closing of the acquisition. In the 363 Sale process, a buyer has the option to assume or reject certain liabilities. In some situations, a buyer will choose to assume certain liabilities of the debtor if the buyer plans to continue to operate a line of business of the debtor. The assumption of certain liabilities by a buyer acquiring a debtor's entire business may be important for the buyer with respect to maintaining relationships in the go-forward business and also provides additional value to the debtor's estate that competing bidders who may only bid to purchase selected assets cannot provide.
- **Forms of Consideration**. Lenders will want to understand the sources and uses of consideration for a 363 Sale, which can be different than in an ordinary acquisition. In a leveraged acquisition outside of bankruptcy, there are two types of consideration: debt and equity. In a 363 Sale, there are potentially three types of consideration: debt; equity; and "credit bidding". Pursuant to section 363(k) of the Bankruptcy Code, a secured creditor has the ability to use up to the full amount of its outstanding debt to purchase any collateral securing that debt in a 363 Sale. A credit bid must be used to purchase specific assets that secure specific debt. Credit bidding gives a buyer a substantial advantage over any competing bidders, as it allows a buyer to offer a higher purchase price, if necessary, since part of the consideration is really secured claims on certain assets rather than cash. In order to credit bid, the secured creditor must hold first lien debt or pay all creditors that are senior to it in full unless it reaches a different agreement with the more senior creditors.

  From a lender's perspective, (i) credit bidding can create uncertainty if there are disputes about the validity of the debt being used to credit bid or if there is uncertainty as to the allowed amount of the creditor's claim, or if the value attributed to the credit bid changes, and (ii) credit bidding can be very complex if there are different tranches of debt with different co-lenders of varying seniorities.
- **The Sale Order**. Lenders and their counsel will want to have the chance to review, understand and comment on the sale order. It can be efficient to connect the bankruptcy team for the buyer directly with counsel to the lenders to walk through the sale order to address any comments or questions. The lenders particularly will want to ensure that: (i) the sale order approves the sale and assignment of the material assets to the business; (ii) the order finds that the debtor owns the assets and is able to deliver them to the purchaser; (iii) the sale is delivering the assets free and clear of liens, claims and encumbrances and that sufficient notice has been provided to parties in interest of the sale; (iv) that the sale consideration is fair consideration; (v) the sale and auction process has been robust and the sale is the highest and best use of the debtor's assets; (vi) the purchaser is a purchaser in good faith (which limits the risk of a later challenge to the sale); and (vii) there has

been no collusion with other bidders or other parties. The lenders also will want to ensure that the terms of the sale agreement cannot be modified without the purchaser's (and effectively the lenders') consent.

d. Heightened Concerns of Conditionality

As with any other acquisition financing, conditionality in the commitment documentation is extremely important and will be a central consideration to the debtor when evaluating the viability of the bid. While the conditions to funding in leveraged acquisitions outside of bankruptcy have become rather standardised in recent years, the conditions to funding in a bankruptcy asset sale will very much depend on the circumstances of the deal. As a rule of thumb, one should generally expect the conditions in the commitment papers for a bankruptcy asset sale to be more robust. While some of these additional conditions will be related to the bankruptcy process generally, there are other conditions that lenders will insist on in the financing agreements due to the financial condition of the debtor or the business being acquired.

Generally speaking, one should expect the standard closing conditions of an acquisition financing, including those relating to: (i) equity contribution and control; (ii) receipt of proceeds from other debt; (iii) no material adverse effect; (iv) all specified acquisition agreement representations and specified representations are true and correct in all material respects; (v) all lender fees have been paid (including reasonable and documented attorneys' fees); and (vi) information has been provided to satisfy know-your-customer laws. However, there are a few differences and additional conditions that may arise in negotiations with lenders in connection with a 363 Sale:

- **The 363 Sale Shall be Consummated in Accordance with the Terms of the Executed Acquisition Agreement**. While this condition is common across acquisition financing transactions, the difference with a 363 Sale is that this condition also includes a consent right for the lenders if the assumption of any liabilities is in excess of the amounts disclosed in the acquisition agreement or if there are certain changes to the terms of the sale order from the exhibit attached to the acquisition agreement at signing. Consent rights are generally triggered in connection with changes to the sale order if such changes impact the following: (i) the sale of the acquired assets to the buyer is free and clear of all liens, claims, and liabilities pursuant to section 363(f) of the Bankruptcy Code; (ii) findings that the buyer is a "good faith" purchaser within the meaning of section 363(m) of the Bankruptcy Code and granting the buyer certain protections pursuant to section 363(m) of the Bankruptcy Code for good faith purchasers; (iii) findings that there was no collusion by the purchaser with other parties; (iv) findings that the consideration provided by the buyer for the transaction constitutes fair consideration and reasonably equivalent value; or (v) any other findings or terms of the sale order that the lenders determine, in their reasonable discretion, are adverse to any of the lenders.
- **Delivery of Financial Statements**. As with many acquisition financings, the lenders will require that financial statements be delivered to them prior to signing and/or closing the transaction. However, the requirement to provide *pro forma* financial statements and other financial information as a condition to funding can vary depending on the type of transaction, the target company and the presence of a private equity sponsor. In 363 Sales, it is highly likely that, as a condition to funding, the buyer will be required to provide the lenders with *pro forma* financial statements of the buyer entity and its subsidiaries prepared after giving effect to the transactions as if the transactions had already occurred. While a buyer bidding for a debtor with a strong operating business may try to resist this condition, it is unlikely to be successful.
- **Marketing Period**. While a marketing period condition is common in most syndicated bank deals, the coordination of a marketing period in a 363 Sale can be challenging. 363 Sales often move very quickly. Under the Bankruptcy Code, a 363 Sale can close as quickly as 15 business days after the bankruptcy court approves the transaction (once the sale order becomes a final non-appealable order). However, the Bankruptcy Code also permits the bankruptcy court to allow the parties to close prior to the time the sale order becomes a final non-appealable order. Bankruptcy courts regularly grant such relief when the parties show the bankruptcy court that value will be lost if the sale does not close immediately (or nearly immediately), and in certain instances, sales have closed within a few days after the sale order was entered. Notwithstanding the foregoing, if committed financing is syndicated, lenders may insist on having a marketing period. When financing a 363 Sale with a marketing period, timing must align with the bankruptcy process and timeline. The bankruptcy team for the buyer should be involved in these discussions, bearing in mind the debtor will want a purchaser to have an unconditional bid prior to the court approval of the transaction.
- **The Sale Order**. For a 363 Sale, lenders will want to include a closing condition stating that the bankruptcy court has entered into the sale order and such sale order is in full force and effect and shall not have been stayed, vacated or modified. This should also be a closing condition in the acquisition agreement. So long as the language is consistent in the conditions, it should not be a point that is controversial to a buyer in most instances.
- **Liquidity**. In acquisition financings in connection with 363 Sales, there may be a condition to funding regarding sufficient liquidity at the company after giving effect to the acquisition, which would be unusual in a leveraged acquisition outside of bankruptcy. Such a condition would refer to liquidity within the *pro forma* structure, so cash held by the parties to the financing agreements after giving effect to the transactions. This can include cash proceeds of the debt financing, as cash on hand at the debtor will likely not be transferred to the buyer as part of the acquisition. The inclusion of this condition is very much dependent on the financial situation of the debtor and whether the lender has confidence in the buyer's ability to turn the business around.

III Conclusion

While acquisition financing in connection with a 363 Sale may seem fairly consistent with acquisition financing outside of bankruptcy, lenders and purchasers should prepare for the additional procedural requirements in a 363 Sale and, in negotiations, lenders and purchasers should understand and be prepared to handle the additional financial considerations and deal points associated with assets purchases in bankruptcies. As the process moves along, the parties will need to be nimble, as the deal may move at a rapid pace (perhaps faster than usual for a complex transaction outside of bankruptcy). The parties should also anticipate a dynamic deal process and be ready to negotiate deal

terms as the process evolves. Flexibility, efficiency and coordination between the buyer's deal team and bankruptcy team are key in ensuring each stage of the negotiation is covered.

Endnote

1. Under the Bankruptcy Code, a secured creditor has the right to bid up to the full amount of the debt the debtor owes to such secured creditor in a bankruptcy auction of the collateral securing the secured creditor's debt. Credit bidding is discussed further below.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The main significant developments were (i) the reinstatement of foreign exchange controls, and (ii) the issuance of the Law of Social Solidarity and Productive Reactivation No. 27,541, which declares the public emergency in financial, fiscal, administrative, pension, tariff, energy, health and social matters that was adopted during the COVID-19 pandemic.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

- In 2020, Banco de Galicia y Buenos Aires S.A.U., Citibank N.A. Argentina, Banco Santander Río S.A. and Industrial and Commercial Bank of China (Argentina) S.A. granted Aeropuertos Argentina 2000 S.A. a USD 19,000,000 loan.
- In 2020, Industrial and Commercial Bank of China (Argentina) S.A. (ICBC) granted Aeropuertos Argentina 2000 S.A. an ARS 622,188,666.48 loan.
- In 2020, International Finance Corporation granted Adeco Agropecuaria S.A. a USD 100,000,000 loan.
- In 2019, Citibank N.A., Industrial and Commercial Bank of China (Argentina) S.A., Banco de Galicia y Buenos Aires S.A.U., and Banco Santander Río S.A. granted Aeropuertos Argentina 2000 S.A. a USD 120,000,000 loan.
- In 2019, Banco de Galicia y de Buenos Aires S.A.U., Banco Supervielle S.A., HSBC Bank Argentina S.A., Banco Hipotecario S.A., Banco Itaú Argentina S.A. and Banco de la Provincia de Buenos Aires granted Los Grobo Agropecuaria S.A. a USD 44,399,500 loan, expandable up to USD 70,000,000.
- In 2019, Banco de Galicia y de Buenos Aires S.A.U., Banco Santander Río S.A., Banco Supervielle S.A., HSBC Bank Argentina S.A., Banco Hipotecario S.A. and Banco Itaú Argentina S.A. granted Agrofina S.A. a USD 37,850,500 loan, expandable up to USD 50,000,000.
- In 2019, International Finance Corporation, together with international banks, granted Telecom Argentina S.A. a USD 450,000,000 loan.
- In 2019, Banco de la Ciudad de Buenos Aires, Banco de la Provincia de Buenos Aires, and Banco de Galicia y Buenos Aires S.A.U., granted Araucaria Energy S.A. and SPI Energy S.A. a USD 35,000,000 loan.
- In 2018, CVI Investment Holdings Limited granted Supercanal S.A. a USD 63,000,000 loan.
- In 2018, ING Capital LLC and Itaú Unibanco S.A., New York Branch granted CPS Comunicaciones S.A. a USD 60,000,000 loan.
- In 2018, BNP Paribas granted Volkswagen Argentina S.A. a USD 30,000,000 loan.
- In 2018, BNP Paribas granted YPF a USD 50,000,000 loan.
- In 2018, Citibank N.A., HSBC México S.A., Industrial and Commercial Bank of China Limited Dubai Branch, JPMorgan Chase Bank N.A. and Banco Santander S.A. granted Telecom Argentina S.A. a USD 500,000,000 loan.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, it is possible to secure the borrowings of other members of the corporate group. The company acting as a guarantor should receive proper (arm's-length) benefits or consideration in return. Otherwise, it may be considered that the granting of the guarantee derives no benefit for the securing company and, hence, other creditors could challenge such transaction.

In addition, the by-laws of the securing company should include the prerogative to grant borrowings to third parties or, alternatively, the main activity of the company should be financing. Nevertheless, certain jurisprudence resolved that if the by-laws do not include said prerogative, the irregularity may be fixed by a subsequent ratification of the shareholders.

These requirements should be strictly defined when the guarantee is upstream (a controlled entity acting as guarantor of an obligation of its direct or indirect parent company or an affiliate).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

If the securing company does not have any financial corporate purpose, nor receives a consideration or benefit, the guarantee may be deemed out of the scope of the securing company's corporate purpose (*ultra vires*) and, consequently, may be declared void.

Further, pursuant to Argentine law, directors must act loyally towards the company and its shareholders, which includes the director's responsibility to perform its duties with the diligence

of a "good businessman" and in the interest of the company. Any failure to comply with these standards results in directors' unlimited liability for the damages arising therefrom.

To be released from any such liability, the director must timely file written objections to the company's resolution that caused the damages, and, if applicable, give notice thereof to the company's statutory auditors or file proceedings for challenging the decision.

Therefore, although it is not specifically provided, if a guarantee is deemed out of the scope of the securing company's purpose, it might be understood as a breach of the director's duties and, consequently, the director would be deemed responsible for negligence.

2.3 Is lack of corporate power an issue?

Yes. Corporate power is required to grant guarantees and any guarantee granted without sufficient corporate power could trigger director liability, as explained above.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental authorisation, consent or approval is required to grant a guarantee. However, it is advisable that the Board of Directors or the shareholders' meeting previously approves the transaction, particularly if the guarantee is for a significant amount considering the net worth of the guarantor and there is no specific provision in the by-laws of the guarantor. A unanimous approval through a shareholders' meeting is also advisable.

Also, if the security consists of a mortgage over real property located in a security zone (close to borders and other strategic zones), upon execution, transfer of land will require prior approval from the Security Zone Commission, unless the transferee is an Argentine individual.

In addition, third parties' consents and registration may be required for the assignment of agreements to a trust. As a general rule, since contracts involve both rights and obligations, the transfer of the obligations is not allowed unless the express consent of the counterparty is obtained (see questions 3.1 and 3.4).

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

As long as the company operates within its corporate purpose, as explained in question 2.1, Argentine law does not provide limitations on the amount of a guarantee; however, deduction of interest may be limited under certain thin capitalisation rules. Please refer to question 6.5.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Yes. Residents with foreign debt or trusts established in the country may access the Argentine Foreign Exchange Market (the "**FX Market**") to comply with the capital and interest services of such indebtedness, and to purchase foreign currency for the constitution of guarantees for the amounts due in the debt contracts under the following conditions: (i) when commercial debts for imports of goods and/or services take place with a foreign financial institution or an official export or foreign financial indebtedness credit agency with creditors that are not related parties, who have legal access to the FX Market for its repayment, in whose contracts the accreditation of funds in guarantee accounts for future debt services abroad is contemplated; (ii) when the funds acquired are deposited in accounts opened in local financial institutions within the framework of the conditions established in the contracts. The constitution of the guarantees will only be admitted in accounts opened in foreign financial entities when that is the sole and exclusive option provided for in debt contracts contracted prior to August 31, 2019; and (iii) when guarantees accumulated in foreign currency, which may be used for the payment of services, do not exceed the value to be paid in the next expiration of services.

As of the time of writing, the ability of non-Argentine residents to remit out of Argentina the proceeds of any judgment awarded in non-Argentine currency is subject to foreign exchange restrictions. In principle, the transfer of the proceeds of any judgment by a non-Argentine resident out of Argentina is not permitted by the Argentine Central Bank (the "**BCRA**"). Moreover, the rules related to these restrictions and authorisations may vary over time.

In order to access the FX Market for outflow of funds, the following requirements shall also be complied with:

- **Survey of Foreign Assets and Liabilities regulated by Communication "A" 6401 of the BCRA (as defined below)**. Individuals, entities and estates residing in Argentina must file either annual and quarterly or only annual statements of their foreign assets and liabilities with the BCRA if the sum of their foreign assets and liabilities during the previous calendar year, or their balance of foreign assets and liabilities at the end of the previous calendar year, amount to: (i) USD 50,000,000 or more, in which case a quarterly statement must be filed in advance of each quarter, in addition to the annual statement (which may in turn complement and/or ratify the quarterly statements); (ii) between USD 10,000,000 and USD 50,000,000, in which case only an annual statement must be filed; or (iii) between USD 1,000,000 and USD 10,000,000, in which case only an annual statement must be filed, with an option to use a simplified version of the statement.
- **Debt between related counterparties**. Prior approval of the BCRA is required to access the FX Market for the repayment of principal of foreign financial indebtedness when the creditor and debtor are related counterparties. The definition of related parties corresponds to the criterion set in the regulations regarding large exposures to credit risk.
- **Limitations arising from Communication "A" 7030 of the BCRA, as modified**:
  - *Liquid external assets*: prior approval of the BCRA is required to access the FX Market for transactions related to the outflow of funds, except that when accessing the FX Market all holdings in foreign currency in Argentina are deposited in accounts with financial institutions and there are no "liquid external assets" available. If liquid external assets are held on the date in which access to the FX Market is required, evidence that such assets were used in their entirety on such date to make payments that would have been allowed access to the Argentine FX Market must be provided. The definition of "liquid external assets" include, among others, holdings of foreign currency bills and coins (which would include any USD received by the company by virtue of a capital increase), coined or "good delivery" gold, demand deposits in foreign financial institutions and other investments that allow for immediate liquidity in foreign currency (such as investments in foreign government securities, funds in investment accounts held abroad, crypto-assets, funds in payment service providers, etc.).

- *Compromise to transfer and settle through the FX Market*: the person who is accessing the FX Market shall commit himself to transfer and settle through the FX Market within five business days of their availability any funds received abroad in the collection of loans granted to third parties, collections of term deposits or the sale of any kind of asset, when each of such had been granted, created or purchased after May 28, 2020.
- *Blue-Chip swap transactions*: the BCRA restricted access to the FX Market those who sell securities against foreign currency in Argentina or transfer those securities to depositary entities abroad for the previous 90 calendar days before accessing the FX Market. Moreover, the client shall commit not to arrange sales of such securities against foreign currency in Argentina or transfer them to a depositary abroad from the moment it requires access to the FX Market and for the subsequent 90 calendar days.
- *Subsidised loans*: those who have obtained, or will obtain within the following 30 calendar days, subsidised loans in pesos at an interest rate of 24% for working capital, including payments of salaries and coverage of deferred checks, and healthcare service providers, will require BCRA prior approval for the repayment of principal and interest of foreign indebtedness of any kind. Also, those who have received subsidised loans provided for in the framework of the Labour and Production Emergency Assistance Program will not be allowed to access the FX Market for investment purposes, remittance of family aid or derivatives, nor to sell securities against foreign currency or transfer them to other depository entities, until such financings are fully repaid.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

"Personal" guarantees are granted by a person or a legal entity committing its property to assure the performance of one or more obligations of the debtor. Upon the debtor's default, the creditor may eventually take legal action over the debtor's property and the guarantor's property. This guarantee, unlike asset-backed guarantees, does not create a lien or a privilege in favour of the creditor.

"Asset-backed" guarantees are granted over a specific property owned by the guarantor. In this kind of guarantee, either the debtor or a third party may be the guarantor. Unlike personal guarantees, asset-backed guarantees grant the creditor (i) the rights of "persecution" and "preference" over the asset in question, which means that the creditor has the right to pursue the guarantor's property, even if the guarantor sells or transfers the property, and (ii) the right to execute the guarantee and receive the corresponding payment with preference over other creditors, even in the event of insolvency or bankruptcy of the debtor or the guarantor.

The most common guarantees are the following:

(a) Mortgage: The mortgage is the most frequently used security over immovable property. Also, for certain movable property which has significant value, the law specifically demands the constitution of a mortgage instead of a pledge (i.e. airplanes). For further details, please refer to question 3.3.

(b) Pledge: A pledge may be constituted over movable property, including but not limited to: machinery; vehicles; patents; and trademarks. For further details please refer to question 3.3.

(c) Trust in Guarantee: A trust may secure both movable and immovable property for a maximum term of 30 years. Goods held in trust form an estate separate from that of the trustee and the trustor. Trusts must be registered with the appropriate public registry. Also, if the property given in trust is registered in a public registry, the relevant registry will record the property in the trustee's name. Therefore, they should not be affected by any individual or joint actions brought by the trustee's or trustor's creditors, except in the case of fraud. The beneficiary's creditors may exercise their rights over the proceeds of the goods held in trust and be subrogated to the beneficiary's rights. Any individual or legal entity may be appointed as a trustee of an ordinary trust. Financial entities that solicit services to act as trustees must obtain prior authorisation to do so. Although there is no ruling on the issue, it is advisable that the trustee be a different person from the secured creditor (although there is no obstacle if the trustee is a controlled or controlling entity of the secured party).

(d) Security Assignments: Assets may also be assigned as security. One of the differences with a trust is that, in the case of security assignments, assigned assets are typically limited to rights or credits including, without limitation, receivables.
The creditor may demand payment of the credit to either the assignor or the debtor of the assigned credit. If the assignor pays the amounts owed, then the assigned credit should be assigned back to the assignor.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Although it is not possible to execute a general security agreement, including different types of collateral securities, it is possible to execute a general agreement including more than one asset of the same type; for example, a pledge may include machinery and vehicles. In any case, the assets must be clearly identified in the security agreement.

In relation to the procedure, a security is executed by means of an agreement between parties, subject – in certain cases – to certain formalities. For example, mortgages must be made through public deeds.

Argentine law allows the pledge over an inventory of goods ("floating pledge"). Please refer to question 3.3.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral security can be taken over real property (mortgage) or over machinery and equipment (pledge).

(a) Mortgage: A mortgage generally secures the principal amount, accrued interest, and other related expenses owed by the debtor. To be valid, the following conditions should be met:
   (i) The mortgagor must own the property or properties to be mortgaged.
   (ii) The mortgagor must have the capacity to transfer its assets.
   (iii) In certain cases, prior consent of the spouse is required.

(iv) The mortgage must be granted over one or more specific properties and the maximum amount and the obligation secured must be certain and determined. Conditional, future or undetermined obligations are permitted to be secured, provided that a maximum amount of the guarantee is determined upon creation of the mortgage. Additionally, the mortgage over real property extends to: (i) all its accessories as long as they are attached to the principal property; (ii) the supervening improvements made to the property; and (iii) the asset's earned income (*frutos civiles y rentas*).

Mortgages must be executed in writing by means of a public deed, which must be registered with the Land Registry of the jurisdiction where the property is located to be valid *vis-à-vis* third parties.

A mortgage remains in full force and effect until all amounts secured have been paid or the mortgage is otherwise cancelled. The registration of a mortgage will automatically expire 20 years after the date upon which it was registered, unless renewed.

(b) Pledges: The debts secured by a pledge can be conditional, future or undetermined, or otherwise uncertain in amount. Pledges in Argentina are mainly governed by the Argentine Civil and Commercial Code, which came into force in August 1, 2015.

According to the provisions of the current legislation, there are two classes of pledges:

(i) "Unregistered pledge": the pledged assets can be delivered to the creditor or placed in the custody of a third party. Upon default, the creditor may sell the pledged asset through a public auction. The distinction between Civil and Commercial Pledge adopted by both abrogated Civil and Commercial Codes was not embodied in the new Civil and Commercial Code. The New Code provides that parties may agree on the following: (i) that the creditor may obtain ownership of the asset for the estimated value of it, made at the time of maturity of the debt, as set by the expert appointed by the parties or designated by the judge at the request of the creditor; or (ii) by means of a special sales proceeding.

(ii) "Registered pledge": There are two types of registered pledges: the "fixed pledge", used for specified assets; and the "floating pledge", used for a certain inventory of goods, with no precise identification of the goods. A floating pledge allows for the replacement of the goods of the pledged inventory.

The registration of a fixed pledge involves the filing of the petition to the Pledge Registry of the jurisdiction in which the personal property is located.

The pledge agreement is legally binding between the parties from the date of execution. Upon registration, the agreement is effective *vis-à-vis* third parties. It is effective *vis-à-vis* third parties from the execution date if the petition to register the pledge is filed before the corresponding registry within 24 hours of its execution.

The registration of a pledge expires five years after the date on which it was registered, unless renewed. Once perfected, a pledge remains in full force and effect until all amounts secured have been fully paid or the pledge is otherwise cancelled.

The floating pledge may be created through a notarised private document, using the form provided by the Registry of Pledges for such purposes (a public deed is not required).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. Collateral security can be taken over receivables. In order to have effect *vis-à-vis* third parties, a private assignment agreement must be executed and the assigned debtor must be notified by a notary public.

Alternatively, a trust structure may be used. Please refer to question 3.1.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Argentine law recognises the validity of a pledge over cash. In this case, the pledge has full effect upon delivery of the amounts pledged to the pledgee. These guarantees are not usual, though.

As for the procedure, please refer to question 3.3.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes. To be valid, the shareholder must inform the company about the terms and conditions of the pledge and the Board of Directors must record the existence of the pledge (i) in the Registry of Shares Book, and (ii) with a notation at the back of the share certificate (unless the shares are not represented in titles – i.e., book-entry shares).

Pursuant to Argentine law, movable assets which are permanently situated in a place and are not intended to be moved to a different jurisdiction are governed by the rules of the place where they are located. Thus, a guarantee agreement over the shares of a local company must be governed by the rules of Argentina.

Parties in a loan agreement may freely agree on the law applicable to the contract (see question 7.1), but Argentine law must rule the content, conditions and effects of a security over the shares of the company.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, under a "floating pledge". Please refer to question 3.3.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

(i) Yes, debtors may guarantee their own obligations. Please refer to questions 3.1 and 3.3 above.

(ii) Yes. It is a third-party guarantee, different from the debtor. Please refer to questions 3.1 and 3.3 above.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notarisation, registration and other fees vary depending on the jurisdiction in which the agreement is executed.

The following table details the main costs applicable to different securities:

Security	Fees
Real Property (Mortgage)	Notary Fees: 1% of the principal amount. Stamp Tax: 1% of the economic value of the agreement in the City of Buenos Aires; 1.8% in other jurisdictions such as the Province of Buenos Aires. Registration Fees: ARS 940.
Chattel Personal Property (Pledge)	Notary Fees: low depending on the characteristics of the pledge. Registration Fees: 1% to 2% of the guaranteed obligation. Stamp Tax: 1% of the economic value of the agreement in the City of Buenos Aires; 1.2% in other jurisdictions such as the Province of Buenos Aires.
Accounts Receivable/ Debt Securities	Notary Fees: low, depending on the characteristics of the security. Registration Fees: 0.2% of the guaranteed obligation. Stamp Tax: 1% of the economic value of the agreement in the City of Buenos Aires; 1.2% in other jurisdictions such as the Province of Buenos Aires.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Registration before the applicable registry may take between approximately one and six months, depending on the type of assets involved.

As to expenses, please see the table in question 3.9.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

There are no explicit statutory restrictions on the ability of Argentine companies to create pledges on their assets to secure *their own* obligations. However, certain limitations to, or special requirements on, the ability of an Argentine company to create pledges in its assets may be included in the by-laws of the company.

In addition, the by-laws may require express approval for the creation of any pledge on the assets of a company by its Board of Directors, in which case a resolution of the Board would be needed. In the absence of such requirement, the pledge may be created by any representative acting pursuant to an adequate power of attorney or, in the case of a corporation, by the president of the company.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No special priorities are provided for revolving credit facilities.

In this kind of loan, careful drafting should be taken into account. The guarantee granted at execution of the agreement may secure the subsequent renewals of the loan.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

For documentary requirements, please refer to question 3.3.

When a public deed is required, signing in counterparts, although not expressly prohibited, is not advisable since it could create certain issues in terms of proof.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

The limitations referred to above with respect to guarantees also apply here. In addition, there might be a tax impact related to a leverage buy-out operation.

It should be noted that the Income Tax Law ("**ITL**") does not provide clear parameters to distinguish between "debt" and "capital". Guidelines can be found in the ITL and its Regulating Decree, when they require – for irrevocable contributions – that "in no case shall there accrue interest or any accessories for the contributor".

As explained in question 6.1, a borrower is able to deduct interest (for income tax purposes) as long as the expenses were incurred to generate taxable income.

The Argentine Tax Authority has challenged the deduction of interest in cases of a leverage buy-out to acquire shares of local companies. The Argentine Tax Authority considered that such expense is not necessary to obtain taxable income or to keep or maintain its source. In certain cases, the resolution of the Tax Authority was confirmed by the Tax Court. The matter is pending a final ruling from the Argentine Supreme Court.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

In Argentina, the role of the agent or trustee is governed by the rules of contract. Therefore, the parties in a syndicated lending may freely determine the functions and powers of the agent; such powers might include calculating the due amount of principal and interest, calculating financial ratios, informing the compliance or defaults of the debtor's obligations under the agreement, and keeping and guarding the loan documentation.

Law No. 27,440 follows the classic US-like structure of a collateral agent, pursuant to which security interests are granted directly to the trustee for the benefit of the lenders. The Law states that the powers of the collateral agent must be indicated in the contract and that the same must act upon the instructions of the lenders.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

- The credits and the guarantee might be transferred to a trustee, who will be committed to enforcing the security if the debtor fails to comply with the agreement and applying the proceeds from the security among the grantors-beneficiaries.
- A real property might be transferred to a trustee, who might constitute a guarantee trust over such property in favour of the creditors.
- The guarantee might be granted in favour of one creditor, who commits to act as a collateral agent based on an inter-creditor agreement.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The assignment of credits must be documented in an agreement. A debtor's intervention in the agreement is not required.

The enforceability of the credits by the new lender is subject to two requirements: (i) the transfer of the credit; and (ii) the debt being payable.

Debtors should be given notarised notice of the assignment to be effective *vis-à-vis* third parties and the debtor itself, in case of a judicial claim. The notice could also be made through a private instrument with an unequivocal date (*fecha cierta*).

In case of pledges over credits, the publication of a notice in the Official Gazette is enough to make it effective against third parties (including the debtor).

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

As a general rule, deduction is allowed only for expenses incurred to generate taxable income.

Interest is deductible for the borrower. Interest deduction is limited by thin capitalisation rules (see question 6.5), unless a Double Tax Treaty with a non-discrimination clause is applicable. In such a case, total deduction could be possible. The ITL establishes that interest on financial debts – without including the debts generated by acquisitions of goods, leases or services related to the business line – incurred with individuals, residents or not, will be deductible up to the annual amount that establishes the Executive Power or up to the equivalent of 30% of the net income of the fiscal year that results before deducting both interest and amortisation, whichever is higher. Decree No. 862/2019 established ARS 1,000,000 as the annual amount to compare.

Decree No. 862/2019 provides some exceptions to the capitalisation rules if certain requirements are met.

The accumulated surplus in the three previous fiscal years may be added to this limit, as the amount of interest effectively deducted from the applicable limit is lower. The interest that could not have been deducted may be added to those corresponding to the following five fiscal years.

In addition, if the loan is made with a related party, with a party located in a low-tax jurisdiction or the funds do not arise from a low-tax jurisdiction (regardless of whether it is related or not), interest is deductible only when paid, and transfer-pricing rules apply. The ITL defines a non-cooperative jurisdiction as any jurisdiction or country that: (i) has not signed an information exchange agreement with Argentina; (ii) has not signed a convention to avoid double taxation with Argentina; or (iii) has signed either an agreement or convention but does not comply with its obligation to share information with Argentina.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no tax incentives for foreign lenders.

Foreign lenders will be taxed by income tax only on their profits from Argentina (Argentine-source income). When the lender is a banking or financial institution under the supervision of the relevant Central Bank or equivalent authority and is situated either in a jurisdiction that, in accordance with the regulations under the ITL, is not considered as a "low-tax jurisdiction", or in a jurisdiction that is party to an exchange of information treaty with Argentina and, as a result of the application of its internal regulations, cannot refuse to disclose information to Argentine authorities on the basis of bank or stock secrecy rules, the presumed net income in case of cross-border interest payments is 43% and, deriving from that, a 15.05% effective withholding rate. In all other cases of cross-border interest payments, the presumed net income is 100% and, therefore, the effective withholding rate is 35%. The Argentine debtor is responsible for the withholding and payment of the tax. Argentina has entered into treaties for the avoidance of double taxation with different countries. In certain cases, such treaties set forth ceilings to the effective withholding above-mentioned. Value-Added Tax ("**VAT**") applies to the sale of goods, the provision of services and the importation of goods and services. Under certain circumstances, services rendered outside Argentina, which are effectively used or exploited in Argentina, are subject to VAT.

Interest arising from a loan granted by a foreign entity is subject to VAT and the Argentine debtor is responsible for the payment of the tax.

The tax is levied on the interests paid and the current general rate is 21%. However, interests arising from loans granted by foreign banks are subject to a 10.5% rate when the central banks of their countries of incorporation have adopted the regulations provided by the Basel Committee.

Argentine Provinces and the City of Buenos Aires apply Turnover Tax (Tax on Gross Income), levied on gross income obtained from the exercise of onerous and habitual activity within each relevant jurisdiction. The tax rate varies in each jurisdiction.

For tax purposes, the activity of lending money is presumed to be carried out on a habitual basis, even if carried out once, and therefore is subject to Turnover Tax. The amount of returned capital is excluded from the taxable base. Thus, only the total amount of interest will be subject to Turnover Tax. Notwithstanding, it is not clear if interest collected by a foreign lender is subject to Turnover Tax.

Stamp Tax is a local tax levied on public or private instruments executed in Argentina, or documents executed abroad with effect in one or more relevant jurisdictions within Argentina. In general, this tax is calculated on the economic value of the agreement. Each jurisdiction applies different tax rates to different types of agreements, but the most common rate is 1%, e.g., the City of Buenos Aires. Certain ways of entering into contracts do not trigger this tax.

Finally, a tax imposed on credits and debits in bank accounts (the "**TDC**") must be paid in the case of credits and debits in Argentine bank accounts at a rate of 0.6%. However, the credit of the borrower in an Argentine bank account arising from the disbursement of principal of the loan would not be subject to the TDC since the disbursement of principal under a "banking loan" is exempt from the TDC.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Non-Argentine residents without a permanent establishment in Argentina are only subject to Income Tax on their Argentine-source income. Only income from Argentine sources will be taxed by Argentine Income Tax.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

For notarisation, registration and other fees, please refer to question 3.9. In addition, the loan and the guarantees will generally be taxed by Stamp Tax. For the purposes of the Stamp Tax, the loan and the guarantees could be considered independently even if they were agreed in the same document. Then, the transaction might be doubly taxed in certain jurisdictions. However, in the City of Buenos Aires, for example, there is an exemption by which the guarantees are not subject to Stamp Tax if the main agreement has already paid the tax.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Under the ITL (please refer to question 6.1), thin capitalisation rules apply only to interest in respect of loans granted by resident-related or foreign-related institutions (located in or with funds that do not arise from jurisdictions that are not considered non-cooperative jurisdictions). It establishes that interest on financial debts – without including the debts generated by acquisitions of goods, leases or services related to the business line – incurred with individuals, residents or not, will be deductible up to the annual amount that establishes the Argentine Executive or up to the equivalent of 30% of the net income of the fiscal year that results before deducting both interest and amortisation, whichever is higher. Decree No. 862/2019 established ARS 1,000,000 as the annual amount to compare. The accumulated surplus in the previous three fiscal years may be added to this limit, as the amount of interest effectively deducted from the applicable limit is lower. The interest that could not be deducted may be added to those corresponding to the following five fiscal years. This limitation will not apply if the recipient of the interest payments is a non-related party. Additionally, Decree No. 862/2019 provides some exceptions to the capitalisation rules if certain requirements are met.

If the lender is located in a non-cooperative jurisdiction (regardless of whether it is related or not) or in a low-tax jurisdiction, interest is deductible only at the moment it is paid and transfer pricing rules apply.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes. Parties are able to choose the laws that will govern the agreement as long as some connection to the system of the chosen law exists. Further, foreign law will only be valid to the extent that it does not contravene Argentine international public policy (i.e. criminal, tax, labour and bankruptcy laws). Also, rights associated with real estate are governed exclusively by local laws.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Yes. In principle, the courts of Argentina will recognise as valid and will enforce judgments of foreign courts if they refer to monetary transactions, subject to the compliance with certain procedural conditions (exequatur).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In Argentina, the length of litigation disputes depends on the complexity of the case and on whether appeals to court rulings are admitted.

Assuming the lender's creditor is unsecured, it might take between three and six years to obtain and enforce a final judgment. The rendering of a final decision might be delayed if foreign legislation governs the relationship between the parties.

Argentine procedural rules provide a fast-track proceeding called "exequatur" for the recognition and enforcement of a foreign judgment, which might last between one and three years. Exequatur proceedings do not require a re-examination of the merits of the case.

Despite the estimation above, freezing injunctions might be granted by Argentine courts if procedural requirements are met.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

In principle, there are no restrictions in order to enforce collateral security. Nevertheless, if the guarantor does not comply with its obligations, the creditor would have to file a suit in court.

Please refer to questions 2.6 and 7.3.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

In order to file a suit against a company in Argentina, the foreign lender must prove, if it is a company, that it is duly incorporated under the laws of its country.

Please note that, due to the pandemic, Decree 319 of March 2020 ordered the suspension, throughout the national territory, of foreclosures, both judicial and extrajudicial, in which the guarantee falls on residential properties that are occupied for that use. This measure covered all seizures already ordered that had not yet been carried out on the date of entry into force of the decree. The statute of limitations and expiration of applications were also suspended for foreclosures and pledges updatable by the Purchasing Value Unit (UVA). However, these measures expired on January 31, 2021.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The Bankruptcy Law does not provide any kind of moratorium on enforcement of lender claims.

Please refer to question 8.1.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Arbitral tribunals are competent in monetary disputes. The enforcement of the arbitral award will be as equal as the enforcement of a judgment.

Arbitral tribunals may not solve cases in which Argentine tribunals have exclusive jurisdiction, nor when there is an express prohibition against arbitration (e.g. certain provincial matters).

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy and reorganisation ("*concurso preventivo*") proceedings in Argentina generally cause personal actions to mutate into credit verifications ("*verificación de créditos y privilegios*") within the proceeding. All creditors with credits with cause or title prior to the debtor's petition for reorganisation proceedings, or a court's declaration of bankruptcy, must file their credit verification requests with the bankruptcy/reorganisation proceeding court.

Although the creditor does not have to wait until the credit filing procedure is finished before requesting the liquidation of the asset, the court will perform a summary examination of the documentation evidencing the creditor's preference and request the opinion of the trustee before carrying out the liquidation of the asset. During the reorganisation proceeding, security interest claims with respect to real guarantees must continue its procedure before the court where they were initiated, provided that the creditors first verify their credits with the reorganisation proceeding's court.

Also, in the case of reorganisations, the court may, in the event of evident urgency or need, order the suspension for 90 days of any auction of property subject to a mortgage or a pledge ordered by any other judge.

A credit with a special preference has priority over credits with general preferences and unsecured credits. However, the recognition of these credits must be verified and accepted by the court, as explained in question 7.6.

Credits with special preferences will have priority on a specific asset, such as mortgages and pledges. This kind of preference can be enforced exclusively on the relevant assets and up to the proceeds of the liquidation of such asset.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The court may determine a preference period of up to two years prior to the bankruptcy proceedings, depending on the date when insolvency was first evidenced.

Certain acts which occur during that preference period may be ineffective, such as: acts for which no consideration is given; debts paid prior to its maturity; and security interests obtained for a debt that is un-matured and that was originally unsecured.

There are two types of preferences:

(i) Special preferences, which are granted exclusively over certain specific assets of the debtor, e.g.: securities over the proceeds from the sale of the secured asset; expenses related to the assets that continue to be in debtor's possession; and salaries, etc.

(ii) General preferences, which are granted over all of the debtor's assets, e.g.: labour credits not subject to a special preference; social security debts; and certain personal expenses (such as funeral or medical costs), etc.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Yes. Among others, insurance companies, cooperative associations and public entities, such as the Nation, Provinces and Municipalities, the Catholic Church and embassies.

Financial institutions are, with a few exceptions, subject to general bankruptcy law. However, the Argentine Central Bank's cancellation of their banking licence is required, and they may not voluntarily enter into a reorganisation or bankruptcy proceeding.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes. The debtor may enter into out-of-court agreements with all or part of the creditors. A certain majority of unsecured creditors is required.

These agreements imply a debt restructure and are enforceable against all the unsecured creditors who executed it, including those that did not approve its content or voted against it.

To be enforceable against all unsecured creditors, the out-of-court agreement must be endorsed or validated by a competent court. Companies that are regulated by special insolvency rules (e.g., banks and insurance companies) cannot enter into this kind of proceeding.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

In principle, Argentine law allows parties of an international contract to submit to a foreign jurisdiction in matters of an economic nature.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes. The waiver of sovereign immunity is valid under Argentine law (it should be expressly provided in the underlying agreement).

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no eligibility requirements in Argentina for lenders, agents or security agents, whether they are residents or foreigners, from the licensing perspective. A loan may be granted by, and the agent may be, an individual, a company, a bank, or any other entity.

In the case of loans granted by banks, the role of an agent is generally performed by a financial entity.

In principle, lenders do not need to be licensed or authorised to grant loans, provided that the financing activity is not performed on a regular basis. Otherwise, certain corporate and regulatory issues should be considered.

From a corporate standpoint, foreign companies are able to perform isolated acts in Argentina but if they want to perform their activities on a regular basis, a branch or a subsidiary must be established. For such purpose, foreign companies must: (i) evidence before the Public Registry the existence of the company; (ii) establish a domicile in Argentina; and (iii) justify the decision of establishing such branch or subsidiary, and appoint a legal representative.

From a regulatory perspective, if the activities performed by the lender fall under "financial intermediation" (intermediation between the supply and demand of financial resources on a regular basis), prior authorisation of the Argentine Central Bank is required. An activity is deemed financial intermediation if it combines both raising local or foreign funds and granting financing to third parties with such funds.

The activity in Argentina of the subsidiaries or representation offices of foreign financial entities is subject to regulation by the Argentine Central Bank, who will grant the required authorisation subject to the analysis of the backgrounds and responsibility of the foreign entity and its local office.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

Regarding document execution, although no specific regulation has been issued during the pandemic, digital and electronic signatures are valid under Argentine regulations, therefore allowing the digital and electronic signing of documentation to be viable during the pandemic. The element that defines the existence of a digital signature is the existence of a digital certificate (the result of applying to a digital document a mathematical procedure that requires information that is exclusively known to the signer, which is under his absolute control) issued by a certifier licensed by the licensing entity, which must be capable of verification by third parties, such that said verification simultaneously allows the signer to be identified and the detection of any alteration of the digital document after its signature. Electronic signatures are defined by exclusion, as those that lack any of the requirements to be considered a digital signature. It should be noted that although both signatures are valid means to express consent, only digital signatures are considered equivalent to handwritten signatures in terms of the Argentine Civil and Commercial Code, and it is the only signature sent by an automatic device that possesses a *iuris tantum* presumption of authorship, integrity and non-repudiation, meaning that in many cases, only digital signatures comply with the essential formal element required for a legal act.

Additionally, the Public Registry of the City of Buenos Aires, the institution that registers and supervises legal entities in this jurisdiction, has dictated several measures in order to allow remote corporate meetings and to facilitate other mechanisms that contributed to the functioning of entities during the lockdown period.

Moreover, institutions such the Argentine Securities and Exchange Commission allow digital presentations of documents and procedures. It is expected that once the pandemic is over, physical documentation will again need to be presented in public offices.

It should be noted that as part of its COVID-19 response, the Argentine Government suspended until January 31, 2021 the execution, judicial or extrajudicial, of mortgages and pledges updatable with the value of the *Unidad de Valor Adquisitivo* or UVA.

With regard to notary requirements, remote notary certificates are available in order to comply with regulations during the pandemic. Further, certain bodies waived certain notary requirements during the first few months of the pandemic.

It is expected that these mechanisms will be implemented during 2021, but no regulations have been issued for permanent amendments to the procedures in place before COVID-19.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

There are no other material considerations that should be taken into account.

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Marval O'Farrell Mairal is the largest law firm in Argentina and a market leader at both local and Latin American levels. With over 300 lawyers, the firm has been providing sophisticated, high-quality advice to international and local clients for over 95 years on international business issues and the complexities of cross-border transactions. Marval is in the general practice of law including: Banking and Finance; Capital Markets; Project Finance; Commercial and Competition Law; Corporate Law; Foreign Investments; Mergers and Acquisitions; Real Estate and Construction Law; Administrative Law; Entertainment and Media; Environmental Law; Insurance Law; Intellectual Property; Internet and Information Technology; Natural Resources; Utilities and Energy Law; Tax and Customs Law; and Telecommunications and Broadcasting. The firm ranks at the top of major legal publications and has been awarded with many international awards. *Chambers & Partners* recently recognised Marval as "Argentina Law Firm of the Year 2020".

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Austria

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The COVID-19 pandemic has had a dramatic impact on all global economic sectors, putting enormous pressure on the lending markets as well. In Austria, lockdowns of almost the entire economy have ultimately led to an economic crisis, which resulted in a desperate need for capital by companies facing insolvency.

The European Central Bank (ECB) and national governments have been trying to provide liquidity and attractive lending conditions to credit institutions. While the ECB has provided long-term refinancing conditions and bond purchase programmes, the Austrian governmental authorities introduced other mechanisms, such as unconditional guarantees, to improve credit institutions' liquidity situation and enable them to apply less restrictive credit assessments. Nevertheless, banks had to adapt their lending policies in light of this rapidly changing and volatile economic situation, inevitably forcing them to tighten their financing conditions. In fact, banks also had to suffer a loss in profits due to securities purchase programmes and negative interest rates imposed by the ECB.

Apart from the impact of the COVID-19 pandemic, Austrian credit institutes, like all European banks, have continued to focus on their strategies concerning lending business in connection with an increasing regulatory framework, such as regulations relating to the determination of risk-weighted assets and own funds, though the effectiveness of these regulations has been partly diluted by legislative exceptions with respect to the COVID-19 pandemic. European Banking Authority (EBA) stress tests are growing in importance in this context.

Austrian credit institutions have also continued to deal with their fair share of non-performing loans, which kept the market trading with such non-performing loans active, with the CESEE region being mainly responsible for non-performing loans in the portfolios of Austrian banks' subsidiaries.

The Act on the Recovery and Resolution of Banks (*Sanierungs- und Abwicklungsgesetz* (BaSAG), implementing the Bank Recovery and Resolution Directive 2014/59/EU (BRRD)), covers EU Capital Requirements Regulation (CRR) credit institutions and CRR investment firms, including certain CRR financial institutions, financial holding companies and branches of third-country institutions to the extent they are part of a group of credit institutions. BaSAG, which came into effect on 1 January 2015, requires "recovery plans" to be drawn up by institutions to identify impediments and outline measures which could guarantee effective resolutions. The impact of this Act on the lending market might be described as having a confidence-building effect, in particular with respect to the syndicated loan market. In November 2018, the Austrian federal government decided to restructure the banking supervisory framework by bundling supervision over the financial market with the Austrian Financial Market Authority (FMA). This took effect on 1 January 2020.

Additionally, particularly in syndicated loan scenarios, the Austrian Act on Financial Collateral (*Finanzsicherheiten-Gesetz* (FinSG)), which regulates the granting and enforcement of financial collateral arrangements between participants in the financial markets, is becoming increasingly important. The FinSG provides for wider and less regulated means of enforcement of the collateral and in particular provides for the option to agree on an immediate realisation of the collateral if an insolvency, liquidation, or reorganisation proceeding is opened against the collateral provider.

Even though the issue is broadly overshadowed by the discussion about COVID-19 financing, criteria for green and sustainable financing products are becoming increasingly concrete throughout Europe and also in Austria. With the adoption of Agenda 2030 by all members of the United Nations and the ratification of the Paris Agreement, Austria has also committed itself to the goal of a more sustainable economy and society. The Paris Agreement assigns the financial sector a key role in this process. The "Green Supporting Factor" mentioned in the current Austrian Government Program, with its programmatic declaration to work at European level to ensure that banks have to deposit less equity capital for loans that effectively contribute to accelerating the transition to a sustainable, climate-neutral economy, also pursues this approach. Green loans and sustainable financing are likely to play an increasingly important role in Austria in the years to come.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

One major loan transaction was the European Investment Bank's EUR 400 million financing of the Vienna Airport passenger terminal, with the involvement of Austrian credit institutions as guarantors. It is worth mentioning that there is also a general trend in the Austrian lending market to scrutinise long-term loans in terms of agreed interest *versus* market interest. As sustainability is an issue with ever-increasing importance, the Österreichische Kontrollbank AG (Austria's central finance and information services provider for export and the capital market) issued its first Sustainability Bond with a volume of EUR 500 million in 2019. The net issue proceeds are being used in order to (re-)finance social as well as environmental projects. A further example of the financing of green projects that support the production of CO_2-neutral energy is the expansion of one

of the largest wind farms in Austria, which started in 2019 and is debt financed mainly by the European Investment Bank and UniCredit in the amount of EUR 107.4 million. In addition to these sustainable loans, in the shadow of the state aid financing of Lufthansa Group in Germany, its Austrian subsidiary Austrian Airlines was also financed with a state-guaranteed syndicated loan in 2020. Refinancing of Austrian state aid measures is also a topic of increasing importance, Fellner Wratzfeld & Partner having advised in a long-term refinancing of EUR 600 million in Lower Austria.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Downstream guarantees (or other securities) are not restricted by Austrian law. Stringent limitations apply, however, to upstream and side-stream guarantees provided by corporations (and equivalent entities).

As a basic principle, distributions to (direct or indirect) shareholders of a corporation (AG, GmbH, GmbH & Co KG, i.e. a limited partnership in which the only unlimited partner is a GmbH) may only be effected under specific circumstances, namely (a) in the form of formal dividend distributions based on a shareholders' resolution, (b) in the case of a capital decrease (which also requires a shareholders' resolution), or (c) in the form of a distribution of liquidation surplus. Besides that, it is recognised that a company and its shareholders may enter into transactions with each other on arm's-length terms and conditions. This requirement entails that the management of the company makes – prior to entering into such a transaction – a comprehensive assessment of a proposed transaction, in particular of the risks involved, and shall only enter into such transactions with its (direct or indirect shareholder or a sister company) if and to the extent that it would enter into the transaction on identical terms and conditions with any unrelated third party. However, the management must not enter into a transaction, if by any such transaction the existence of the company would be threatened.

To some extent, Austrian law jurisprudence also accepts specific corporate benefits as an adequate means of justification for granting upstream and side-stream guarantees. Requirements for such corporate benefit are that the corporate benefit must not be disproportionate to the risk and that it must be specific and not only general, such as a general "group benefit".

Austrian case law on these restrictions is based on a case-by-case evaluation and has become increasingly stringent over the last 20 years. In practice, it is advisable to have the management of the company assess the proposed transaction in accordance with the above criteria. Potential consequences of a breach of these Austrian capital maintenance rules include personal liability of the management as well as nullity of the respective transaction.

The above principles do not only apply in respect to funds or loans paid by a company but to all benefits granted by such, including guarantees for borrowings.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

As discussed in question 2.1, a violation of the stringent capital maintenance rules will have the result of the transaction being deemed void (*ex lege*). The company would then have a claim for repayment against the person or entity that has received the funds. Only if transactions are *per se* (economically and as per the assumed intention of the parties, if they reasonably would also have entered into the remaining part of the transaction) dividable into separate parts, then Austrian jurisprudence holds that the violation of capital maintenance rules shall render the transaction only partially void. Whether any such transaction (e.g. a guarantee) would be found by any competent court to be only partially or entirely void is decided on a case-by-case basis, which therefore causes tremendous risks to the predictability of such type of transaction.

Shareholders and managing directors of corporations may be held personally liable for damages, if capital maintenance rules are violated. The provision of a guarantee/security for only a disproportionately small (or no) benefit would presumably constitute such a violation. In case of a violation, managing directors are liable for their own culpable behaviour; i.e. if they did not act in accordance with the standard of care of a prudent businessman, provided that the directors' liability is in principle only towards the company, but not towards individual shareholders or creditors (although exceptions apply).

In order to mitigate the risks of nullity of a guarantee or personal liability of the management of the company providing the guarantee, it has become common practice in Austria to include limitation language, restricting the (potential) enforcement of upstream or cross-stream security arrangements to the maximum permissible extent under Austrian capital maintenance law. Since the validity of upstream or cross-stream guarantees needs to be subject to a case-by-case evaluation, any reliance on upstream or cross-stream guarantees and the according use of limitation language causes ambiguities and is likely to decrease the commercial value of such guarantees.

2.3 Is lack of corporate power an issue?

Austrian companies are generally not subject to the *ultra vires* doctrine. Internal restrictions, which may be based on organisational regulations or on internal approval procedures (e.g. if the supervisory board has to consent to a measure), are allowed and very common, but they generally have no effect on the validity of agreements with third parties. However, such internal restrictions may have to be observed if the third party was aware of the excess of corporate power by the corporations' representative and if the damage to the company resulting therefrom must have been obvious to such third party or if the management and the third party had acted collusively with the management to the company's detriment.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

The Austrian Banking Act (*Bankwesengesetz*) requires a banking licence to be issued by the Austrian regulator (FMA) for the lending business, i.e. the commercial providing of financing to borrowers. Notified licences of a credit institution domiciled in another European Economic Area (EEA) jurisdiction (based on the home Member State concept) will be held equivalent for that purpose. The same applies for the acquisition of (loan) receivables on a commercial basis (i.e. factoring) which, in principle, prevents work-around structures, such as the disbursement of a loan by an Austrian "fronting bank" and immediate acquisition of the loan by a foreign, non-licensed lender. Insurance

companies granting loans in order to create a reserved asset base for the purpose of their insured persons/customers are, *inter alia*, subject to some exceptions.

Limited exceptions also apply in the context of small-category financings such as crowd-funding which, in Austria, was regulated in statutory law in 2015 (and was then amended in 2018) and provides for exceptions from both the bank licence and capital markets' prospectus requirements, if and to the extent that a financing does not exceed certain thresholds.

Resolutions, such as shareholders' resolutions, are – as set out in question 2.3 – not a general requirement for the validity and enforceability for an act of the legal representative of an Austrian corporation (limitations may apply as set out in question 2.3). However, it is, especially with respect to larger/syndicated financings, standard market practice to obtain shareholder approvals for entering into a loan agreement, security agreement or other associated finance documents or to obtain capacity opinions, which will be based on the respective review of corporate resolutions.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Apart from general limitations in connection with capital maintenance rules (as discussed above) and customary contractual enforcement limitations, it shall be noted that guarantees, and the maximum amount owed under a guarantee, will be interpreted on a very strict basis and ambiguities in the wording of the guarantee may be interpreted by a court to the detriment of the beneficiary of the guarantee.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Under Austrian law, there are no such exchange controls which would pose obstacles to the enforcement of guarantees.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

In Austria, there are two general groups of collateral that may be used to secure lending obligations: personal collateral on the one hand; and *in rem* collateral on the other hand.

The following types of personal collateral for securing lending obligations are the most common: (a) assumption of debt (*Schuldbeitritt*); (b) sureties (*Bürgschaften*); (c) guarantees; and (d) letters of comfort (*Patronatserklärungen*).

The most common types of *in rem* collateral used are the following: (a) pledge of assets (such as a pledge on movables or a mortgage); (b) transfer of title for security purposes (*Sicherungsübereignung*); (c) assignment for security purposes (*Sicherungszession*); and (d) retention of title (*Eigentumsvorbehalt*).

In general, the most common types of collateral are share pledges, mortgages, account pledges, assignment of current and future receivables, trademark and IP-right pledges, and sometimes the pledge on stock in warehouses (which, based on the very stringent law on perfection of pledge, basically requiring that the pledgee takes control over the stock, is extremely difficult to establish and maintain under Austrian law).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

The concept of a general security interest in all (current and future) assets of the pledgee to the assignee does not exist under Austrian law. As a result of the various different perfection requirements for different types of collateral under Austrian law (e.g. entry into the land register for mortgages, book entry for the assignment of claims as an alternative to the notification to the third-party debtors, the notification of the company when pledging shares in an Austrian Limited Liability Company), but also for reasons of enhancing the enforceability of collateral even in case one category of collateral was not perfected or is not enforceable, it is standard market practice to have one security agreement for each class.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

A mortgage is the only form of security over real property (land). A mortgage grants a right of preferential satisfaction to the pledgee when the pledgor does not meet its payment obligations. It is necessary that a mortgage deed be agreed upon between the pledgor and the pledgee. For perfection, the mortgage needs to be registered in schedule C of the land register. When intending to effect the entry into the land register, the pledgor of the property must provide a specific consent declaration in authenticated form regarding the registration (*Aufsandungserklärung*). Multiple pledges over one individual property are possible and will be ranked among each other in terms of priority (the point in time when the application for registration of the pledge in the land register reaches the competent land register). A mortgage can be registered for a fixed amount as a regular mortgage, including a certain percentage of the interest, interest on default, and a fixed amount of ancillary costs. Additionally, it is also possible for a mortgage to be registered with a maximum amount for loans granted. The secured obligations under such a mortgage can vary over the lifetime of the mortgage, with the amount actually secured being the outstanding amount owed by the pledgee from time to time. There is also a possibility to establish a mortgage over more than one property by creating a simultaneous mortgage (*Simultanhypothek*).

Registration fees play a significant role in the registration of a pledge over real property in the land since they amount to 1.2% of the secured amount of the real property. In order to avoid such fees in some lending scenarios, the lender agrees to receive a registrable (i.e. authenticated) pledge agreement in combination with a ranking order resolution (*Rangordnungsbeschluss*), which ensures for one year that no third party may enter another mortgage into the specific rank.

A pledge of real estate generally also extends to any fixtures and accessories. Any equipment that is not connected to a real property in the sense of the preceding sentence is considered to be movable property. With regard to security agreements in respect to movables, no specific formal requirements must be observed. However, Austrian law imposes strict standards of perfection that either require a physical transfer of the pledged goods or any equivalent measure, such as handing over via declaration, in case the physical transfer would be too burdensome to be performed. The same strict perfection requirements are required in case of full title transfer of such goods for security purposes (in order to avoid circumvention).

Warehouse pledges are generally admissible under Austrian law as well, provided the stringent rules in respect to the perfection of the assets contained in the warehouse are observed, which basically requires signage of the goods and the appointment of a warehouse custodian, who shall be strictly bound by the instructions of the pledgee only and shall ensure that goods are only removed from the warehouse if such is accepted by the pledgee.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security rights may be taken over receivables either by way of pledge or by way of full transfer of rights (for security purposes) via assignment. In the case of a pledge, the pledgee will be granted preferential satisfaction out of the proceeds. On the other hand, however, in the case of an assignment, the assignee becomes the owner of the claim, holding it in trust for the assignor for security with the purpose of obtaining preferential satisfaction.

In accordance with the principle of speciality, the pledge can only be perfected in relation to a specific object (chattel). This means that it is impossible to grant a pledge over all of the assets of the debtor. Furthermore, the pledgee is obligated to keep the pledged chattel and prevent the pledgor from further utilising it.

Under Austrian law, in general, no more requirements other than an agreement between the assignor and the assignee have to be fulfilled in order to take receivables as security. While not each and every claim has to be specifically identified, any receivable that is to be assigned must be sufficiently realisable (capable of satisfaction). If the respective receivables are recorded in the creditor's/assignor's books, it is mandatory that the pledge is annotated in both the list of obligors of the assignor and in the list of open accounts. Notifying third-party debtors, however, provides an alternative perfection procedure. Future receivables, which are determined or at least determinable (i.e. if the parties and the legal reason of the agreement are certain), can also be subject to assignments (or pledges). Receivables pledges and security transfers may also extend to future receivables or certain categories of receivables, if and to the extent that such receivables are duly described in the security agreement.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Under Austrian law, collateral security may be taken over cash deposited in bank accounts. Such cash collateral is commonly established in the form of account pledges, which are not subject to any special form requirements and therefore in practice principally drawn up in simple written form. In order to become perfected, the bank that holds the respective account must be notified or adequate markings must be made in the pledgor's records and accounts (in its capacity as the third-party debtor).

The commonly used general terms and conditions of Austrian banks provide for a general pledge over all funds of a bank's customer for any funds transferred by customers into custody of the bank (i.e. the funds of customers on bank accounts). This standard pledge agreement contained in the general terms and conditions is typically waived or subordinated if the funds on bank accounts are pledged for security purposes for a pledgee other than the bank holding the account. As of the date the pledge has been created, the owner has no access to the funds in the bank account and the respective garnishee must not pay out money from the pledged account to the owner.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Security rights over shares in a Limited Liability Company (*Gesellschaft mit beschränkter Haftung – GmbH*) are generally created by way of pledge. While the actual transfer of GmbH shares requires a notarial deed, a share pledge may be done in (simple) writing form. Such shares are not evidenced by a share certificate. Therefore, for the perfection of the GmbH share pledge, notification to the managing directors of the company is required. In practice, share pledges are commonly made together with a power of attorney for the sale of the shares in case of an event of default by the pledgee, whereby such power of attorney needs to be executed by the pledgor in authenticated form to comply with the requirement that a power of attorney for the sale of shares in a GmbH has to be authenticated.

The pledge of shares of a Stock Corporation (*Aktiengesellschaft*) differs from the pledge of GmbH shares, as shares of an AG are typically certificated as securities, which is especially reflected in the different perfection requirements. In contrast to the GmbH, the sale of shares in AGs requires no specific form and thus, powers of attorney for the sale, if any, are not required to be authenticated.

Generally, the perfection of *in rem* securities over movables (such as certificated securities) requires that the pledgee obtains direct or indirect (e.g. via the account bank) possession in the shares. Only shares in stock-exchange listed companies may be certificated as bearer shares (*Inhaberaktien*). This is effected through a global share certificate with the shares then being introduced into an electronic clearing system. In such case, a pledge may be created by transferring the shares to the pledgee's securities deposit account or by blocking the pledgor's account in the pledgee's favour.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

As set out in question 3.3, Austrian law imposes strict standards of perfection for all kinds of movables, including inventories, and either requires a physical transfer of the pledged goods to the pledgee (or its custodian) or any equivalent measure, such as handing over via declaration, in case the physical transfer would be too burdensome to be performed. In respect to inventory – as is the case with respect to general warehouse pledges – for perfection of the security, it will be necessary that the inventory is stored separately from all other goods of third parties and access to the inventory (and any release of inventory) is strictly observed – and subject to agreement by the pledgee – by a custodian of the pledgee.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Subject to the limitations arising from the stringent capital maintenance rules under Austrian law, there are no general obstacles under Austrian law that a company may at the same time under one credit facility grant security for its own obligations as borrower under such credit facility and grant security (or guarantee) for the obligations of other obligors under such guarantee facility (which is, e.g., regularly the case if a holding company

takes up the loan and guarantees as the borrower the obligations of all or certain of its direct and indirect subsidiaries).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Stamp duty is governed by the Stamp Duty Act (*Gebührengesetz*) and follows a strict civil approach, which is that stamp duty is levied on various legal transactions concluded in physical written form (but also electronically, such as via e-mail). Also, legal documents executed abroad can trigger stamp duty. Stamp duty is levied either when both parties to an agreement are Austrian residents or when the written document evidencing the transaction is brought to Austria in its original form or in the form of a notarised copy, provided that the legal transaction has legal effect in Austria; or a legal obligation is assumed under the legal document or will be performed in Austria. Furthermore, stamp duty may be also triggered if based on a written document another legal binding action occurs in Austria or if such document is used as evidence before authorities or courts.

The Stamp Duty Act provides for a wide variety of documents, which trigger stamp duty. Documents often used in connection with loan agreements include: sureties, which trigger a 1% stamp duty; assignment agreements, which trigger a 0.8% stamp duty; or mortgages, which trigger a 1% stamp duty, in each case calculated from the fair value of the security.

A significant potential tax burden/risk has been removed from granting loans to Austrian borrowers, in the form of the abolition of Austrian stamp duty (*Rechtsgeschäftsgebühr*) on loans (*Darlehen*) and credits (*Kredite*), effective for loans and credits granted on or after 1 January 2011.

When creating mortgages, the underlying pledge agreement must be authenticated to obtain registration in the land register. Notarisation fees usually depend on the value of the transaction. In addition, registration of mortgages in the land register triggers a registration fee of 1.2% of the fair value of the mortgage.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Registers for perfection of security over assets exist in Austria for mortgages and – even though in principle an entry in the books of the owner of IP rights is also considered a permissible method of perfection of, e.g., trademark pledges – the trademark and patent register. Thus, only in respect of mortgages and IP rights will public authorities be involved in the perfection (registration) process of pledges. Registration of pledges in those registers shall usually be completed in a timeframe of up to two weeks. If timing is of the essence, informal pre-notification to the register is a practical means to ensure a swift process.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory or similar consents are required with respect to the creation of security. It shall be noted, however, that if, e.g., a mortgage is created or shares are pledged in a corporation owning real estate, the realisation of such collateral might be hampered by the fact that the acquisition of real estate by non-Austrian parties might be subject to restrictions as to real estate transfer in relation to foreign parties. Further, the realisation of pledges in shares or in a business may be subject to merger control.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No special priorities or other concerns exist in relation to the securing of revolving borrowings, provided that, if future claims are to be secured, such future claims must be clearly identifiable.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

With regard to notarisations, see questions 3.3 and 3.6 above. Where a security agreement is executed on the basis of a power of attorney (*Vollmacht*), parties require authorisation pursuant to the power of attorney to be evidenced on the basis of a complete chain of corresponding powers certified by notaries or corresponding entries in commercial registers (*Firmenbuch*). In case a power of attorney is executed by a foreign company, a foreign notary may confirm the identity of the signatories and the content of the respective foreign commercial register. In some cases of foreign certification, an apostille is required. With regard to changes due to the COVID-19 pandemic, see question 11.1 below.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

As set out in more detail in question 2.1 above, Austrian companies are subject to strict capital maintenance rules, which generally (subject to exemptions which are described in question 2.1 above) do not permit upstream guarantees or other upstream securities. Thus, in case of acquisition of shares in a company, such acquisition must not be collateralised by shares of the target company. The same restrictions apply to "sister subsidiaries", if they are directly or indirectly subsidiaries of the target's direct and indirect shareholders.

On the other hand, downstream collateral, such as shares in a direct or indirect shareholder company (holding company) of the target company, can serve as collateral for the acquisition financing without violating the downstream collateral capital maintenance rules.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Collateral that is accessory, such as sureties or pledges, must not be separated from the underlying secured obligation, otherwise the collateral will cease. The concept of "security trustees" or agents, as well as a generic type of "parallel debt", is not recognised under Austrian law to validly establish collateral for one

"security agent" which is not at the same time a lender or not a lender in respect of all obligations that shall be secured by the (accessory) collateral. It is, therefore, market practice to include a parallel debt structure for the security trustee concerning security governed by Austrian law. In order to ensure that the requirements of the accessory collateral are met, the Austrian market practice either provides that all secured parties are at the same time pledgees (or direct beneficiaries) under the security agreements or that a "security agent" is appointed, whereby it is agreed among all lenders with the consent of the borrower (or other obligors) that such security agent is the joint and several creditor (*Gesamthandgläubiger*) of all claims, it being further agreed among all creditors that only the security agent shall (following a decision process among all lenders) have the right to enforce the collateral and will then distribute the proceeds from such enforcement among all lenders in proportion to their exposure under the secured obligations.

In respect of non-accessory collateral (e.g. guarantees), it is not required for their validity that they are directly connected with the secured obligation. However, since loan documentation typically includes accessory and non-accessory collateral, it is market practice to provide for joint and several creditorships if the lenders desire to execute their rights arising from the collateral via one security agent.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

As discussed in question 5.1, the most common lending practice provides that the (Austrian type of) security agent is a joint and several creditor (*Gesamthandgläubiger*) of all claims of any of the lenders.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

In this context, it is necessary to observe that Austrian law differentiates between fully abstract guarantees (*Garantien*) and sureties (*Bürgschaften*).

Guarantees are considered to be separate non-accessory claims against the guarantor according to Austrian law. Therefore, generally, a guarantee would need to be assigned to Lender B, provided, however, that the guarantor retains all objections *vis-à-vis* Lender B that result from the guarantee agreement with Lender A upon a transfer of the loan and assignment of the guarantee.

In contrast, sureties are considered to be accessory claims according to Austrian law, which are consequently automatically transferred upon assignment of the secured loan. Another difference to guarantees is that the grantor of a surety is not only entitled to raise objections resulting from the surety upon transfer of the loan, but also to raise objections which stem from the relationship between the obligor and creditor under the loan agreement.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Generally, repayments of principal under loan transactions are not subject to withholding tax. In addition, interest payments are not subject to withholding tax as a general rule. Rather, such payments will have to be taken into account for purposes of the (corporate) income tax of the lender. If payment of interest is effected, however, to a non-Austrian lender then withholding tax in the amount of 35% may apply.

There are numerous double taxation treaties concluded between Austria and other jurisdictions, which typically provide for such withholding tax to be considered as deductible and/or refundable; even though there is a new OECD model convention in force as from 2017 and such model convention is also applicable to existing tax treaties due to acceptance through the Multilateral Instrument (MLI), there are no changes in this respect.

Due to the introduction of comprehensive cross-border information undertakings among authorities, the withholding tax legislation is not applicable from the end of 2016 onwards.

As regards proceeds of a claim under a guarantee or the proceeds of enforcing security, there is generally also no requirement imposed by Austrian law to deduct or withhold tax.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No Austrian taxes of any kind, e.g. stamp duty, issue, registration or similar taxes apply with regard to loans, mortgages or other security document for their effectiveness or registration and, similarly, no incentives whatsoever are provided in a preferential way to foreign lenders.

In case the foreign lender acts as an investor, the Austrian government in general would welcome such foreign direct investment. This is especially the case if those investments have the prospect to create new jobs in high-tech fields or promote capital-intense industries (cash grants may possibly be awarded). A particular focus is also given to investments that enhance research and development where specific tax incentives are available. A similar priority for the government is the environment; thus, investments should not have any negative impact in this regard. Financial incentives may also be provided according to EU guidelines to promote investment in Austria, which are equally available to domestic and foreign investors, and range from tax incentives to preferential loans, guarantees and grants. Most of these incentives are available only if the planned investment meets specified criteria (e.g. implementation of new technology or reduction of unemployment).

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Generally, no income of a foreign lender will become taxable in Austria, solely because of a loan, a guarantee or generally the grant of a company in Austria.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

In Austria, no taxes or stamp duty will apply for the granting of loans (such loan fees were abolished in Austria in 2011) or (abstract) guarantees.

With regard to surety agreements and mortgages, stamp duty at the rate of 1% of the secured interest will apply. Similarly, for assignments, stamp duty at the rate of 0.8% of the secured interest will apply. In connection with bill transactions, stamp duty at the rate of 0.125% of the secured interest will apply.

Also, notary fees may be payable; e.g. with respect to the creation of mortgages, which must be notarised for registration and will depend on the transaction value. In addition, the registration of a mortgage in the land register will incur a registration fee of 1.2% of the mortgage.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

In general, Austrian law does not provide for any such consequences.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Austrian law and conflicts of law rules generally permit the choice of a foreign law as the governing law of a contract, which is also the case if the respective contract is to be enforced in Austria. Regulation (EC) 593/2008 of 17 June 2008 on the Law applicable to Contractual Obligations (*Rom I Verordnung*) is applicable in Austria and must be observed in this context. Following such Regulation, Austrian courts will principally recognise the contractual choice of foreign law, subject to certain requirements (e.g. actual conflict of laws, or the contract relates to a civil and/or commercial matter), and to this extent, Austrian courts have jurisdiction for claims under such a contract. However, some restrictions apply regarding the granting and perfection of security rights, which, depending on the type of security, is in many cases governed by local Austrian law (e.g. for pledges over shares in Austrian companies, pledges over security assignments of Austrian law-governed receivables or for the creation of mortgages over real estate properties located in Austria). Hence it is common market practice that security rights over assets that are located in Austria, including those which are provided by Austrian domiciled transferors or pledgors, have Austrian law-governed security documentation.

In addition, in cases where there is no actual conflict of law or where the contract is solely connected to EU Member States, the parties are not allowed to choose the law of a non-Member State. Additionally, no choice of law will be recognised by Austrian courts which would violate Austrian *ordre public*.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

As regards the enforcement of judgments or awards that were not rendered in Austria, there are generally the following options:

- **Court judgments of EU Member States**: The enforcement of judgments rendered in another EU Member State is governed by Regulation (EC) No 1215/2012 on the Jurisdiction and Recognition and Enforcement of Judgments in Civil and Commercial Matters (Brussels Ia Regulation). As in Austria the Brussels Ia Regulation is applicable, judgments from other EU Member States are recognised without any special procedure being required or any re-examination of the merits of the case (exceptions may apply, mainly with respect to Austrian *ordre public*).
- **Court judgments of non-EU Member States**: Beyond the applicability of the Brussels Ia Regulation, enforceability of foreign judgments is conditional and depends on whether there is a bilateral treaty between Austria and the domicile of the other party. According to Austrian law, reciprocity is ensured under bilateral treaties/regulations and is assumed as a fundamental criterion for the enforcement of court judgments. Additionally, it is required that Austrian law would not have denied the foreign court, having rendered the relevant decision, if the defendant in the enforcement proceedings has been duly convoked in the original proceedings before the foreign court and if the relevant judgment is final in the sense that it may no longer be challenged before the courts and authorities of the foreign state. In case the counterparty had not had the opportunity to participate in the foreign court proceedings, the enforcement of such court judgment may be denied. The same applies in case the enforcement is aimed at an action which may not be enforced or that is not allowed under Austrian law, or if the Austrian *ordre public* would be violated.
- **Arbitral awards**: Austria is a contract state of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Arbitral proceedings and the enforcement of arbitral awards are common in Austria (see in this respect question 7.7 below).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

As a general rule, the duration of court proceedings depends on several factors such as the complexity of the case and the overall workload of the specific court. Usually (considering the above-mentioned factors) a judgment might be expected within one year with regard to question 7.3 (a). With regard to question 7.3 (b), the best case scenario for an enforcement of a judgment from an EU Member State may be expected within a few days and a couple of months in case of judgments from a non-EU Member State. Although those estimations are generally applicable, they vary from case to case and proceedings could require significantly more time. The timeframe may be stretched by remedies especially, and in particular by appeal against first instance judgments (as is the case most of the time).

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

For the different types of securities and any other contractual arrangements, the enforcement of contractual security rights varies significantly. Security rights are usually enforced through statutory law applied by courts as a general principle, but deviations are possible in case of contractual arrangements between parties, which are permissible. Regarding the most relevant types of security, the following statutory rules and market practices apply:

- **Share pledges**: Common market practice for shares in Limited Liability Companies and shares in Stock Corporations is to agree on out-of-court enforcements. This requires notification of the pledgor as well as a valuation of the shares and subsequent disposal to the best bidder (usually the pledgor is also granted the right to participate in the bidding process).
- **Mortgages**: A public auction is required for mortgages; the involvement of the court could lead to delays in the enforcement procedure.
- **Receivables**: There is no specific enforcement procedure in place for receivables. The assignee (or the pledgee if granted a power to collect) is entitled to directly claim the payment from the debtor in case of default.
- **Guarantees/suretyships**: There is no specific type of enforcement procedure for personal security such as guarantees or surety. Following the terms and conditions agreed in the security arrangement (e.g. priorities), the payment can be requested directly from the obligor (and enforced in court proceedings).
- **Movable property**: The standard practice for movable property is to modify the enforcement procedure under statutory law to permit out-of-court enforcements. Adhering to a cooling-off period of one month and following public auctions, movable goods may be sold after notification of the pledgor.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Foreign lenders may be required to deposit court fees before proceedings commence. Lenders seated in EU Member States or states that are party to the Hague Convention on Civil Procedure of 1 March 1954 are usually not required to post collaterals for court costs.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

As of the opening of the insolvency proceedings, the litigation and execution of claims by individual creditors is no longer permitted. As of such date, the enforcement of a claim requires its filing as an insolvency claim (*Insolvenzforderung*) with the insolvency court. The application period (*Anmeldungsfrist*) is published in the decree; however, the claim can also be filed after expiration of such period, although additional court fees may apply. Afterwards, the insolvency administrator collects all claims in the claim table (*Anmeldeverzeichnis*), which is presented to the court. During the examination hearing (*Prüfungstagsatzung*) all duly filed claims are examined. At such hearing, the insolvency administrator must declare which of the individual claims shall be acknowledged or declined. For a claim to be considered acknowledged, however, it is also required that no other creditor contests such claim. When acknowledged, the creditor will take part *pro rata* in the distribution of the applicable insolvency quota. With regard to the enforcement of collateral security, please see questions 8.1 and 8.2 below.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

An arbitral award rendered by an arbitral tribunal having its seat in Austria generally constitutes an executory title under the Austrian Enforcement Act (*Exekutionsordnung*) and does not require a declaration of enforceability by a domestic court. Under these circumstances, it is considered sufficient to attach to the enforcement request a copy of such arbitral award with a confirmation of its final and binding nature and enforceability issued primarily by the chairman of the arbitral tribunal.

In respect to foreign arbitral awards, the New York Convention of 1958 is the prime basis for the recognition and enforcement. Sec. 611 Austrian Code on Civil Procedure (*Zivilprozessordnung*) provides possible legal grounds for re-examining/setting aside an arbitral award. However, in general, an Austrian Court will not re-examine the merits of an arbitral case, but review the award with regard to procedural errors (e.g. if the decided dispute is not covered by the arbitral agreement or if an arbitral agreement does not exist at all or if the matter in dispute must not be arbitrated). Certain exceptions apply; especially where an arbitral award conflicts with the fundamental values of the Austrian legal system (*ordre public*).

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

A secured creditor is barred from exercising enforcement rights regarding its security for a maximum period of six months after the opening of insolvency proceedings if the exercise of such enforcement rights would endanger the operation of the debtor's business. However, this does not apply where the performance of such enforcement rights is necessary to prevent the secured creditor from being exposed to severe personal or economic danger, provided that it is not possible (and will not be possible) to provide full satisfaction to the creditor by execution into other assets of the debtor.

In insolvency proceedings, secured creditors are divided into categories. The claims of secured creditors are settled in a determined order. First, rights to separation of property (*Aussonderungsrechte*) are handled. Property of third parties caught in the insolvency proceedings must be returned to such third parties. After that, rights to separate satisfaction (*Absonderungsrechte*) are handled. Separate satisfaction is granted to creditors, whose claims are secured by a pledge or otherwise either by law or by agreement. The insolvency administrator may initiate auctions or forced administration of the insolvency estate's immovable assets, even if the asset is subject to a right of separate satisfaction.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The Austrian Insolvency Act provides rules which enable creditors to contest certain transactions which possibly decrease the assets of the debtor prior to the opening of insolvency proceedings. In this respect, transactions that were entered into by the debtor and a third party, which discriminate against other creditors, might be contested. The respective transaction must be contested by the appointed insolvency administrator.

Generally, for the contestation of transactions, the following is required: (i) it concerns an existing transaction; (ii) that such transaction is entered into prior to the opening of the insolvency proceedings; (iii) the transaction somehow decreases the assets of the debtor; (iv) the transaction discriminates against other creditors; and (v) the claim fulfils one of the specific contesting provisions of the Austrian Insolvency Act.

The Austrian Insolvency Act provides basically for the following specific contesting provisions:

1. Discriminatory intent (*Benachteiligungsabsicht*):
   This provision applies if the debtor acted with the intent to discriminate against creditors and the other party either knew of this intent (in this case all transactions within the last 10 years prior to the initiation of insolvency proceedings are impeachable) or should have been aware of it (then all transactions up to two years preceding the initiation of insolvency proceedings are covered).
2. Squandering of assets (*Vermögensverschleuderung*):
   A transaction is contestable if it is seen as squandering the company's assets. The other party must have known or should have been aware of this (transactions up to one year preceding the initiation of insolvency proceedings).
3. Dispositions free of charge (*Unentgeltliche Verfügungen*):
   Transactions that were made free of charge and which were entered into within the two years prior to the opening of the insolvency proceedings are contestable.
4. Preferential treatment of creditors (*Begünstigung*):
   This provision applies where a transaction discriminates against one creditor *vis-à-vis* the others or is intended to prefer one creditor *vis-à-vis* the others after the debtor is materially insolvent or after the application for the opening of insolvency proceedings has been submitted or 60 days prior to either such event.
5. Knowledge of illiquidity (*Kenntnis der Zahlungsunfähigkeit*):
   A legal act based on the knowledge of illiquidity of the debtor might be contested after illiquidity has occurred, where the contracting third party knew or negligently was not aware of the debtor's illiquidity.

All provisions outlined above secure the debtor's assets prior to the opening of the proceedings. After the opening of insolvency proceedings and appointment of an insolvency administrator, the debtor is solely represented by the insolvency administrator. This does not apply where insolvency proceedings were opened as restructuring proceedings by self-administration of the debtor (*Sanierungsverfahren mit Eigenverwaltung*), which under certain circumstances is subject to the consent of the insolvency administrator, the court or the creditor's committee. Otherwise, any transaction or disposition of a debtor's property can only be undertaken by the insolvency administrator (and under certain circumstances requires the consent of the court or the creditor's committee) after the opening of insolvency proceedings.

Estate claims (*Masseforderungen*) are generally preferred claims when the general estate (not the preferred estate) is distributed. Such estate claims comprise, e.g., claims for the general continuing of the business, including claims of employees, after opening of the insolvency proceedings.

Due to the COVID-19 pandemic, the Austrian legislator amended the law regarding contestation. Pursuant to such amendment, bridge loans that are granted in order to fund short-term working capital up to 120 days cannot be contested if they were granted between 1 March 2020 and 31 January 2021 (the latter date may be postponed by further legislation in the future). In addition, in order to protect the economy from multiple insolvency proceedings, an application for opening an insolvency proceeding can no longer be filed because of over-indebtedness and insolvency proceedings will not be opened in cases where a creditor has filed for proceedings for this reason. This amendment, which currently applies from 1 March 2020 until 31 March 2021, began discussions on whether over-indebtedness could still be a reason to contest payments or other transactions. There is some dissent in the community on this issue and the question may not be answered until a corresponding decision by the Supreme Court is available. The inability to pay debts when they fall due remains a trigger for the obligation to file for insolvency.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Austrian insolvency law is generally not limited to any type of entity. The insolvency ability is rather defined as part of the private law legal capacity. Therefore, generally, any natural person, as well as legal entities (private or public) and inheritances can be a debtor and can become insolvent.

With regard to banks, investment firms, investment services companies and insurance companies, it should be noted that such entities may be subject to winding-up but not to bankruptcy procedures.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

If no out-of-court seizure of assets is agreed upon (or even in case such agreement is made but not observed by the debtor), the process for seizure of assets of companies has to be made via court enforcement.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The contractual choice of forum is generally permissible and legally binding as defined per Art. 25 of the Brussels Ia Regulation, which is applicable for cross-border scenarios in case a party submits to a foreign jurisdiction, although specific form requirements may apply. It is also permissible if expressed and agreed that the forum shall be chosen by one party. It needs to be considered that, for instances where the courts have exclusive jurisdiction pursuant to Art. 24 Brussels Ia Regulation, no choice of forum is permissible. This applies especially to proceedings in respect to rights *in rem*.

The Brussel Ia Regulation may not be applicable in case only one party has its domicile in an EU Member State and the other party also has its domicile in the same country or in a non-EU Member State. The choice of jurisdiction clause would then be governed by domestic law or other applicable conventions on the choice of law. In any case, domestic rules also correspond to the Brussel Ia Regulation to a large extent.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Provided it does not conflict with public international law or special immunities, such as diplomatic immunity, a waiver of sovereign immunity is usually legally binding.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

In order to provide loan financing on a commercial level to companies in Austria, there are three possible options:

- Application for a banking licence. A valid licence is a prerequisite for conducting banking transactions. The licence for conducting banking transactions may have certain conditions and obligations attached to it, whilst parts of individual types of banking transactions may be excluded from the scope of the licence. Obtaining a banking licence is a rather complicated procedure and requires in-depth preparation over a longer period of time. The legal requirements that have to be fulfilled are especially extensive, as is the creation of an appropriate business plan that has to be reviewed by the regulator.
- Credit institutions authorised in an EEA Member State are in principle already authorised on the basis of their authorisation/licence in their home state to provide banking services in other Member States. Hence, a credit institute of another EU Member State may establish a branch based on the "EEA freedom of establishment" (which would need to be notified to the Austrian regulator).
- Utilising the EU freedom of service to render services in Austria, which is the most common approach for non-Austrian banks holding a licence in an EEA Member State that want to become active in the lending business and wish to avoid establishing a permanent presence.

Non-banks may only engage in the lending business to the extent that such activity is exempted from the requirement to hold a banking licence (e.g. acquisition of loan portfolios by special securitisation purpose entities).

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

In Austria, formal statutory requirements on signatures did not change during 2020. When the law imposes agreements or declarations in writing, a genuine signature by the parties as well as the submission of the original document to the recipient is necessary. However, such provisions have to be interpreted in the light of the legislator's intention. In some instances, Austrian courts have ruled that written agreements may be concluded by submitting a scan of the signed agreement by telefax or e-mail. Where the law requires documents to be in writing, only qualified electronic signatures can substitute wet ink signatures and the submission of the original document.

In the course of the COVID-19 pandemic and in order to support social distancing, the Austrian legislator has adapted legislation concerning documents that have to be signed before a notary. Pursuant to the 4th COVID-19 Act, the possibility for digital notarial certification, which was already possible in some corporate law cases, was extended to all other application areas that require a notarial certification by law. The signing parties and the notary are connected in a videoconference (permanent visual and audible connection required). After the identification process, the parties have to sign the document by a qualified electronic signature and the notary creates a digital notarial certified document that serves legal requirements. According to such legislation, notarial certification before an Austrian notary is now possible even if the parties are located outside of Austria.

From a practical perspective, especially in the financing sector, the use of digital signatures that are qualified electronic signatures in the meaning of Regulation (EU) No 910/2014 are much more frequently used and are, with very limited exceptions and according to law, considered equal to the written form requirement of the Austrian Civil Code.

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Belgium

Astrea

Dieter Veestraeten

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The COVID-19 pandemic has significantly impacted Belgian businesses. In order to provide financial relief to companies, the Belgian government has introduced certain financial measures with an impact on the lending market.

The financial sector has agreed to provide payment relief for non-financial companies, viable businesses run by a self-employed person and consumers with mortgage loans, who have difficulties paying their loans and who meet certain conditions, until 30 September 2020. A separate regime for consumer credit has also been introduced.

The payment relief for business and mortgage loans was extended until 31 March 2021. An extension of the payment relief for consumer loans is being discussed.

A state guarantee fund worth €50 billion has been put in place for all new credit facilities with a maximum principal amount of €50 million, which are entered into for a maximum period of 12 months between a financial institution and viable non-financial companies and businesses run by a self-employed person. This measure was introduced to maintain the financing of the Belgian economy. This state guarantee is divided into several credit institutions based on their market share as of 31 December 2019. The maximum interest that can be charged amounts to 1.25%. The commission may amount up to 0.25% for SMEs and 0.50% for large companies, depending on the term of the credit. The state guarantee mechanism was extended up to and including 30 June 2021.

As Belgium remains in a partial lockdown, it is expected that relief measures will continue.

While new Belgian rules on B2B unfair contractual terms entered into force on 1 December 2020, there are no indications yet that they will apply to financial services, which for now have remained excluded from the new rules.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

As there are no official reports on lending transactions in Belgium, we cannot comment on any specific lending transactions over the past few years.

The National Bank of Belgium ("NBB") reported in March 2020 that credits granted to non-financial institutions have been increasing since 2018. Financing conditions have been highly accommodating over the course of the last few years. However, banks have tightened lending criteria to companies due to an increased risk perception. According to the October 2020 Bank Lending Survey of the ECB, the demand for loans or drawing of credit lines has declined in the third quarter of 2020 due to lower emergency liquidity needs related to the COVID-19 pandemic, after the second quarter first saw an increase.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, provided that the guarantee falls within the guarantor's corporate purpose (see below) and corporate benefit.

The corporate benefit requirement should be assessed by the guarantor's board of directors, taking into account: (i) any direct and/or indirect benefits the guarantor derives from the loan; (ii) the balance between the risk relating to the guarantee and the benefit for the guarantor; and (iii) the guarantor's financial capacity.

It is market practice for Belgian subsidiaries granting a cross-stream or up-stream guarantee to include so-called "limitation language" in credit agreements, guarantees and security documents. Although not required by law, this reduces (but does not exclude) the risk of violating Belgian corporate benefit rules.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

If the corporate benefit requirement is not met, the guarantee can be held null and void and the directors of the company may be held liable (i) by the company for negligence in the management of the company, and (ii) by third parties in tort. However, these rules have been seldom tested under Belgian law, and there is only limited case law on this issue.

2.3 Is lack of corporate power an issue?

Yes, a guarantee must always serve the guarantor's corporate purpose, as mentioned in its articles of association. However, if the corporate purpose test is not met, the guarantee can only be held void towards a third party if that party knew or should have known that the transaction was *ultra vires*. Lenders are reasonably expected to verify a borrower's or guarantor's articles of association prior to granting a loan.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In general, no. However, in case of a listed public limited liability company (*naamloze vennootschap/société anonyme*), the guarantor's general shareholders' meeting must approve any change of control clauses in the finance documents that may considerably influence the assets of the company or create a considerable debt or obligation for the company, whereby these shareholders' resolutions must be filed with the commercial court. If not, such change of control clauses are null and void.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Belgian law does not impose any specific solvency limitations; the general test for assessing the amount of the guarantee is the corporate benefit test (see above). In view hereof, guarantee limitation wording based on the net asset value of the guarantor is usual in Belgium.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no such exchange controls or other obstacles in Belgium.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

The following types of collateral are common in Belgium: mortgage on real estate; mortgage mandates; and pledge on (i) movable assets (both tangible and intangible), (ii) the entire business, (iii) financial instruments (including shares and bank accounts), (iv) receivables, or (v) IP rights.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

In principle, a separate pledge agreement will be required for each asset type. Another possibility is a non-possessory pledge on the pledgor's entire business, which must be registered with the national pledge register in order to be enforceable.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over real property is created by a mortgage in the form of a public deed before a notary and must be registered with the mortgage register. It can, under certain conditions, either include plant, machinery and equipment, or these can be pledged by means of a pledge on the entire business that must be registered with the national pledge register to be effective against third parties.

A mortgage mandate (i.e., an irrevocable proxy to vest a mortgage) does not create any security right *in rem* and will only become perfected and take rank as of the moment of its conversion.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, a pledge over receivables can be created by a pledge agreement, which is perfected and enforceable against third parties upon its execution. However, the pledge only becomes enforceable against the debtor of the pledged receivable as of the date of notification of the pledge to, or the acknowledgment of the pledge by, this debtor.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Bank deposits qualify as receivables held against the account bank and can be pledged by way of a pledge agreement. The pledge only becomes enforceable against the account bank as of the date of notification of the pledge to, or the acknowledgment of the pledge by, the account bank. The same procedure as set out in question 3.4 applies.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes, although restrictions can apply in the articles of association; approval by a majority of the shareholders is required for certain corporate forms such as the private limited company. Foreign law chosen by the parties may govern the contractual aspects of the pledge, except for the proprietary aspects of the security which will be governed by Belgian law if the company is located in Belgium, or if the dematerialised shares are registered in a special account in Belgium. To become effective: (1) a pledge on registered shares must be recorded in the company's share register; and (2) a pledge on dematerialised assets must be registered in a special financial account.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, as a non-possessory pledge on inventory, which must be registered in the national pledge register to be effective against third parties.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A Belgian company can grant a security interest in both situations, save for the limitations of the corporate purpose and benefit (see questions 2.2 and 2.3) and financial assistance (question 4.1).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

A mortgage must be vested by notarial deed and registered with the mortgage register; this entails the payment of registration

duties (1.30% of the secured amount), notary fees and possible additional costs.

The registration of a pledge on movable assets in the national pledge register costs up to €518 per registration.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Registration of a pledge in the national pledge register can be done easily online through the website of the national pledge register. The pledge is effective immediately after payment of the registration fee. Mortgages take longer, as they require notary involvement (at least three to four weeks).

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In general, none.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

In principle, no. Security can also be vested for future debts.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In general, no. However, a notarial deed is required to document a mortgage.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company
Under the new Belgian Code of Companies and Associations, a company is allowed to grant financial assistance in the form of a loan, a guarantee or a security to secure a loan which shall be or has been used to fund directly or indirectly the acquisition of shares of the company by a third party as long as: (i) the rights of the minority shareholders are not disregarded; and (ii) the continuity of the company is not jeopardised. Only funds that are eligible for distribution can be used to provide financial assistance. To avoid available funds being used several times, the creation of an unavailable reserve for the value of the financial assistance will be required. Finally, the shareholders' meeting has to authorise the transaction, which will then be carried out under the responsibility of the management body that draws up a special report for this purpose. In practice, this procedure is rarely applied.

(b) Shares of any company which directly or indirectly owns shares in the company
The financial assistance rules do not apply when a Belgian company guarantees or secures borrowings used to acquire shares in a parent or sister company. However, it should be verified if the corporate interest test for such transaction is met.

(c) Shares in a sister subsidiary
See (b) above.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes, the financial collateral act (which applies to financial collateral such as shares and bank accounts) and the new rules in the Civil Code with respect to pledges on movable assets explicitly recognise the concept of a security agent. For mortgages, the concept of a security agent does not yet exist and a parallel debt structure might be required. The concept of trust currently does not exist in Belgian law.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Alternative mechanisms to allow one party to enforce the loan documentation and collateral security include parallel debt structures or joint creditorship.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The loan can be transferred by (a) assignment, or (b) novation.

(a) Upon an assignment, all accessory rights and security will follow the principal debt (i.e. the loans). All underlying debtors must be notified for the transfer to be effective. An unnotified debtor in good faith remains entitled to act (e.g. by paying or applying set-off to the original lender).

(b) Upon novation, new debt is created. Therefore, all accessory rights and security attached to the original debt will cease to exist, unless expressively stated otherwise.

A transfer of a mortgage-backed claim must be registered with the mortgage register. This requires a notarial deed.

A transfer of a registered pledge on movable assets must be registered with the national pledge register. This can be done online.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) A 30% withholding tax rate applies to interest payments to domestic and foreign lenders, unless exceptions or reductions from withholding taxes apply deriving from Belgian law provisions or double-tax treaties. US and EEA credit institutions are, in principle, exempt.

(b) In principle, none.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

None (save for the exceptions mentioned in question 6.1). The same taxes and incentives apply to Belgian and foreign lenders.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

In principle, no.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

In principle, no, since typically all costs (e.g. notary fees and registration duties for vesting a mortgage) are borne by the borrower.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

The rules of the EU's Anti-Tax Avoidance Directive ("ATAD") on interest limitation entered into force on 1 January 2020 for the tax year 2019 in Belgium, and replace Belgian thin capitalisation rules applicable to interest payments if a related party grants a loan or if this lender is located in a low-tax jurisdiction.

Certain reporting duties and/or proof that the payments were made in the framework of the actual and real activities may be required in order for the interest payments to be deductible, if the borrower's lender is located in a "blacklisted" or low-tax jurisdiction.

Transfer pricing rules require the "at arm's length principle" for borrowings from foreign affiliated lenders.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

A Belgian court will recognise the parties' contractual choice of foreign law, save for: (i) any mandatory provisions of other jurisdictions; (ii) applicable EU law; (iii) overriding mandatory provisions of the jurisdiction in which the obligations arising out of the contract are performed; (iv) Belgian overriding mandatory provisions; or (v) Belgian public policy provisions that might override the foreign governing law and apply directly to the contract.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

In principle, a Belgian court will recognise and enforce such judgment without re-examining the merits of the case, save for some exceptions (e.g. a judgment that is manifestly contrary to Belgian public policy or that violated the rights of defence).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) The regular judicial procedures apply if one (or both) of the parties is (are) registered with a European database of enterprises. It will take at least one year to obtain an enforceable judgment, which is, in principle, executable with immediate effect, regardless of any appeal.

Summary proceedings are possible for undisputed debts and usually provide an enforceable judgment within three months, unless the defendant disputes the claim and ordinary proceedings therefore must be held.

(b) In principle, an exequatur is required to enforce a foreign judgment in Belgium and could be obtained within 15–30 days, unless a party files an opposition.

The period for the lender to attach the borrower's assets will depend on the attachable goods (e.g. attachment of real estate can take between one and six months due to certain formalities).

A conservatory attachment of assets is possible before a final judgment or exequatur is rendered in certain situations (e.g. pending insolvency) and, generally, takes between five days and three months, depending on the assets and formalities to be fulfilled.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

(a) Following the competent attachment judge's required permission to enforce a collateral security, a bailiff or public notary will be appointed to sell the assets that the collateral security covers during a public auction. Under certain conditions, a private sale is possible.
Financial collateral or a pledge on movable assets can be enforced in a flexible manner without the prior authorisation of a court.
(b) In principle, no.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Belgian courts may require a sworn translation of any documents used as evidence and filed in a language other than the language of the court.

At the request of a Belgian defendant, a foreign plaintiff may be required to post a bond to secure payment of any expenses or damages for which the plaintiff might be liable, unless waived in an applicable treaty.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Upon the initiation of reorganisation or bankruptcy proceedings, an automatic stay of enforcement applies. However:
(a) In reorganisation proceedings, it still remains possible to create new security and prior conservatory attachments can be enforced under certain conditions. Pledges on specifically pledged receivables, pledges or security assignments on certain financial instruments and netting agreements other than close-out netting agreements remain enforceable too. However, pledges or security assignments of bank accounts cannot be enforced, unless a payment default occurred.
(b) In bankruptcy proceedings, there is an automatic annulment of all attachments. However, advanced attachment proceedings can continue under certain conditions. Financial collateral can also be enforced, even after bankruptcy of the pledgor.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

An arbitral award will be recognised and enforced without re-examination of the merits subject to the provisions of the New York Arbitration Convention and the provisions of the Belgian Judicial Code, which, however, includes a number of reasons for which an arbitral award cannot be recognised, e.g. if it infringes Belgian public policy or if it has been insufficiently motivated.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

A bankruptcy judgment suspends the enforcement rights of individual creditors. However, the suspension for creditors holding a security interest on specific movable assets and mortgagees will usually be limited up to the closing of the first minutes of the verification of the claims, unless the trustee in bankruptcy requests that they are extended up to one year from the bankruptcy judgment. Pledges or security assignments of bank accounts and certain financial instruments, as well as close-out netting agreements, will still be enforceable immediately despite the opening of bankruptcy.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

In principle, the day of cessation of payment is the day on which the company is declared bankrupt. Upon certain conditions, the trustee in bankruptcy or any interested third party can request the court to bring that date back up to six months before the date of the bankruptcy order to create a so-called "suspect period". The court will, upon the request of the trustee in bankruptcy, render certain acts of the bankrupt company performed during this period (gifts, sub value contracts, payments (in kind) of undue debts and security interests granted for antecedent debts) unenforceable against the body of creditors (and sometimes it will be obliged to do so).

The court can also declare other acts performed during the "suspect period" unenforceable if the third party was aware of the company's cessation of payments. Finally, any acts or payments, whenever performed, that are to the fraudulent detriment of the creditors, can be declared unenforceable (*actio pauliana*).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Public bodies, and organisations without legal personality and purpose of payment to its members are excluded from bankruptcy proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Subject to certain conditions, the beneficiary of a pledge over financial collateral does not need prior court intervention to directly seize the pledged assets.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Under Belgian law, a party is allowed to choose any foreign jurisdiction as a forum for its dispute. However, under certain

conditions, Belgian courts will nevertheless maintain exclusive jurisdiction (e.g. for disputes concerning rights *in rem* on immovable property located in Belgium or for overriding mandatory provisions). A Belgian court will also be competent if the case is closely tied to Belgium and it would be impossible or unreasonable to bring proceedings before a court of a chosen foreign jurisdiction.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Immunity can be waived by explicit consent.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Under Belgian law, lending money (excluding consumer credit and mortgage-backed credit to individuals for residential purposes) is not a regulated activity, provided that the lender does not solicit funds from the public in Belgium. As a result, investors and foreign banks can, in principle, grant a loan to a Belgian company without being licensed as a credit institution or a lender.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

Due to the impossibility to organise physical meetings for document execution and delivery requirements, parties to lending and secured finance agreements have been forced to move to virtual closings.

Documents are: (i) signed in original copies, whereby first digital copies are exchanged and originals are sent to the other party(ies) later; or (ii) given that digital signatures are accepted in Belgium (e.g. DocuSign), provided they are qualified as defined in the eIDAS Regulation, parties may also choose to execute copies by digital signature. Deliverables are often exchanged through e-mail or through shared files.

Due to COVID-19, a change of law has been introduced to allow notaries to execute notarial deeds upon receipt of a digital power of attorney, which is provided by holding a videoconference between the notary and the client(s).

As the pandemic continues to develop, we foresee that these mechanisms will remain in force. Even after COVID-19, it cannot be excluded that many parties will rather opt for digital document execution and virtual delivery requirements as they can be less time-consuming than holding physical meetings.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Save for those mentioned above, we do not find there to be any other material considerations to be taken into account.

Dieter Veestraeten has more than 20 years of experience advising large Belgian and foreign banks, companies and multinationals in the fields of international financial transactions (including acquisition finance, project finance, general corporate finance), debt transactions, restructuring and financial regulatory advice.
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Astrea is one of the leading independent full-service law firms in Belgium, with offices in both Brussels and Antwerp, the two largest economic and financial centres in the country. It currently has 13 partners and approximately 45 fee-earners in total. The lawyers at Astrea have a very business-oriented, pragmatic and flexible no-nonsense approach, and are known for offering good value.
Astrea has extensive experience in advising Belgian and international companies in the field of financing (including general corporate finance, acquisition finance, real estate financing, project finance, structured finance and asset-based finance) and debt capital market transactions. Astrea's banking & finance team has been involved in several domestic and cross-border transactions, both as borrowers' and lenders' counsel. They work together on a regular basis with international law firms.

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astrea

Bermuda

Erik L Gotfredsen

Jemima Fearnside

Wakefield Quin Limited

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

During 2020, there were no changes to Bermuda's Companies Act 1981 (**Companies Act**) affecting the rights of secured parties or Bermuda's reputation as a leading creditor-friendly jurisdiction.

As a result of Bermuda's favourable regulatory regime, there has been substantial growth in Bermuda's fintech industry, which has helped Bermuda remain a top choice for the establishment of fintech companies.

Bermuda's Incorporated Segregated Accounts Companies Act 2019 came into effect on 15 January 2020. ISACs enable the creation of corporate group structures to operate multiple businesses or "accounts", each ring-fenced with its own separate legal identity, under one corporate body. Each account has many of the attributes of a company, including the ability to hold assets, sue and be sued in its own name, and establish its own board of directors. It is expected that these structures will have applications in numerous sectors including insurance, investment funds, multinational enterprises, family offices, asset management and securitisation.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

2020 was a tempestuous year for lending transactions in the construction and real property development sectors, with several projects affected by uncertain economic times in both Bermuda and across the globe. One of the significant lending transactions that took place in Bermuda was the financing of the construction of the $120 million St. Regis Hotel in St. Georges, Bermuda.

We continue to see an increase in the use of special purpose vehicles in the oil and gas, mega yacht, shipping and aviation sectors.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

A company may guarantee borrowings of members of its corporate group provided the company has capacity to provide such guarantees and there is a sufficient corporate benefit to the company, which may be in the form of a benefit to the company group.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In these circumstances, there is a risk that the directors are not adequately discharging their fiduciary duties or statutory directors' duties to act honestly and in good faith with a view to the best interests of the company.

In considering whether to approve such a guarantee, the directors would need to satisfy themselves that a sufficient direct, indirect or group commercial benefit exists. If the company is insolvent, the directors may be liable for wrongful trading and there is a risk that the guarantee may be void on the grounds that it amounted to a fraudulent preference.

2.3 Is lack of corporate power an issue?

The constitutional documents of the guarantor company should be reviewed to ensure the company has capacity to give the contemplated guarantee. A company's memorandum of association may not set out an express power to give guarantees; however, in most cases, the company's objects would typically be sufficiently broad to permit the entry into guarantees that are ancillary to the business of the company.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In most cases, no such consents or filings are required unless the company undertakes regulated activity, such as insurance, in which case consent may be required from the Bermuda Monetary Authority (**BMA**).

Guarantees of loans to directors (and other persons related to directors) are generally prohibited without the consent of members holding 90% of the company's voting rights and if such member consent is not obtained, the directors authorising the entering into of the guarantee shall be jointly and severally liable to indemnify the company against any loss arising. Member consent to directors' loans or guarantees can be obtained to mitigate concerns of corporate benefit and breach of fiduciary obligation.

Guarantees are often executed as a deed to avoid disputes concerning due consideration.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No statutory limitations are imposed; however, directors should consider the solvency of the company and ensure that any guarantee to be granted is in the best interests of the company.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control restrictions that would act as an obstacle to the enforcement of a guarantee against a company; however, non-Bermuda exchange control and any applicable international sanctions should be reviewed and considered.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Both tangible and intangible assets of a company are available to secure lending obligations.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

In lending transactions, companies typically grant general security agreements, such as debentures, to secure underlying obligations. Where shares of a Bermuda company form part of the asset security, it is usual for a Bermuda law-governed share charge to be used. Specific regimes apply for security over Bermuda land, ships, aircraft and aircraft engines registered in Bermuda.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over real property in Bermuda is typically granted by way of either a legal mortgage (executed as a deed), where title is transferred to the mortgagee (or lender), or an equitable mortgage (executed under hand), where a charge is established without title being transferred to the mortgagee. Security is typically granted over plant, machinery and equipment by way of fixed charge or chattel mortgage.

Given that a legal mortgage involving real property transfers title to the mortgagee, such a mortgage has typically been executed subject to a requirement that title be transferred back to the mortgagor upon satisfaction of the underlying secured obligations.

When the Land Title Registration Act 2011 (**2011 Act**) came into effect on 2 July 2018, the grant of both a legal mortgage and an equitable mortgage came to trigger compulsory first registration of title to the real property forming the subject matter of the mortgage or charge and it became necessary to lodge the relevant mortgage or charge, as well as the balance of the title documents relating to the property in question at the Land Title Registry Office (**LTRO**) (as established in accordance with the 2011 Act).

Upon first registration, a mortgagee's priority position is now established on the property register. Priority is based on the date that an application for first registration is submitted to the LTRO. The 2011 Act also operates to automatically convert a legal mortgage into a registered charge (meaning that title is returned to the mortgagor by way of a statutory vesting and the mortgagee comes to own a registered charge (only), rather than title to the real property in question. This system replaces the historical regime, which required that any legal mortgage or charge be registered in the Book of Mortgages in order to protect a mortgagee's priority position.

While the new electronic title register that has been established in accordance with the 2011 Act is intended to replace title deeds (as evidence of ownership) most mortgagees are continuing to take possession of title deeds. This is because the detailed plans and other information that is included with the deeds has proven helpful (historically) in respect of resolving title-related challenges, and this continues to be the case.

Both legal mortgages and charges attract stamp duty, generally at the rate of 0.5% of the principal sum secured.

There are special rules that apply if an overseas or exempted company wishes to hold a mortgage over real property in Bermuda, including obtaining the prior consent of the Minister of Finance and the Minister responsible for Immigration, respectively. If a mortgage taken by an overseas or exempted company is subsequently enforced, any land obtained by such company (as mortgagee in possession), must be sold within five years to either a person or entity having Bermudian status or to another licensed party.

In relation to a fixed charge over plant, machinery and equipment, registration is not necessary in Bermuda to perfect the security interest created. However, to ensure the priority in Bermuda of the charge, the charge must be registered at the Registrar of Companies (**ROC**) and upon registration, to the extent that Bermuda law governs the priority of a charge, such charge will have priority in Bermuda over any unregistered charges and over any subsequently registered charge.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Collateral security can be granted over receivables by way of assignment or fixed or floating charge. Assignments can be legal or equitable. Legal assignments must be in writing, signed by the assignor and unconditional and written notice must be provided to the debtor. An equitable assignment will result if any of these requirements are not satisfied.

Under a legal assignment, the assignee can sue in its own name and the debtor can only discharge its obligations as instructed by the assignee.

Although not legally required to perfect the security interest, assignments and charges over receivables should be registered with the ROC to ensure priority.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Companies may grant security over cash in its bank accounts, which is typically effected by way of a fixed or floating charge. The amount of control that the chargee will have over the account will determine whether a charge is fixed or floating.

Serving notice on a bank will ensure a chargee's priority in relation to subsequent assignees, provided the chargee has no knowledge of an earlier assignment. Service of notice on a bank will perfect the security granted by the chargor, regardless of whether or not the bank provides an acknowledgment.

Bermuda banks typically require chargees and chargors to enter into a deposit account control agreement to regulate the administration of the account, including restricting withdrawals, unless permitted by the chargee and the banks' agreement not to exercise set-off rights.

Although not legally required to perfect the security interest, charges over accounts should be registered with the ROC to ensure priority.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Security over shares of Bermuda companies is typically granted by way of a share charge. Legal mortgages are uncommon, although share charges usually provide the chargee with the right to create a legal mortgage upon the occurrence of certain events. It is recommended that chargors also be required to deliver certain ancillary documents to strengthen their security, including executed but undated share transfer forms, irrevocable voting proxies and undertakings.

Bermuda companies cannot issue bearer shares. Share certificates do not need to be issued unless required under the company's bye-laws or requested by a shareholder; if issued, share certificates are generally a deliverable under a charge over shares of a Bermuda company.

For efficacy of enforcement, it is recommended that share charges be governed by Bermuda law. However, it is possible for New York or English law to govern the charge if required by the underlying transaction documents.

Bermuda exchange control regulations generally require the consent of the BMA prior to any disposition of shares of a Bermuda company, which would include the creation of a security interest. The BMA has granted a blanket consent where the chargee is a licensed bank or lending institution in certain appointed jurisdictions and the BMA is provided with written notification.

Although not legally required to perfect the security interest, share charges should be registered with the ROC to ensure priority.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security is typically taken over inventory by means of a floating charge, due to the fluctuating nature of inventory.

Although not legally required to perfect the security interest, a floating charge should be registered with the ROC to ensure priority.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

There should be no issues in any of these situations, provided there is a demonstrable corporate benefit to the company (which may be in the form of a benefit to the company group, if applicable) and the company is solvent.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Stamp duty rarely applies to documents that are executed by Bermuda companies engaged in international business. However, legal mortgages on Bermuda real estate do attract stamp duty at different rates, depending on the amount of the sum secured.

With limited exceptions, stamp duty is payable on most documents executed by local Bermuda companies.

A fee of between $380 and $665 will be payable for registering a charge at the ROC, depending on the value secured. There is also a $95 fee for registering a satisfaction of a charge at the ROC.

A fee of between $100 and $1,300 is payable to the Land Title Registry Office on the first registration of real property. Thereafter, a fee of between $50 and $400 is levied to register a charge against a registered title.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Security arrangements can be registered in Bermuda on a same-day basis. Certain prescribed forms need to be filed; however, Bermuda counsel can attend to these requirements.

If a chargee is taking security over shares in a Bermuda company and the chargee is not a licensed bank or lending institution and is not known to the BMA, the BMA may require a few working days to provide its consent to the granting of the charge for exchange control purposes.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally, other than for BMA consent that may be required for exchange control purposes, no regulatory or similar consent is typically required for companies to grant security over their assets.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Generally, no.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Secured parties will want to receive copies of authorisation board resolutions to ensure corporate formalities have been followed and issues regarding corporate benefit have been considered.

Special rules apply for deeds, including that the deed be in writing, that it was intended to be executed as a deed and that the deed was validly executed as a deed in accordance with the company's bye-laws.

In most cases, powers of attorney must be executed as a deed.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

There is no general prohibition or restriction on financial assistance, but loans to directors or security in favour of director loans (or loans to persons connected to a director) are restricted.

(a) Shares of the company
Without the consent of the members of the company holding shares with 90% of the voting rights, it is unlawful for a company to make a loan, enter into a guarantee or provide security in connection with a loan to a director (or to certain persons connected with a director) except in certain limited circumstances.

(b) Shares of any company which directly or indirectly owns shares in the company
See question 4.1 (a) above.

(c) Shares in a sister subsidiary
See question 4.1 (a) above.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

A Bermuda court would recognise the role of a security agent or trustee and allow the agent or trustee to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders pursuant to the terms of the intercreditor, loan and security documentation.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Agency and trustee relationships are well established in Bermuda.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

There are no special requirements to make the loan and guarantee enforceable by Lender B so long as the transfer or novation procedures are complied with pursuant to the terms of the loan documentation.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Bermuda has no income, corporate, withholding or capital gains tax and no estate duty or inheritance tax. No such taxes or duty are payable to any authority in Bermuda whether on loan interest or proceeds of claim.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no tax incentives. Foreign lenders will not be deemed to be resident, domiciled or carrying on business in Bermuda by reason only of the execution, performance and/or enforcement of the loan and security documents.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No income of a foreign lender will become taxable in Bermuda solely because of a loan to or guarantee and/or grant of security from a Bermuda company.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Generally, no. Neither notarisation nor registration is necessary to perfect a security interest, but registration with the ROC (for which fees are payable; see question 3.9 above) confers priority ranking over subsequent registered security interests.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Generally, no.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

In proceedings to enforce the obligations of a Bermuda company, Bermuda courts generally would give effect to the choice of foreign law as the governing law of the contract, provided that: (i) the point is specifically pleaded; (ii) the choice of law is valid and binding under foreign law; and (iii) recognition would not

be contrary to public policy as that term is understood under Bermuda law. Where the foreign governing law is the laws of England and Wales, Bermuda courts are well practised in enforcing such contracts. Not only are English court judgments automatically enforceable in certain circumstances (see question 7.2 below), but Bermuda courts regularly refer to persuasive English case law, and the ultimate court of appeal in Bermuda is the UK Privy Council.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A final and conclusive judgment in the New York courts against a Bermuda company, based on a contract under which a sum of money is payable (not being in respect of multiple damages, or a fine, penalty, tax or other charge of similar nature) (**a Money Claim**), may be enforced in Bermuda under the common law doctrine of obligation for the debt evidenced by the New York court judgment. When considering whether a New York court judgment should be recognised and enforced, such proceeding would likely be successful provided that (a) the New York court was competent to hear the action in accordance with private international law principles as applied in Bermuda, and (b) the judgment is not contrary to public policy in Bermuda, has not been obtained by fraud, or in proceedings contrary to natural justice and is not based on an error in Bermuda law.

A final and conclusive judgment in the superior courts of England against a Bermuda company, based on a Money Claim would, on registration in accordance with the Judgments (Reciprocal Enforcement) Act 1958, be enforceable in Bermuda without the necessity of any retrial of issues or any re-examination of underlying claims, provided that the judgment: (a) is final and conclusive (notwithstanding that any appeal may be pending against it or it may be still subject to an appeal in England); (b) has not been given on an appeal from a court in England which is not a superior court in England; and (c) is duly registered in the Supreme Court of Bermuda.

Additionally, a foreign judgment against a Bermuda company may form the basis of a statutory demand, even if the judgment has not been registered as a judgment under Bermuda law, provided that the jurisdiction of the foreign court is not disputed on genuine grounds. Non-payment of the statutory demand would be sufficient for the secured creditor to seek commencement of liquidation proceedings.

Where a foreign judgment is expressed in a currency other than Bermuda dollars, the registration will involve the conversion of the judgment debt into Bermuda dollars on the basis of the exchange rate prevailing at the date of the judgment. The current policy of the BMA is to permit payment in the original judgment currency.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Bermuda maintains a separate Commercial Court division of its Supreme Court, with judges experienced in commercial matters.

A commercial claim is commenced by issuing a writ of summons in the Registry of the Supreme Court, endorsed with a statement of claim and the relief sought. A Bermuda company respondent generally has 14 days to submit and file a response or contest the jurisdiction of the Bermuda court. It is possible for a suit to be filed and judgment obtained within a few weeks.

If jurisdiction is contested or the respondent disputes the matters which form the statement of claim, the appellant is entitled to respond and proceedings can be prolonged in a similar fashion as they may be in other common law jurisdictions.

If satisfied that a foreign judgment fulfils the requirements for registration, a Bermuda court will register the judgment as a matter of course. However, actual enforcement cannot proceed until the expiry of the judgment debtor's allotted time for challenging registration or any challenge has been determined. Foreign lenders may request summary judgments, interim judgments, costs awards and injunctions, such as Mareva and interlocutory injunctions, which can be obtained on a "same day" basis to prevent dispersal of assets.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

There are no significant enforcement restrictions under Bermuda law. Most foreign judgment creditors seek the appointment of a receiver, to assist with gathering and realising the assets of a defaulting debtor and speed up the process, or seek to liquidate the defaulting debtor and engage liquidators to undertake collateral realisation.

Additionally, it may be possible to obtain a Bermuda writ of sequestration to have sequestrators appointed to take charge of all the defendant's assets until the defendant complies with the judgment.

There are restrictions in Bermuda regarding the ownership of land and real estate (see question 3.3 above) and shares of a Bermuda company (see question 3.6 above), which may require prior authorisation from Bermuda authorities.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

There are no specific restrictions applicable to foreign lenders in the event of filing suit against a Bermuda company or otherwise applicable to foreclosure on collateral security. However, most foreign lenders prefer to appoint receivers or provisional liquidators to assist with the realisation of assets or foreclosure of collateral security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

After the presentation of a winding-up petition, the Bermuda company or any of its creditors may apply to the Bermuda court for a stay of proceedings.

No moratoriums apply to the enforcement of collateral security, as secured parties generally operate outside of Bermuda's bankruptcy regime.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Bermuda is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and recognises awards made under arbitration agreements in a foreign jurisdiction that is also party to the New York Convention. If a foreign arbitral award is given against a defaulting debtor company as a result of arbitration in a "convention" jurisdiction, Bermuda's International Conciliation and Arbitration Act 1993 (**ICAA**) provides that the award may be enforced in Bermuda either by action or, with leave from the court, in the same way as a judgment or order to the same effect. The enforcing party must make an application for leave (with or without notice) under section 48 of the ICAA, regardless of the jurisdiction in which the award was made and (where leave is given) judgment can be entered in terms of the award, without re-examination of its merits.

On an *ex parte* application where leave has been granted to enforce the award, the order will not allow enforcement until the other party has 14 days to respond and bring an application to set the award aside. The 14-day response period is increased in certain circumstances.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy proceedings against a Bermuda company may affect the ability of a lender to enforce its rights as underlying transactions may be attacked. See question 8.2 below.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Any conveyance or other disposition of property made by or against a Bermuda company within six months prior to the commencement of its winding up will be invalid if it was made with the intent to fraudulently prefer one or more of such company's creditors at a time that the company was unable to pay its debts as they became due.

Under the fraudulent conveyance provisions of the Conveyancing Act 1983, a creditor may seek to set aside a disposition of property (including the creation of a security interest) if the disposition was made in circumstances where the transferor's dominant purpose was to put the property beyond the reach of a person (or class of persons) who is making, or may make, a claim against the transferor and the disposition was at an undervalue. Such a claim can only be made by an "eligible creditor", which is a person who: (i) is owed a debt by the transferor within two years after the disposition; (ii) on the date of the disposition is owed a contingent liability by the transferor, where the contingency giving rise to the obligation has occurred; or (iii) on the date of the action to set aside the disposition, is owed an obligation arising from a cause of action which occurred prior to or within two years after the date of the transfer.

In relation to floating charges, where a Bermuda company is being wound up, a floating charge on the undertaking or property of the Bermuda company created within 12 months of the commencement of the winding up will, unless it is proved that such Bermuda company immediately after the creation of the charge was solvent, be invalid, except to the amount of any cash paid to such Bermuda company at the time of or subsequently to the creation of, and in consideration for, the charge, together with interest on that amount at the statutory rate.

Certain debts are preferred by statute but only over (i) claims of unsecured creditors, and (ii) claims of secured creditors who are holders of floating charges. In a winding up of a Bermuda company, debts secured by fixed charges retain first priority, followed by: (a) all taxes owing to the Bermuda government and rates owing to a municipality; (b) all wages or salary (up to a maximum of BD$2,500 in respect of any one claimant) of any employee for services rendered to the company during the four months before the winding up; (c) all accrued holiday remuneration payable to any employee on termination of his employment before or following the winding up; (d) certain amounts due by the company as employer of any persons under the Contributory Pensions Act 1970 or any contract of insurance; (e) certain amounts due in respect of any liability for compensation under the Workmen's Compensation Act 1965, being amounts which have accrued before the winding up; (f) secured creditors under floating charges; and (g) unsecured creditors.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Generally, the winding-up and insolvency provisions in the Companies Act apply to all Bermuda companies. Licensed Bermuda banks are governed by a separate insolvency regime under the Banking (Special Resolution Regime) Act 2016, which has been passed but has not yet been brought into effect.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The remedies available to a creditor would generally be set out in the loan and security documents and would include exercising the power of sale, taking possession of assets and appointing a receiver.

Creditors can also reorganise, or reach a compromise with, a Bermuda company under a scheme of arrangement, provided that the scheme is approved by the company and a supermajority of its creditors. Although a scheme will bind all creditors (or class of creditors), it must be sanctioned by the Bermuda court to be effective.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The submission by a Bermuda company to the jurisdiction of a foreign court under a loan or security agreement would be recognised by a Bermuda court as a legal, valid and binding submission to the jurisdiction of the foreign court, provided that such submission is accepted by the foreign court and is legal, valid and binding under such foreign law.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, both private and public Bermuda companies can validly waive any claim of sovereign immunity.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licences or consents required for foreign lenders, foreign agents or trustees unless they undertake lending business in Bermuda or establish a branch office in Bermuda. There are certain restrictions on foreign lenders holding mortgages over Bermuda property.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

COVID-19 continues to have a major impact on the world. In March 2020, the ROC implemented a system permitting the electronic filing of all applications and submissions. Bermuda has now largely transitioned to paperless processes and e-signatures are generally accepted.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The information included in this chapter covers the key issues to be considered in secured lending transactions in Bermuda. Specific advice should be sought from Bermuda counsel at the earliest opportunity to ensure security is effective and readily enforceable in Bermuda.

Erik L Gotfredsen is a Director, Senior Counsel and the Chief Executive Officer of Wakefield Quin and has been internationally recognised by *Chambers Global* and *The Legal 500* as one of Bermuda's leading corporate lawyers. Erik's practice spans a broad range of sophisticated finance and capital market transactions with an emphasis on debt and equity offerings, banking and financial services, structured and project finance, secured lending, mergers and acquisitions and reorganisations. Erik has significant experience advising on joint ventures, partnerships, asset and fund management and regulatory compliance. Erik has an active general corporate practice, including advising on the establishment of companies in Bermuda and is routinely instructed by a large number of leading international banks, financial institutions, public companies, private equity firms and onshore law firms. Erik is admitted as a solicitor in British Columbia, England and Wales, Ontario and Bermuda and has received his B.Com. and LL.B. from the University of Victoria, Canada and his LL.M. from Kyushu University, Japan after being awarded the prestigious Monbukagakusho Scholarship by the Japanese government. Erik is an active member of the Restructuring and Insolvency Specialists Association of Bermuda.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Bolivia's current situation and regulations regarding lending markets is the result of a series of legal dispositions that have been issued since 2014 and that remain in force today. In 2014, several changes regarding financial intermediaries were established by the Financial Services Law, with the objective of creating specialised bodies and aiming to have a stronger government presence in this specific area by means of a regulatory entity. In early July 2014, specific regulations were issued in order to establish loan rates that must be applied by financial intermediaries, especially for lending transactions completed in the industry sector and for social housing loans. These specific regulations were expected to allow portfolio growth in priority sectors defined by the national government, specifically production credits and access to social housing. As of the beginning of the implementation of these changes at the end of June 2019, Bolivian financial entities are reported to have fully complied with the goals (and to have even exceeded them) set by the aforementioned laws and regulations. This situation has been maintained during 2020, despite the scenario created by the COVID-19 pandemic, although growth levels of loans portfolios have decreased.

Since 2014, very few changes regarding financial loans and credits have been made in Bolivia. However, among the main changes and trends in this regard in Bolivia, we should mention:

(a) The creation of a guarantee fund for production credits (as of the issuance of Supreme Decree 2136 (dated 9 October 2014) and Supreme Decree 2614 (dated 2 December 2015)), by which the Central Bank of Bolivia created the aforementioned guarantee fund as a hedge mechanism for production microcredits and credits granted by financial entities in Bolivia. This guarantee fund is based on a percentage of the annual net incomes of multiple banks in Bolivia.

(b) The creation of a guarantee fund for social housing loans (as of the issuance of Supreme Decree 2137 (dated 9 October 2014)), by which the Central Bank of Bolivia created the aforementioned guarantee fund as a hedge mechanism for loans granted to people who intend to buy their first home. This guarantee fund is also based on a percentage of the annual net incomes of multiple banks in Bolivia.

(c) The creation, in 2018, of a non-conventional guarantee form, for the acceptance of construction progress worksheets that are pending payment, duly signed by a construction auditor. This new guarantee aims to promote credits granted to the construction sector exclusively for public work constructions, which also belong to the production credits category that has been promoted by the Bolivian government since the issuance, in 2014, of new financial legal measures. The acceptance of construction progress worksheets as a guarantee has been regulated by Supreme Decree 3722, issued on 21 December 2018.

(d) Several laws and decrees issued by the Bolivian government during the pandemic crisis, providing for the deferral of loan instalments. Such deferrals have been in force since April–December 2020.

(e) The recent increase (dated 23 December 2020) of the Additional Aliquot on the Profit Tax (which already required a payment of 25% on all company profits) to an additional 25% on profits of those financial entities (including Financial Auxiliary Services Entities, which are subject to the Bolivian banking and stock market regulatory authority (ASFI)) that have a return on equity ratio higher that 6%. Even though it is too early to anticipate the impact of this tax measure, it will probably have significant effects on the loan and credit markets.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The Bolivian Financial Services Law distinguishes three types of financial institutions: (i) State-owned or State-controlled financial institutions, which include (a) development banks, (b) public banks, and (c) financial development institutions; (ii) private financial institutions, which include (a) private development banks, (b) private banks, (c) small and medium companies-focused banks, (d) savings and loans cooperatives, (e) housing loans-focused financial institutions, (f) financial development institutions, and (g) rural communities financial institutions; and (iii) complementary financial services companies, which include (a) leasing companies, (b) factoring companies, (c) warrant companies, (d) clearing houses, (e) financial information bureaus, (f) money transferal companies, (g) electronic cards administration companies, (h) money exchange companies, and (i) mobile transfer or payment companies.

As of September 2020, and despite the COVID-19 scenario, the financial intermediation system in Bolivia remained stable, with good levels of financial performance as a result of continued deposits and loan portfolio growth, accompanied by low levels of credit defaults and adequate patrimonial support.

Loans Portfolio

As of September 2020, the loans portfolio closed at US$ 27,208 million, an increase of almost US$ 806 million compared to the end of 2019. Although statistics as of June 2019 show that

financial entities reached and even exceeded their loans portfolio goals (more than 50% of their loans portfolio) set by specific regulations that have been issued in Bolivia since 2014, the growth level of the loan portfolios of Bolivian financial intermediaries has decreased from 9.7% (December 2019) to 3.5% (September 2020), which may be a direct result of the pandemic.

Industrial, Commercial and Services Sector Portfolios
Up until September 2020, the loan portfolio for the industry sector, which comprises entrepreneurs' credits, micro credits and SMEs credits for all types of activities and industries (such as agriculture, cattle raising, forestry and fishing, extraction of crude oil and natural gas, metallic and non-metallic mineral mining, manufacturing, electricity, gas, water and construction) amounts to US$ 12,235 million (45% of the total loan portfolio of Bolivian credit institutions).

Social Housing Sector Portfolio
The Financial Services Law of Bolivia No. 393, dated 21 August 2013, introduced Social Interest Housing loans as a new category for bank loans, which is targeted at middle income families or individuals that want to buy or build their first house or apartment. One of the main conditions required in order to apply for this type of loan is that the cost of said house must not exceed the US$ 120,000 price barrier, or US$ 100,000 in the case of apartments.

This particular type of loan has a State-regulated fixed interest rate, which can only vary from 5.5% to 6.5%, depending on the amount of the specific loan.

Another particular characteristic of this type of loan is that no down payment or guarantee is required. In order to guarantee these loans, the Bolivian government issued a regulation that forces private banks to invest 6% of their annual earnings into special guarantee funds created by them for that sole purpose.

As of September 2020, the social housing sector portfolio in Bolivia reached US$ 3,898 million (14.3% of the total loan portfolio of Bolivian credit institutions).

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

In Bolivia, it is very common that companies within a corporate group secure loans of one or more other members of their corporate group. On the other hand, companies that belong to financial groups are prohibited from securing loans unless they are companies dedicated to investments.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

If the company is dedicated to guaranteeing investment, the responsibility lies with those who have approved the transaction. In general, however, directors also have responsibility as the operation is guaranteed by the goods of the company.

If the directors of a company ensure an operation and such directors do not have the authority to perform such act, they are also responsible for their own assets.

2.3 Is lack of corporate power an issue?

Indeed, the lack of authority enabling a person or persons to act on behalf of a company is a grave and serious problem. There are certain powers that enable people to carry out the activities and business of a company, and any person who acts without such authority is liable to penalties which are provided by law. All further acts performed by those people and the company might be void or voidable.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Bolivian law does not provide for State authorisation and credit approval for the creation of securities, except concerning State-owned companies.

However, when a company applies for a loan, the application must have the appropriate support, such as financial analysis of the company demonstrating the need for a loan, and, overall, approval of the shareholders of the company.

In the stock market, it is necessary to have the approval of the shareholders in order to issue bonds.

For the granting of guarantees, such guarantees must be fully sanitised and free from all liens. If the security has a lien, the creditor will require permission for the property to be used as security for other creditors.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

It depends on the amount requested. If the company has some financial indicators that are not in line with the credit policy of the entity, it may request the granting of additional collateral to support the operation.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

For the enforcement of a guarantee there are no exchange controls in Bolivia. The main obstacle is the time it takes to enforce a guarantee in the judicial system; such time frame depends on the individual case (please see section 8 below).

For the enforcement of a security with no exchange controls, the obstacles encountered are the extended time frames required for the judicial system and the processing of its guarantees.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

In Bolivia, lending obligations are secured by mortgages, collateral and unsecured personal guarantees.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

The creation of securities depends on the type of loan requested. The procedure is to sign a contract, and each contract must be guaranteed. The contract also specifies the kind of guarantee given by the borrower, its characteristics, its value, its usefulness and for how long the collateral will be in force.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes, it can. Once the loan has been approved, the borrower delivers all relevant documents pertaining to the guarantee. These documents remain in the custody of the lender, which is usually a bank. The appropriate authorities then keep track of whether the property is collateral for a bank or institutional lender. However, this does not mean that the borrower transfers his ownership of the property to the bank, except where there is breach of property ownership, in which case it may be transferred to third parties to honour the debt.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Bolivian law does not provide for this.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Generally not, but most loan agreements in Bolivia provide that the borrower has to keep a bank account where there is enough money to cover the monthly loan instalments; if the account is declared to have no money, the bank has the power to debit the money from other accounts that the borrower may have with the same bank, after communicating these actions to the debtor.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Bolivian law does not allow companies to give its shares in warranty as in other countries. What is usually done is that the shareholders of a company must agree to be guarantors of the credit operations of the company and they guarantee the loan with their shares.

In Bolivia, shares have to be issued certificates and such certificates must be registered in the books of the company's shareholders.

As part of a loan agreement, a clause allowing the resolution of disputes and enforcement of a security to be resolved under the laws of another country may be included. This is not a usual practice in Bolivia, but it is allowed, depending on the terms of the agreement between the parties.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, it can. Collateral may be taken over goods in process, finished goods or raw materials. The debtor must request a warrant from the company storing the materials. The bank has control of such materials and each time the debtor needs to access the materials it has to apply for the bank's authorisation. Therefore, the bank has control over the debtor's production and is satisfied that the debtor will honour its debt.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

No, it cannot. In Bolivia, this is regulated by the Supervisory Authority of the Financial System and is punishable by law.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notary fees on guarantees are 4/1,000^{ths} of the loan amount for warranty registration in the office of property rights. Further legal costs of around US$ 150 also apply, along with the cost of registration at the Commercial Register in Bolivia, which is US$ 25.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

For the registration of a guarantee, on average a time period of 30 to 45 days is required. On top of this, notary processes will also take between 10 and 15 days. A total of 60 days, on average, is required, and the costs vary in relation to the amount of each loan.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory or similar consents are required for the creation of a security.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

The priority on the enforcement of a guarantee is given by the number of loans that were requested in that line, taking into account that the line of credit has a limit, and that limit defines how many loans can be requested. This also dictates if the warranty covers all of the borrowing in that line of credit.

The priority is given predominantly by the order in which the loans were requested; if the guarantee is executed, the amount collected will first cover the oldest operations and then operations that were requested at a later date.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

For the enforcement of a security, financial institutions have to give their representatives power of attorney, enabling them to pursue the enforcement of the security. These powers must be registered in the Commercial Registry of Bolivia, which is also responsible for their validation.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company
In Bolivia, it is expressly forbidden by law for a company to acquire its own shares.
(b) Shares of any company which directly or indirectly owns shares in the company
Cross shareholding is not legally possible in Bolivia.
(c) Shares in a sister subsidiary
Bolivian law does not provide any restrictions in this case.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

In Bolivia, the law does not prohibit the role of an agent or trustee and thus its capacity to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of a group of lenders of the same borrower.

The Bolivian Civil Code states that all of the assets of a multiple debtor constitute their common guarantee.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

In Bolivia, agents are recognised as long as they have a written legal mandate from the lenders, so they are responsible for performing the collection and enforcement of security granted by banks to borrowers. This does not mean, however, a transfer of the portfolio of the banks to the agent.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

No, there are not, because the lender has cancelled the amount due. The requirement for this transfer is that Lender A has to lift the lien on the collateral, so that Lender B can record the loan and have the right to charge his debt and the guarantee.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interests or proceeds paid to domestic lenders are not subject to any withholding tax since the lenders are required to file a tax return and pay taxes by themselves. On the contrary, when interest or proceeds are paid to non-residents, the debtor shall withhold a 12.5% rate on such interest or proceeds (capital reimbursement is not subject to taxation) pursuant to *Impuesto sobre las Utilidades de las Empresas – Beneficiarios del Exterior* (IUE-BE), a tax levied on Bolivian-source incomes obtained by both entities and individuals that are not domiciled in our country.

Bolivia has signed five tax treaties to avoid double taxation based on the OECD model tax convention (France, Germany, Spain, Sweden and the United Kingdom), reserving its right to tax interests up to a limit of 15%; this means that the tax treaties provide no additional tax benefit for cross-border lending transactions. On the other hand, some of these tax treaties (specifically, those with France, Germany, Spain and Sweden) include different tax exemptions on interest paid when the lender is the other contracting State, its political subdivisions or its public financial institutions.

Bolivian tax law sets two important rules that apply to cross-border lending transactions, aimed primarily at the prevention of profit shifting:

(a) Transfer pricing rules based on the arm's length principle, following the OECD guidelines. Therefore, a lending transaction that takes place between related parties or with entities or individuals that are resident in tax havens (according to a list issued by the Tax Administration) shall be made on an arm's length basis.
(b) Additionally, interest from lending transactions between non-resident shareholders and local entities shall not be higher (only for tax purposes) than LIBOR + 3%; the portion of interest paid that exceeds this amount shall not be eligible as deductible.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Besides the IUE-BE's exemptions provided in the tax treaties detailed in question 6.1, Law No. 843 sets a general exemption for interest paid to governmental and international lending organisations or agencies that have signed conventions with the Bolivian State and which have been ratified by the Congress.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Under the IUE-BE's rules, an interest has to be effectively paid and not only accrued in order to be taxable. It is perfectly legal not to fix an interest rate (presumptive interests are not provided by our tax regulations) as long as the transaction complies with the transfer pricing rules (see question 6.1).

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Besides those listed in question 3.9, there is a mandatory 2% transfer service fee set by the Bolivian Central Bank, levied on the gross amount of money transferred from a local to a foreign bank account. This cost shall be taken into account when a cross-border lending transaction is negotiated.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are no additional concerns that should be noted.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Bolivian courts recognise and enforce contracts subject to foreign law, provided they contain two elements: first, that the benefits arising out of these contracts are to be utilised in Bolivia; and second, that the foreign law under which the contract was created is not contrary to Bolivian laws.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The courts in Bolivia execute foreign judgments as long as there is a treaty in place with the country concerned. Following the principle of reciprocity, and in the absence of treaties on the matter, Bolivian courts will grant these judgments the same force that the nation in question gives to Bolivian judgments. However, if a foreign judgment was enforceable, it would be necessary to follow a procedure in which the concerned party must seek the enforcement of the judgment at the Supreme Court, and later request the answers of the other party within 10 days. With or without such answers, and after a fiscal opinion (which involves additional time), the court will determine whether or not to enforce the judgment. The enforcement of the judgment shall correspond to the tribunal which would have been the case at first instance in Bolivia.

The new Bolivian Procedure Code (which came fully into force in February 2016) maintains the same principles and procedure on this matter that were established in the previous Procedure Code. However, it specifies that even though it is not necessary for courts in Bolivia to re-examine the merits of the case, it is necessary for the Supreme Court to recognise the foreign judgment (to determine whether the judgment meets the requirements and procedural basic principles) in order to proceed to its execution (only if the judgment concerns the compliance of an obligation or if it is the intention of a party to validate its probative effects).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

A suit for non-payment can be filed as soon as the deadline the parties have agreed has expired. Generally, it will be possible to act by the way of an executive process, which is quite quick (the suit is filed, the judge examines the procedural requirements of executive judgment, and if appropriate he shall issue a formal notice to be fulfilled within three days, besides having the injunction of the debtor's assets). The executive process should take about one to two months (depending on which exceptions shall be made, also counting the evidence term which will take 10 additional days). In case the loan agreement included a waiver clause regarding the executive procedure, the obligation may also be required by way of coercive procedure, which takes less time than the executive procedure. In all cases, the enforcement of the judgment will depend on if it is enforceable, and, if it is enforceable, the court will execute the judgment within the time established or, failing that, within three days.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

It depends on the guarantee. In general, a public auction is required. This involves a procedure that might take over a month. However, no regulatory consents are needed to enforce collateral securities.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No. If the requirements are met, there is no restriction on the lender to filing a lawsuit against the borrower or the guarantee it has granted.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Please see the answer to question 8.1.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Bolivia has signed and ratified the New York Convention on the enforcement of arbitral awards. In this sense, the Bolivian courts do recognise such decisions without needing to re-examine their merits. Moreover, the new civil procedure code prescribes that

arbitral awards enable a lender to initiate a coercive enforcement of a debt, and it is not necessary for the judge to re-examine the merits of such arbitral award.

The procedure to enforce a foreign arbitral award is the same as described in question 7.2 for foreign judgments.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The ability of a lender is affected because the entire bankruptcy process is handled by a judge. In this sense, the affected lender cannot seek the enforcement of its security as freely as in the case of not being subject to the debtor company's bankruptcy. However, bankruptcy does not involve any other violation of the right of the lender to make a debt enforceable and the debt shall be paid by means of the security given by the debtor.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

All guarantees have priorities on the enforcement of the goods or assets given as such. However, tax debts and employee claims are always taken as preferential creditors' rights in the case of bankruptcy of the borrower.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Yes; financial intermediaries, for example, are only subject to a process of "intervention", after which it is to be decided whether to give it a solution or to proceed to compulsory liquidation.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The only way other than court proceedings to seize the assets of a company in enforcement is a process called "*dación en pago*", which consists of a new transaction between the creditor and the debtor through which the creditor receives a new asset, or the asset given as a guarantee, as payment of his credit.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Please see the answer to question 7.1. However, a party cannot submit to a foreign jurisdiction on its own, for it takes both parties to choose the jurisdiction that will rule the contract and its enforcement.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

If sovereign immunity was awarded to a party in Bolivia, it would be by means of a law; therefore it would not be a disposable right, which implies that a party's waiver of sovereign immunity would not be legally binding and enforceable under the laws of Bolivia. Nevertheless, in the event a party's sovereign immunity was awarded in a country the laws of which allow the waiving of sovereign immunity, then it would be legally binding and enforceable in Bolivia.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Bolivian law provides that a bank or financial institution must be of domestic or foreign origin and dedicated to performing financial intermediation and financial services to the public, both in the country and outside the country.

Financial intermediation and auxiliary financial services can only be carried out by financial institutions authorised by ASFI. No person, natural or legal, will perform regularly in the territory of Bolivia the activities of financial intermediaries and financial auxiliary services described by law, without prior permission of incorporation and operation granted by ASFI, with the formalities established by law.

Any natural or legal person, domestic or foreign, domiciled in the country or not, who does not meet the requirements and formalities concerning the organisation and functioning of financial intermediaries and financial auxiliary services under the law is prohibited from making announcements, publications and circulating papers, written or printed, the terms of which imply that such person has legal authorisation to perform activities reserved by law to the said banks. In the same way, any natural or legal person may not use in its name, in Spanish or another language, terms that may lead the public to be confused with legally authorised financial institutions.

The requirements for the establishment of a financial institution in Bolivia and for obtaining the operating licence are as follows:

(a) Founders may not:
  (1) Be declared legally incapable to engage in commerce.
  (2) Have an indictment or conviction for committing crimes.
  (3) Have outstanding debts related to the financial system or running of loans.

(b) In order to obtain an operating licence, a financial institution must:
  (1) Have conducted a study of economic and financial feasibility.
  (2) Have drafted articles of incorporation and bylaws of a corporation.
  (3) Have a certified personal history for individuals issued by the competent authority.
  (4) Have a certificate of fiscal solvency and disclosure of assets of the founders.

Additionally, in August 2015, ASFI issued a regulation establishing the criteria to determine if a loan, a financial intermediation activity or any activity reserved for financial institutions exclusively, is made in a "massive" or in a "regular" way. Those criteria are based on the frequency of the activities aforementioned (weekly, monthly, quarterly, semi-annually and annually) and/or on the gross incomes earned monthly, quarterly, semi-annually and annually by the lender. According to this regulation, if a natural or legal person acts as a lender or as a financial intermediary meeting the criteria set out in the regulation, such activity is considered illegal and has the following consequences: (a) ASFI will issue a stopping order for the person performing the illegal activity; (b) if an unauthorised lender has any office in Bolivia, ASFI will be able to close it permanently; and finally (c) unauthorised financial intermediation activities can be prosecuted as crimes before Bolivian courts. This regulation remains in force today.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

From March to August 2020 (the lockdown period), most notary offices and almost all public offices and registries and even law courts barely functioned at all. Regarding document executions, pending executive processes were paralysed until August 2020. However, the second half of 2020 showed a progressive regularisation of the situation, and notarial and judicial activities have resumed, although most pending judicial cases remain delayed even in 2021. Despite the situation, law courts have not developed measures that allow the filing of lawsuits (for executive processes, for example) by electronic means, and telematic hearings have not been successfully implemented. In view of this situation, we do not anticipate any changes in document execution and delivery requirements during 2021, which means that delays in legal procedures may continue. It is unlikely, however, for judicial or notarial activities in Bolivia to be suspended during 2021, unless new lockdown measures are reinstated.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The considerations that should be taken into account are those that are provided by law and detailed in this chapter.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Official interest rates (SELIC, created in 1996) are currently at their lowest level in the history of this index, and lending activity is expected to pick up pace when the Brazilian economy starts to recover from the COVID-19 pandemic. In addition, BNDES, the development bank that has traditionally been the key lender to the infrastructure sector in Brazil, has changed its strategy and now offers rates that are closer to market rates. This creates an opportunity for commercial banks (national and foreign) and capital markets to assume increasing importance in long-term financing of infrastructure. In this context, infrastructure bonds are increasingly used to finance projects in Brazil. Despite the interruptions caused by the COVID-19 pandemic, according to the Brazilian Ministry of Finance, last year the issuance of such bonds surpassed BNDES disbursements for the first time. In addition, there are changes in law being discussed in the Brazilian congress that may facilitate international lending to purely domestic transactions, by expanding the list of cases where contracts between Brazilian entities can be linked to foreign currency (currently, there are restrictions that severely limit foreign currency transactions in the domestic market). Some companies are already structuring alternatives around the existing structures as mentioned below, but these involve more complex structures and potential legal risks.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

In October 2020, the equity group Actis obtained a US$67 million loan to build solar plants in north-eastern Brazil, to supply energy under a 15-year Power Purchase Agreement with Dow Chemicals – the same length as the term of the loan. The transaction is considered as one of the first financings for a Brazilian solar project made solely in U.S. Dollars. Despite the relatively small size of the transaction, it is quite innovative in that the long-term PPA is also denominated in foreign currency (which is unusual due to the current legal restrictions mentioned in question 1.1 above), generating receivables to service the international loan and avoiding the need for expensive hedging instruments.

In July 2020, Câmara de Comercialização de Energia – CCEE, a private, non-profit clearing house for the Brazilian electricity sector, obtained a R$15.3 billion (~US$2.8 billion) loan from a syndicate of 16 banks led by Brazil's development bank BNDES to launch a financial support scheme for Brazil's electricity sector amid the COVID-19 crisis. The support scheme was designed to support the stability of the sector by providing greater liquidity to Brazilian power distribution companies, which are facing financial strain amid the COVID-19 pandemic, with an estimated average 6.3% loss in revenue in the sector since the coronavirus outbreak.

In April 2019, Engie and CDPQ raised a US$2.4 billion cross-border loan from a syndicate of banks and R$14 billion (US$3.7 billion) in bonds (debentures) in Brazil for the purchase of TAG, which is Brazil's largest gas pipeline company, operated by Petrobras. The financing was obtained without the need for shareholders' guarantees and the transaction was backed only by the assets acquired by TAG.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, companies may guarantee borrowings of one or more other members of their corporate group. However, when the company is granting upstream guarantees (a subsidiary guaranteeing the debt of a parent company) and the company has minority shareholders, there may be concerns regarding potential claims of shareholder abuse.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

There are no specific financial assistance laws in Brazil, but shareholders and management are required to act in the best

interest of the company and could be subject to liability in the context of rules regarding shareholder abuse. However, in principle, there should be no enforceability concerns if the relevant transactions were properly authorised pursuant to company bylaws.

2.3 Is lack of corporate power an issue?

Yes. The signatory of the guarantee must have the appropriate corporate powers as per the bylaws/articles of associations of the guaranteeing/securing company. However, there are some court decisions recognising the validity/enforceability of guarantees granted without the formalities of corporate power (without observing the procedural rules set forth in the bylaws), but where the company seemed to be properly represented (for example, where documents were signed by company executives) and the beneficiary acted in good faith.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

All requirements contained in the company's bylaws for the granting of guarantees/security must be complied with. The bylaws would determine whether any approvals by the company's board of directors or shareholders are required.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no legal limitations on the amount of the guarantee that may be granted, but the relevant counterparty may take these aspects into consideration.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Payments under guarantees in favour of foreign counterparties may be made directly at a commercial bank authorised to carry out foreign exchange transactions upon presentation of the relevant documentation.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Collateral provided for under Brazilian law may be divided into three main classes: (i) personal guarantees (*garantias pessoais*), which entail the creation of a personal commitment for the performance of a given obligation; (ii) real guarantees (*garantias reais*), covering obligations that are secured by one or more specific assets, which property rights remain with the debtor; and (iii) fiduciary real guarantees (*garantias reais fiduciárias*), which generally involve the transfer of the title over the secured asset to the creditor, which restitution shall be subject to the satisfaction of the secured obligation. Each of the classes of guarantees generally described above are subject to some particularities provided for under Brazilian law. Please see question 3.3 below.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

All-asset security structures present in other countries are not available under Brazilian law, and each individual asset over which security is created must be properly identified. The security agreement will depend on the type of asset to be secured. Depending on the type of security, different perfection requirements and other peculiarities must be observed, such as registration with various public registries depending on the type of asset, notices to counterparties, etc.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. The most common types of real guarantees are mortgages, pledges and fiduciary assignments of title to real property. Mortgages are generally created over immovable properties, although some movable properties may be secured by mortgages, such as aircraft and vessels, which are also regarded as special mortgages (*hipoteca especial*) and governed by specific federal laws. The title and possession over the assets remain with the borrower. Mortgages are created through the registration of the security with the competent public registry of the place where the asset is located and second and third mortgages may be created over a given asset. As a general rule, pledges may be created over movable assets. The custody of the pledged assets should be transferred to the lender as a default, but more often than not the debtor is allowed to keep possession of the pledged assets. Pledges are created through the registration of the security with the competent public registry of the place where the asset is located. The main difference between a security created under a fiduciary assignment (*alienação/cessão fiduciária*) in relation to the security created by mortgage or pledge is that, in the fiduciary assignment, the debtor effectively transfers its property rights over a given asset to the creditor. The creditor then becomes vested with a special sort of "reversible ownership", under which restitution to the debtor is conditioned on the satisfaction of the secured obligation. Possession rights over the secured asset, however, remain with the debtor.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Collateral security can be taken over receivables. For an assignment of receivables to be perfected, the debtors must be notified of the assignment. Another alternative would be to create security over the account into which receivables are paid, but that would not constitute a true assignment of receivables and would not give the creditor the right to enforce payment directly from the debtors.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Collateral security over cash deposited in bank accounts is very usual and can be formalised under Brazilian law by pledge or fiduciary assignment structures. In order for the bank to agree to control the account and block unauthorised transfers, it is

common for an account management agreement to be entered into with the relevant bank where the cash is deposited in order to control access to the relevant account.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes, security is frequently taken over shares or quotas of the relevant company by means of pledge or fiduciary assignment structures. For purposes of perfection, the security must be formalised in written form, contain references to the secured amount, describe the shares/quotas granted as security and be registered with the relevant Registry of Titles and Deeds of the debtors' corporate seat, as a condition of effectiveness for pledges and validity of the fiduciary property. In addition, in order to be enforceable against third parties, the pledge must be registered, as the case may be, in the shares registry book of the relevant company (if it is a *Sociedade Anônima*). The granting of such collateral of shares/quotas of a company incorporated under Brazilian law (and located in Brazil) is typically governed by Brazilian law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, but revolving pledges are not generally available. Revolving pledge structures may be implemented in certain specific cases, or else the parties may agree to amend the list of assets covered by the security from time to time.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, as long as the rules of the bylaws/articles of associations of the guaranteeing/securing company are observed.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

According to Brazilian law, security instruments must be registered with applicable public registries in Brazil, and the specific registry will vary depending on the type and location of the security (for example, the real estate registry of the relevant municipality in case of a mortgage, the registry of deeds and documents of the debtor's headquarters in the case of a pledge on receivables, etc.). Documents signed abroad must be notarised by a notary public at the place of execution, legalised with the nearest Brazilian Consulate (or apostilled if the country where the document is signed is a member of the Hague Convention), and translated into Portuguese by an official translator before they can be registered with the relevant public registry in Brazil. Public registry fees are determined by local regulation and will also vary depending on the type of security and value of the secured obligation.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Depending on the location of the registration, type of security and amount of the secured obligation, the public registry fees may be significant. Public registries located in larger cities tend to have faster processing times than those located in remote areas.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Transactions involving public entities or relating to projects that involve public concessions or are otherwise subject to regulation (such as power, oil & gas, public infrastructure concessions, etc.) are subject to the applicable rules of the relevant regulations, and which may impose restrictions regarding the project's ability to give security over assets that are deemed essential to the company's operations and may limit the lenders' ability to enforce certain of the debtor's obligations.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Brazilian law requires the amount of the secured obligation to be stated in the security documents. In case of a revolving credit facility, this will usually be the maximum amount available under the credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In addition to the requirements mentioned in questions 2.3 and 3.9 above, it is worth noting that: (i) documents formalising the collateral security must be in written form, executed by all parties and attested by two witnesses; (ii) security agreements involving certain assets, such as real property and vessels, must be in a public form (recorded by a public official); and (iii) as Brazilian law does not contemplate the concept of "counterparts", in case the intention is to enforce the agreement directly in Brazil, an original copy of the relevant agreement should be signed in "ink" by all parties, so that it may be presented before Brazilian courts if necessary.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

There are no specific financial assistance rules prohibiting these transactions. However, the bylaws of the company may contain restrictions regarding the granting of collateral to secure third-party obligations, and general rules regarding shareholder abuse may also come into play in cases where the majority shareholder approves transactions that are not in the interest of the company.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

There is no legal concept of a "trust" in Brazil. A mandate structure must be adopted to accommodate the syndicate agent.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

It is common for the agent to sign documentation on behalf of and for the benefit of the lenders, but since Brazilian law does not recognise the syndicate agent as a trustee, in the event of insolvency or enforcement it is common for all syndicate members to participate directly in the insolvency proceedings or enforcement procedures.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Under Brazilian law, the mentioned credit assignment can be considered valid as long as the relevant debtor is notified of the credit assignment by Lender A to Lender B. With respect to the guarantee, in these cases it is advisable to obtain a guarantee confirmation from the guarantor.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interest payments made by Brazilian companies to other Brazilian companies are subject to the same tax treatment applicable to fixed income investments – the interest payments are subject to Withholding Income Tax and the applicable rates vary from 22.5% to 15% based on the term of the loan. Interest payments made by Brazilian companies to foreign lenders are, as a rule, subject to Withholding Income Tax at a 15% rate – exceptions are made for lenders located in low-tax jurisdictions or under privileged tax regimes, in which case the applicable rate is 25%. Lower tax rates may be applicable if Brazil has signed a double tax treaty with the country in which the lender is domiciled. Nevertheless, it is common that gross-up mechanisms are established in these cases, so that the payments abroad are made net of taxes. In any case, transfer pricing and thin capitalisation rules may be applicable to foreign loan transactions. Payments arising out of the enforcement of guarantees or security are generally subject to the same rules applicable to the original guaranteed amounts. In other words, the treatment is the same as if a borrower made the payments.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Brazilian tax law provides for several tax incentives to non-resident investors, which may vary depending on the project, the borrower or even the financing structure. In some cases, the incentives are focused on foreign investors – as an example, payments connected to debentures issued by Brazilian Special Purpose Companies for the development of infrastructure projects, if some requirements are met, are not subject to Withholding Income Tax if the beneficiary is a foreign investor, but are subject to a 15% rate if the investor is a Brazilian legal entity. Non-resident investors also benefit from several tax benefits when investing in the local capital markets. In addition, there are local tax incentives offered by States and Municipalities (generally connected to Value-Added Tax or Tax on Services), which aim at enhancing investment in local production and exports by means of tax exemptions, taxable basis and rate reductions, etc.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Considering that Brazilian rules on international taxation do not provide for the taxation of lending transactions, no taxation would be imposed on the income of a foreign lender solely because of a loan to, or a guarantee and/or grant of security from, a company in Brazil.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

A loan entered into between a foreign lender and a Brazilian borrower would be subject to the collection of withholding income tax on the portion related to interest deriving from the loan transaction (assuming no gross-up mechanism would apply). Upon the inflow of the funds related to the loan, the transaction would be registered with the Central Bank of Brazil on its electronic system (RDE-ROF). Currently, the foreign exchange ("FX") transactions carried out in connection with cross-border loans with a minimum average term of 180 (or more) days benefit from the IOF/Exchange with a zero rate. Cross-border loans with an average term shorter than 180 days are subject to a 6% IOF/Exchange rate.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Cross-border loans involving a Brazilian borrower may subject the Brazilian party to the application of Brazilian thin

capitalisation and transfer pricing rules, which could limit the portion of interest paid considered deductible for Corporate Income Taxes purposes. As for Brazilian thin capitalisation rules, despite the fact that there is no limit on the parties' ability to agree on a given interest rate, interest expenses are only deductible by a Brazilian borrower if (i) it is necessary for the activities conducted by the Brazilian debtor, (ii) the amount of the debt owed to a foreign-related party does not exceed twice the amount of the equity interest held (maximum 2:1 debt/equity ratio), and (iii) the aggregate debt held by all the foreign-related party lenders does not exceed twice the amount of the aggregate equity held by all foreign-related party lenders in the Brazilian borrower. Also, for creditors located in tax havens or privileged tax regimes, the limits indicated in item (ii) above are stricter, so that instead of a maximum 2:1 debt/equity ratio, the maximum indebtedness ratio would be 0.3:1 (30% of the equity held or net worth of the Brazilian borrower). In relation to transfer pricing rules, interest paid to foreign-related parties is not deductible to the extent they exceed the following rate parameters, even if BACEN has granted registration for the loan above such rate: (i) for U.S. Dollar-denominated fixed (predetermined) rate transactions, the parameter is the market rate applicable to sovereign bonds issued in U.S. Dollars by the Federative Republic of Brazil in the external market; (ii) for Brazilian Real-denominated fixed (predetermined) rate transactions, the parameter is the market rate applicable to sovereign bonds issued in Brazilian Reais by the Federative Republic of Brazil in the external market; and (iii) in other cases, the parameter is the six-month LIBOR applicable to the specific currency of the transaction or, if no LIBOR rate is published for such currency, the LIBOR for six-month U.S. Dollar deposits. In addition, any of the parameter rates above may be increased by a spread determined by the Ministry of Finance in accordance with the average spread prevailing in the market (currently, 3.5% for deductibility of interest paid to lenders abroad).

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The choice of a foreign governing law constitutes a valid choice of law and does not contravene Brazilian law. Submission by the parties to another jurisdiction is valid and binding under the laws of Brazil. Brazilian courts would enforce a contract that has a foreign governing law that is subject to the jurisdiction of Brazilian courts. In this case, proof of the foreign law should be presented, but in practice, there is a high risk that Brazilian courts would interpret the agreement using concepts of Brazilian law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A foreign judgment would be recognised and enforceable against a Brazilian company by the courts of Brazil without a re-examination of the merits of the case if it was previously confirmed (*homologado*) by the Superior Court of Justice (Superior Tribunal de Justiça – "STJ"), which confirmation may only occur if such judgment: (a) fulfils all formalities required for its enforceability under the laws of the country wherein it was issued; (b) was issued by a competent court after due service of process on the parties; (c) is not subject to appeal; (d) was authenticated by a Brazilian consulate in the country wherein it was issued or apostilled by the designated authority, as applicable, and is accompanied by a sworn translation into Portuguese; (e) is for payment of a certain sum; and (f) is not contrary to Brazilian public policy, sovereignty, human dignity or good morals.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Generally, it is hard to accurately estimate the duration of lawsuits in Brazil due to the lack of uniformity between each state's jurisdiction in this regard. However, it is likely that, in the case of (a) above, it would take approximately two to three years and, in the case of (b) above, it would take approximately two years.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

The creditor's right to keep the assets given as a collateral security in case of foreclosure is subject to certain legal restrictions. Originally, enforcement procedures under Brazilian law used to require a public auction for sale of the asset given as security. Nowadays, private sales may be allowed depending on the asset, but the principle remains that the creditor should transfer the asset to a third party to recover the debt, and any excess must be returned to the debtor. In respect of security granted by public concession holders, regulatory consent may be required for enforcement, such as the transfer of shares, for example, to another company.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

In order to file a suit against a company in Brazil, Brazilian law provides that non-residents with no real estate property in Brazil will be required to provide a bond as collateral in order to guarantee the payment of statutory attorneys' fees and court expenses. The bond is not required in certain cases, such as for the enforcement of collateral security agreements deemed as directly enforceable documents (*título executivo extrajudicial*).

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Bankruptcy liquidation

Law n. 11,101/2005 (the "Bankruptcy Law") provides for a stay of proceedings triggered by the court decision ordering

the commencement of a bankruptcy liquidation of the debtor. Accordingly, all foreclosure and enforcement proceedings against the debtor, including out-of-court measures, related to claims affected by the bankruptcy liquidation, are stayed. The stay applies to all affected claims, including claims secured by pledges and mortgages. Creditors holding a chattel mortgage (*alienação fiduciária*), a fiduciary assignment (*cessão fiduciária*), or any other collateral which transfers title to the asset, are, in principle, able to enforce the collateral.

Judicial reorganisation

The Bankruptcy Law provides for a stay period of 180 days, which can be extended to up to 360 days, from the court decision ordering the commencement of a judicial reorganisation of the debtor, and during which the debtor has an exclusivity period to propose and obtain approval of a plan of reorganisation (*plano de recuperação judicial*). After expiration of this stay period, the court can grant an additional stay of 180 days if creditors are willing to submit and negotiate an alternative plan of reorganisation. The stay affects all claims subject to a judicial reorganisation, including claims secured by pledges and chattel mortgages. Tax claims and post-petition claims are not affected by the stay. Creditors holding title to the collateral cannot remove the underlying asset from the debtor's premises during the stay period if such assets are essential to the business activities of the debtor.

Pre-packaged reorganisation

The Bankruptcy Law provides that filing of a pre-packaged reorganisation triggers an automatic stay of all enforcement and foreclosure proceedings against the debtor, exclusively in relation to claims affected by the pre-packaged plan. Creditors that are not impaired by the plan, as well as creditors holding title to collateral, are not affected by the stay.

Conciliation and mediation

The Bankruptcy Law provides that the debtor (provided it is not undergoing a reorganisation or a liquidation proceeding) may request to the court a stay of proceedings, for a period of up to 60 days, to negotiate with its creditors within a mediation or a conciliation procedure. If the debtor files a judicial reorganisation or a pre-packaged reorganisation, the 60-day stay is deducted from the stay period ordered in such proceedings.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. For foreign arbitral awards, however, the same procedure as described in question 7.2 will apply.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Creditors secured by a pledge or a mortgage are affected by a stay triggered by the commencement of a bankruptcy liquidation or a judicial reorganisation proceeding, as mentioned above. In a bankruptcy liquidation, such secured claims will be paid pursuant to the priority rule set forth in the law. In a judicial reorganisation, such claims will be impaired by the reorganisation plan. Secured creditors may also be impaired by a pre-packaged reorganisation.

Creditors holding title to assets are not impaired by a bankruptcy liquidation, a judicial reorganisation or a pre-packaged reorganisation. Such creditors may recover the underlying assets without having to take part in the respective insolvency proceeding and are generally not affected by the stay. However, the creditor cannot recover the assets if they are deemed essential to the business activities of a debtor undergoing a judicial reorganisation proceeding.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The clawback period is established by the relevant bankruptcy court and may retroact up to 90 days before: (i) the date of the first protest for non-payment by a public notary (provided that such protest has not been cancelled); (ii) the date of the filing for voluntary or involuntary bankruptcy; or (iii) the date of the filing for judicial reorganisation proceedings (as applicable).

The following actions will be deemed ineffective by the court, regardless of any intent to defraud creditors: (i) payment of debt not yet due within the clawback period; (ii) payment of debt already due by means not provided for in the respective agreement; (iii) creation of a security interest as collateral to pre-existing obligations, within the clawback period; (iv) acts free of charge performed up to two years prior to the commencement of the bankruptcy proceeding; (v) renunciation of inheritances up to two years prior to the commencement of the bankruptcy proceeding; (vi) transfer of assets without express consent or payment of all creditors, if there are no remaining assets left to pay the creditors, unless creditors fail to oppose such transfer in 30 days after being notified; and (vii) registration of rights *in rem* after the commencement of the bankruptcy liquidation proceeding.

In addition, the judicial administrator, the Public Attorney or any creditor may bring a fraudulent conveyance claim to void acts performed in fraud to creditors. Such action may be brought up to three years after the commencement of the bankruptcy proceeding.

In a bankruptcy liquidation proceeding, creditors are paid according to the priority rule set forth by the law, which follow this order of preference: (i) post-petition claims (including DIP loans, fees of the judicial administrator, claims entitled to restitution and claims arising after the filing of a preceding judicial reorganisation); (ii) labour claims up to the limit of 150 minimum per creditor, and occupational accident claims; (iii) secured claims, up to the value of the collateral; (iv) tax claims; (v) unsecured claims (including any deficiency claim); (vi) contractual fines and administrative penalties, including tax fines; (vii) subordinated claims; and (viii) interests due after the commencement of the bankruptcy proceeding. Creditors holding title to the asset (such as in chattel mortgages and fiduciary assignments) can recover the assets.

In a judicial reorganisation, creditors holding title to the asset are not impaired by the plan. Secured creditors are impaired by the plan and paid according to its term. As law does not require the plan to be fair and equitable, or to respect any priority rule, even for cramdown confirmation, secured creditors are not required to be paid in full before any amount is paid to unsecured creditors.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Entities not engaged in business activities (such as civil associations) are not subject to the bankruptcy law, and their insolvency

is governed by the 1973 Code of Civil Procedure. Financial institutions, insurance companies and other entities are subject to specific legislation in respect to insolvency and liquidation proceedings. Entities owned or controlled by government are not subject to any insolvency proceeding.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Out-of-court enforcement is the prevailing rule for security over shares and it is generally authorised under the contract and performed, in case of pledges, through an irrevocable power-of-attorney executed by the guarantor, granting to the relevant lender the necessary powers to conduct the out-of-court sale. The granting of powers-of-attorney on behalf of the lenders as part of the security package, providing the lenders with the power to replace the company's management in case of a default, is an alternative structure aiming to achieve the same objectives as traditional step-in rights. However, self-repossession of assets granted as security like we see in jurisdictions such as the U.S. is usually not allowed.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, submission to a foreign jurisdiction is generally legally binding and enforceable, subject to limited exceptions.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Sovereign immunity in Brazil only applies to governmental bodies and public entities. Foreign governmental bodies usually have absolute sovereign immunity in Brazil, and only an express waiver of immunity would be enforceable against them in Brazil. Brazilian public entities have limitations as to the circumstances in which they may waive sovereign immunity, and when they do waive immunity, the waiver will often be limited to a waiver of immunity from suit, not a waiver of immunity from enforcement. If a waiver has not been expressly granted and properly authorised, it is likely that Brazilian courts would not treat the waiver of sovereign immunity as binding and enforceable.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Lending to a given company in Brazil can be done by individuals or other companies (not necessarily a financial institution under the supervision of the Central Bank of Brazil), but individuals and non-bank companies would be subject to restrictions such as certain limitations on interest rates. Foreign entities need a special authorisation from the Central Bank of Brazil to either open branches in Brazil or hold an interest in Brazilian financial institutions. Financial institutions are, generally speaking, the only agents authorised to hold deposits and issue credit to the public. The performance of activities exclusively reserved for financial institutions is considered a criminal offence. Finally, there are no specific eligibility requirements in Brazil for a financial institution to act as an agent under a syndicated facility for lenders to a company.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

Due to the COVID-19 social distancing restrictions, the execution and delivery of contracts by means of online tools through electronic signatures (i.e., DocuSign, Adobe Sign) vastly increased in Brazil and have become more widely accepted in business practices. The operation of notary offices and real estate registry offices were also affected due to certain restrictions imposed by the relevant States, which involved reduced working hours and remote work of the employees, and deadlines for registration of documents with public authorities were extended. We believe the trend to use electronic execution instead of physical execution in private business transactions will continue even after the pandemic subsides, but considering Brazil's formalistic requirements regarding registration of many types of documents before public registries, a complete shift to online tools does not seem likely in the near future.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Adequate and prompt legal counsel is advisable when participating in financings in Brazil. Depending on the financing transaction and parties involved, different risks should be taken into account (i.e., political and regulatory risk, especially for financings to companies that rely on agreements with the Public Administration for revenues). In addition, care must be taken to ensure the enforceability of security packages under Brazilian law, with due regard for perfection requirements and other peculiarities of a civil law jurisdiction, which is significantly more formalistic than common law jurisdictions tend to be.

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Our services range from providing assistance in M&A transactions, privatisations and company formation to representing clients in disputes, from offering advice on tax issues and infrastructure projects to guiding oil and gas companies through the challenges inherent in a highly regulated industry, to name a few examples of our broad range of work.

At Veirano, we understand that our professionals are our equity in a globalised market. In order to build strong client-service teams of specialists, we recruit Brazilian attorneys with multicultural backgrounds who have received additional education and training in first-tier law schools and law firms in the U.S., Europe and Asia.

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British Virgin Islands

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The British Virgin Islands ("**BVI**") continues to be a jurisdiction of choice for corporate vehicles entering into secured finance transactions. The British Virgin Islands' creditor-friendly and innovative legislation has proven adaptable to the needs of its international clients while remaining fully compliant with international regulations and policies. In particular, the BVI's modern and flexible legislation has enabled business, transactions and entities to be managed effectively during COVID-19 and beyond, from digital incorporation and know-your-client ("**KYC**") regimes to virtual meetings and electronic closings. The recent introduction of rules on economic substance for companies and limited partnerships does not impact third-party lenders and counterparties.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

BVI obligors continue to feature prominently in financed holding structures and joint ventures, notably: in the oil and gas and mining sectors; in development finance and infrastructure projects throughout Africa, Asia and Eastern Europe, CIS, Latin America and elsewhere; in high-end property developments in London and elsewhere; and in shipping, drillships and other asset finance facilities.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

The giving of a guarantee by a BVI company is governed by the key corporate legislation, the BVI Business Companies Act (as amended) (the "**Act**"), and the company's memorandum and articles of association. Subject to its memorandum and articles of association, the powers of a company include (among other things) the power to guarantee a liability or obligation of any person and secure any obligations by mortgage, pledge or other charge of any of its assets for that purpose.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Under the Act, and subject to its memorandum and articles of association, a company has, irrespective of corporate benefit, full capacity to carry on or undertake any business or activity, do any act or enter any transaction and, for those purposes, full rights, powers and privileges.

The directors of a company have fiduciary and statutory duties to act honestly and in good faith and in the best interests of the company. A director who is in breach of his duties may be liable to the company for the resulting loss to the company.

In the event that there is a disproportionately small (or no) benefit to the company, the transaction may be open to challenge; for example, as a transaction at an undervalue, in the event of the insolvency of the company (see below).

2.3 Is lack of corporate power an issue?

Under the Act, no act of a company and no transfer of an asset by or to a company is invalid by reason only of the fact the company did not have the capacity, right or power to perform the act or to transfer or receive the asset.

It should be noted that members' remedies have been codified in the Act, and, for example, if a company or a director of a company engages in, proposes to engage in, or has engaged in conduct that contravenes the Act or the memorandum or articles of the company, the BVI court may, on the application of a member or a director of the company, make an order directing the company or director to comply with, or restraining the company or director from engaging in conduct that contravenes the Act or the memorandum or articles.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

It is not necessary to ensure the legality, validity, enforceability or admissibility in evidence of a guarantee that any document be filed, recorded or enrolled with any governmental authority or agency or any official body in the BVI. Shareholder approval would be required only in the event the company's memorandum and articles of association require it.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

To the extent that, under the applicable governing law, the guarantee is characterised as a debt incurred on behalf of a member of the company, it may be deemed to be a distribution and accordingly be subject to the requirement of the directors to determine that the company will pass the basic solvency test immediately after the deemed distribution. Under the solvency test, the company's assets must exceed its liabilities and the company must be able to pay its debts as they fall due. For former International Business Companies that still have a share capital, the requirements for satisfying the solvency test differ.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There is no exchange control legislation under BVI law and accordingly there are no exchange control regulations imposed under BVI law.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are no limits under BVI law on the types of collateral that a company may give.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

A company may enter into a general security agreement such as a debenture.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

It should be noted that assets would typically be held outside the BVI and collateral instruments would typically be governed by a governing law relevant to the jurisdiction in which the asset is sited. In the event that the company holds an interest in real estate or other assets physically located in the BVI, there are certain licensing, registration and stamp duty considerations.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

BVI law does not make statutory provision for an assignment by way of security. An assignment of receivables governed by BVI law would require the written agreement of the debtor in order to take effect as a legal assignment, failing which the assignee would likely take an equitable assignment only.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A company may give security over cash held in its bank accounts in any jurisdiction. British Virgin Islands law does not make statutory provision for collateral security over cash deposited in bank accounts located in the BVI, and the cooperation of the account holding branch would be required.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Collateral security may be taken over shares in companies incorporated in the BVI and this is a popular and frequently used type of security. Such security can validly be granted under a foreign law-governed document, and New York or English law-governed security is common. In the case of an English law-governed document, the application of the Financial Collateral Arrangements (No 2) Regulations 2003 to shares in a BVI company has been confirmed by the Privy Council in *Cukurova Finance International Limited and Cukurova Holdings A.S (Appellants) v Alfa Telecom Turkey Ltd (Respondent)* [2013] UKPC 2. Shares are in registered form and share security is typically taken by way of an equitable mortgage. The Act provides a mechanism for particulars of a charge over shares to be noted on the register of members, a copy of which the company may file publicly at the Registry of Corporate Affairs in order for a person carrying out a company search to be on notice of the equitable security. The Act enables a chargee to enforce immediately upon an event of default. The Act also provides for the powers of the chargee or a receiver, which may be modified or supplemented by the security instrument.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

A company may give security over inventory. The applicable procedure would be driven by the jurisdiction in which the inventory is located.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Subject to its memorandum and articles of association, a company may grant a security interest to secure its obligations as a borrower, or the obligations of others.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

No steps are required as a matter of BVI law to perfect a security interest where assets are not located in the British Virgin Islands. It is a requirement of the Act that a company keep a register of all relevant charges created by the company, either at the company's registered office, or at the office of the company's registered agent. For the purposes of priority, an application may be made to the Registrar to register the charges created, providing an advantage to secured creditors that is not available in some offshore jurisdictions. Subject to such registration, and any prior security interests registered on the applicable register, the security interest will, as a matter of BVI law, have priority over any claims by third parties (other than those preferred by law)

including any liquidator or a creditor of the company, subject in the case of a winding up of the company in a jurisdiction other than the BVI to any provisions of the laws of that jurisdiction as to priority of claims in a winding up. A floating charge will rank behind a subsequently registered fixed charge unless the floating charge contains a prohibition or restriction on the power of the company to create any future security interest ranking ahead in priority to or equally with the floating charge.

No taxes, fees or charges (including stamp duty) are payable (either by direct assessment or withholding) to the government or other taxing authority in the British Virgin Islands under the laws of the BVI in respect of the execution or delivery, or the enforcement, of security documentation. In the event that the company holds an interest in real estate or other assets physically located in the British Virgin Islands, there are certain perfection, licensing, registration and stamp duty considerations.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The Registry of Corporate Affairs fee for registering a register of charges is US$200. A small amount of time will be required for the preparation of the particulars of the registration.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No, they are not.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

No, there are not.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company
Subject to its memorandum or articles, the powers of a company include the power to give financial assistance to any person in connection with the acquisition of its own shares.

(b) Shares of any company which directly or indirectly owns shares in the company
There are no restrictions on the giving of financial assistance to any person in connection with the acquisition of shares of any company which directly or indirectly owns shares in the company.

(c) Shares in a sister subsidiary
There are no restrictions on the giving of financial assistance to any person in connection with the acquisition of shares in a sister subsidiary.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The BVI courts will recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders, where that is provided for pursuant to the provisions of the applicable security documentation.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not necessary in the BVI.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

This would be dependent on the applicable governing laws of the loan and the assignment documentation. BVI law does not make statutory provision for the assignment of intangibles. An assignment of receivables governed by BVI law would require the written agreement of the debtor in order to take effect as a legal assignment, failing which the assignee would likely take an equitable assignment only. A deed of novation would more typically be used to transfer a loan governed by BVI law.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

No taxes are required to be deducted or withheld under the laws of the BVI from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security. The BVI complies with the EU Taxation of Savings Directive through the automatic exchange of information on savings income with tax authorities in EU Member States.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No taxes are payable to the government or other taxing authority in the British Virgin Islands under the laws of the BVI in respect of the execution or delivery, or the enforcement, of security documentation. In the event that the company holds an interest in real estate or other assets physically located in the BVI, there are certain perfection, licensing, registration and stamp duty considerations.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No income of a foreign lender will become taxable in the BVI solely because of a loan to, or guarantee and/or grant of security from, a company in the BVI.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are no significant costs, such as notarial fees, that would be incurred by foreign lenders in a loan to, or guarantee and/or grant of security from, a company in the BVI.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The BVI courts will recognise a governing law that is the law of another jurisdiction, subject to the considerations applicable generally to choice of law provisions.

The BVI courts may decline to exercise jurisdiction in relation to substantive proceedings brought under or in relation to a contract that has a foreign governing law in matters where they determine that such proceedings may be tried in a more appropriate forum.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Any final and conclusive monetary judgment obtained against a company in the courts of England and Wales, for a definite sum, may be registered and enforced as a judgment of the BVI court if application is made for registration of the judgment within 12 months or such longer period as the court may allow, and if the BVI court considers it just and convenient that the judgment be so enforced. Alternatively, the judgment may be treated as a cause of action in itself so that no retrial of the issues would be necessary. In either case, it will be necessary that, in respect of the foreign judgment:

(a) the foreign court issuing the judgment had jurisdiction in the matter and the judgment debtor either submitted to such jurisdiction or was resident or carrying on business within such jurisdiction and was duly served with process;
(b) the judgment given by the foreign court was not in respect of penalties, taxes, fines or similar fiscal or revenue obligations of the company;
(c) in obtaining judgment there was no fraud on the part of the person in whose favour judgment was given, or on the part of the foreign court;
(d) recognition or enforcement of the judgment in the BVI would not be contrary to public policy;
(e) the proceedings pursuant to which judgment was obtained were not contrary to natural justice; and
(f) the judgment given by the foreign court is not the subject of an appeal.

Any final and conclusive monetary judgment obtained against a company in the courts of New York, for a definite sum, may be treated by the BVI courts as a cause of action in itself so that no retrial of the issues would be necessary, provided that in respect of the foreign judgment:

(a) the foreign court issuing the judgment had jurisdiction in the matter and the company either submitted to such jurisdiction or was resident or carrying on business within such jurisdiction and was duly served with process;
(b) the judgment given by the foreign court was not in respect of penalties, taxes, fines or similar fiscal or revenue obligations of the company;
(c) there was no fraud on the part of the person in whose favour judgment was given or on the part of the court, in obtaining judgment;
(d) recognition or enforcement of the judgment in the BVI would not be contrary to public policy; and
(e) the proceedings pursuant to which judgment was obtained were not contrary to natural justice.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

There is no set timetable for such proceedings, and the time involved will depend on the nature of the enforcement proceedings (for example, an application to appoint liquidators on the ground of insolvency may be quicker than an action of judgment on the debt claim). If there is no defence to the claim and it is unopposed, judgment may be obtained in proceedings against a BVI company in approximately one month from the commencement of proceedings. If the proceedings are defended, then the time involved will depend upon the facts and circumstances of the case. Broadly, the same considerations apply to an application to enforce a foreign judgment in the BVI.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

No, there are not.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

There are no restrictions applicable to foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The appointment of liquidators against a company under the BVI Insolvency Act, 2003 (as amended) (the "**Insolvency Act**") brings about a moratorium on claims against the company, but this does not prevent the enforcement of security.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Under the Arbitration Act 2013, the United Kingdom and BVI arbitral awards will now be treated in the BVI as New York Convention awards. The BVI is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the "**Convention**"). A court in the BVI is required by law to enforce, without re-examination of the merits of the case or re-litigation of the matters arbitrated upon, a Convention award. However, enforcement of a Convention award may be refused if the person against whom it is invoked proves:

(a) that a party to the arbitration agreement was, under the law applicable to him, under some incapacity;
(b) that the arbitration agreement was not valid under the law to which the parties subjected it or, failing any indication thereon, under the law of the country where the award was made;
(c) that he was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case;
(d) that the award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration or contains decisions on matters beyond the scope of the submission to arbitration;
(e) that the composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties or failing such agreement, with the law of the country where the arbitration took place; or
(f) that the award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, it was made.

Enforcement of a Convention award may also be refused if the award is in respect of a matter which is not capable of settlement by arbitration under the laws of the BVI, or if it would be contrary to public policy to enforce the award.

A Convention award which contains decisions on matters not submitted to arbitration may be enforced to the extent that it contains decisions on matters submitted to arbitration which can be separated from those on matters not so submitted.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Security over the assets of a company in liquidation may be enforced by the chargee directly over those assets, which fall outside the custody and control of the liquidator.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

In the event of the insolvency of a company, there are four types of voidable transaction provided for in the Insolvency Act:

(1) Unfair Preferences: Under section 245 of the Insolvency Act, a transaction entered into by a company, if it is entered into within the hardening period (see below) at a time when the company is insolvent, or it causes the company to become insolvent (an "**insolvency transaction**"), and which has the effect of putting the creditor into a position which, in the event of the company going into insolvent liquidation, will be better than the position it would have been in if the transaction had not been entered into, will be deemed an unfair preference. A transaction is not an unfair preference if the transaction took place in the ordinary course of business. It should be noted that this provision applies regardless of whether the payment or transfer is made for value or at an undervalue.
(2) Undervalue Transactions: Under section 246 of the Insolvency Act, the making of a gift or the entering into of a transaction on terms that the company is to receive no consideration, or where the value of the consideration for the transaction, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company will (if it is an insolvency transaction entered into within the hardening period) be deemed an undervalue transaction. A company does not enter into a transaction at an undervalue if it is entered into in good faith and for the purposes of its business and, at the time the transaction was entered into, there were reasonable grounds for believing the transaction would benefit the company.
(3) Voidable Floating Charges: Under section 247 of the Insolvency Act, a floating charge created by a company is voidable if it is an insolvency transaction created within the hardening period. A floating charge is not voidable to the extent that it secures:
    (a) money advanced or paid to the company, or at its direction, at the same time as, or after, the creation of the charge;
    (b) the amount of any liability of the company discharged or reduced at the same time as, or after, the creation of the charge;
    (c) the value of assets sold or supplied, or services supplied, to the company at the same time as, or after, the creation of the charge; and
    (d) the interest, if any, payable on the amount referred to in (a) to (c) pursuant to any agreement under which the money was advanced or paid, the liability was discharged or reduced, the assets were sold or supplied or the services were supplied.

4. Extortionate Credit Transactions: Under section 248 of the Insolvency Act, an insolvency transaction entered into by a company for, or involving the provision of, credit to the company, may be regarded as an extortionate credit transaction if, having regard to the risk accepted by the person providing the credit, the terms of the transaction are or were such to require grossly exorbitant payments to be made in respect of the provision of the credit, or the transaction otherwise grossly contravenes ordinary principles of fair trading and such transaction takes place within the hardening period.
   The hardening period (known in the Insolvency Act as the vulnerability period) in respect of each voidable transaction provision set out above is as follows:
   (a) for the purposes of sections 245, 246 and 247 of the Insolvency Act, the period differs depending on whether the person(s) that the transaction is entered into with, or the preference is given to, are connected persons of the company within the meaning of the Insolvency Act. In the case of connected persons, the hardening period is the period beginning two years prior to the onset of insolvency (see below) and ending on the appointment of a liquidator of the company. In the case of any other person, the hardening period is the period beginning six months prior to the onset of insolvency and ending on the appointment of a liquidator of the company; and
   (b) for the purposes of section 248 of the Insolvency Act, the hardening period is the period beginning five years prior to the onset of insolvency and ending on the appointment of a liquidator of the company regardless of whether the person(s) that the transaction is entered into with is a connected person.

   The onset of insolvency for these purposes is the date on which an application for the appointment of a liquidator was filed (if the liquidator was appointed by the Court) or the date of the appointment of the liquidator (where the liquidator was appointed by the members).
   A conveyance made by a person with intent to defraud creditors is voidable at the instance of the person thereby prejudiced. There is no requirement that the relevant transaction was entered into at a time when one party was insolvent or became insolvent as a result of the transaction, and there is no requirement that the transferring party subsequently went into liquidation. However, no conveyance entered into for valuable consideration and in good faith to a person who did not have notice of the intention to defraud may be impugned.
   There are limited preferential creditors under BVI law.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Certain sovereign entities and treaty-based organisations are protected. For example, the State Immunity (Overseas Territories) Order 1979 extended the State Immunity Act 1978 to the BVI, and the International Finance Corporation Order 1955 extends to the BVI.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Enforcement of a charge over the shares in a BVI company could be effected without recourse to the courts, where the necessary documentation has been provided by the chargor, the issuer company and the registered agent prior to the date of enforcement. As stated above, the remedy of appropriation that may be contained in an English law-governed share charge has been upheld by the Privy Council as applicable to shares in a BVI company.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The BVI courts will recognise that a foreign jurisdiction may be the more appropriate forum for enforcement.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A relevant entity may waive immunity pursuant to the State Immunity Act 1978.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Assuming that the lender is not doing business in the BVI, it will not be caught by the regulatory legislation, or requirements for licensing, in the jurisdiction. Significantly, business is not carried on "in the BVI" by a lender by reason only of it being carried on with a company or limited partnership incorporated or registered in the BVI.

A "foreign" lender, which does not carry on business in the BVI, would not be required to be licensed in order to lend to a BVI company.

There is no distinction between a lender that is a bank *versus* a lender that is a non-bank.

In the unlikely event that, based on the facts of a specific scenario, a foreign lender is found to be carrying on business in the BVI without holding the requisite licence, the loan may be unenforceable by the lender.

As above, assuming that the agent is not conducting business in the BVI, there are no licensing and eligibility requirements for an agent under a syndicated facility.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary

requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

Electronic closings have long been the norm in BVI transactions, and the jurisdiction was quick to legislate for certainty around electronic execution of contracts and deeds after the *Mercury* decision.

The use of electronic signatures has become extremely relevant and common during COVID-19 (particularly where there has been a lockdown in place). To supplement the common law position, the BVI had already enacted legislation that recognises the use of electronic signatures for most types of transactions and has put electronic records on the same footing as paper records. The parties will still need to check that all of the key elements for contract formation are present in the electronic communication or contracting process used, but BVI law removes the obstacle of signing by way of using an alternative electronic signature, these not being temporary relaxations only. There are some documents that may not be allowed to be executed by way of an electronic signature, such as a will or testament, enduring power of attorney or conveyance of real property (in the BVI). Some closings will still require original documents to be delivered, such as an original share certificate being handed over for security purposes. There is no requirement in the BVI to execute documents before a notary public or to legalise or apostille documents for the legality, validity or admissibility in evidence of such documents.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The British Virgin Islands is a dependable common law jurisdiction, and other attractions for lenders not mentioned above include, for example, the statutory recognition of netting, set-off and subordination arrangements, and the ability for a creditor to restore a dissolved company where it is just to do so.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Canadian banks have been widely recognised internationally as well capitalised, well managed and well regulated, and a major contributing force in the Canadian economy. The lending market in Canada is characterised by a wide range of domestic banks, pension funds, credit unions and insurance companies, as well as major foreign banks and finance companies, offering a range of commercial lending services and financial products on par with those offered anywhere else in the world.

In recent years, there has been increasing growth of the private debt investor market in Canada. A number of newer non-bank funds and institutions have become active in mid-market leveraged lending and other lines of business. These opportunities have arisen in large part due to the increased regulatory burden and capital requirements faced by banks following the financial crisis. With continued active participation by Canadian banks as well as foreign lenders, and the increasing presence of non-bank lending funds, the Canadian lending market continues to remain very competitive and lending margins remain tight.

Fintech lending also continues to grow in the Canadian market. At present, the regulation of fintech in Canada is generally fragmented and siloed. No single central authority regulates the wide variety of functions associated with fintech. In general, regulation is entity-based rather than function-based and is split between federal and provincial jurisdictions. Federal law covers banking and anti-money laundering, while provincial law governs such matters as securities, consumer protection and privacy. Both federal and provincial authorities are working towards developing more unified fintech strategies and are experimenting with such innovations as the regulatory sandbox to ease the regulatory burden for startups.

Although it is anticipated that LIBOR will be discontinued after 2021, the future of the Canadian Dollar Offered Rate (CDOR) – the corresponding reference rate to LIBOR used for Canadian Dollar loans – is less clear. On November 12, 2020, Refinitiv Benchmark Services (UK) Limited (Refinitiv) announced that the calculation and publication of the six-month and 12-month tenors of CDOR would cease indefinitely, effective as of May 17, 2021. Publication of the one-month, two-month and three-month tenors of CDOR will continue after that date. The Canadian Alternative Reference Rate Working Group (CARR) was established in 2018 in response to recommendations published by the Financial Stability Board. The CARR is a consultative group comprised of financial sector firms, large financial instrument end users and public sector institutions, with an initial mandate to enhance the Canadian Overnight Repo Rate Average (CORRA) and to analyse the need for, and potentially develop, a new Canadian Dollar risk-free term rate. The Bank of Canada took over the calculation and publication of CORRA from Refinitiv on June 15, 2020, based on an enhanced methodology it developed under the guidance of the CARR (Enhanced CORRA). On October 19, 2020, the CARR's mandate was expanded to include an analysis of CDOR to determine its efficacy as a credit-sensitive benchmark, as well as to make recommendations based on that analysis. As part of this new mandate, the CARR will be responsible for assessing the impact of the discontinuance of the six-month and 12-month tenors of CDOR on financial instruments that reference CDOR and addressing issues that may arise from such discontinuance.

Nevertheless, it is also expected CDOR will continue to be used alongside Enhanced CORRA for the time being. It remains to be seen whether the Canadian market has the liquidity to support both rates in the long term or whether the use of other risk-free rates in other jurisdictions will encourage the adoption of Enhanced CORRA instead of CDOR. In the meantime, there has been increasing usage of fallback language for CDOR in loan documentation to address the potential discontinuance of CDOR entirely.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Domestic and cross-border lending in Canada has remained active in recent years. As a result of the COVID-19 pandemic, certain transactions were either delayed or put on hold, while a number of lenders focused on portfolio management. The market this year saw restructurings in many sectors affected by the pandemic, particularly bricks and mortar retail and entertainment. Notwithstanding a general market slowdown, a number of financing transactions have continued unabated in certain sectors, including health care, public-private partnership (P3), tech and financial services. For example, significant acquisition financings were completed for the going private acquisition of IPL Plastics by Madison Dearborn, and financing of PointClickCare's acquisition of Collective Medical.

Despite a brief slowdown during the initial stages of the COVID-19 pandemic, lending in the P3 space continued to grow in 2020. In Ontario, several P3 projects related to light rail and subway expansion achieved financial close, and the Province announced a pipeline of 37 P3 projects, valued at more than $60 billion. Among other highlights, the Federal Government achieved financial close on the $1.8 billion Energy

Services Acquisition Program (ESAP), the Province of British Columbia closed the $950 million Pattullo Bridge Replacement Project and the Province of Nova Scotia closed the $700 million Highway 104 project.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, it can.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In some circumstances, the enforceability of a guarantee could be challenged by stakeholders on the basis that it was granted in a manner that was oppressive, unfairly prejudicial or that unfairly disregards the interest of creditors or minority shareholders under the oppression provisions of applicable corporate legislation. A guarantee could also be subject to challenge under provisions of applicable insolvency legislation dealing with transactions at under value or preference claims. Directors and officers would only be subject to personal liability in such cases if specific facts were pleaded to justify such a remedy (e.g. wrongdoing).

2.3 Is lack of corporate power an issue?

If the guarantor is a corporation, it must have the corporate power and capacity to give guarantees. Most business corporations have the powers and capacity of a natural person and it is unusual to see restrictions on the power to issue guarantees in the guarantor's constating documents. However, certain corporations created by statute for a public purpose (such as school boards) may still be subject to the doctrine of *ultra vires* and therefore may require express legislative authority to give guarantees.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Other than typical corporate authorising resolutions, no formal approvals are generally required. Where a corporation provides financial assistance by way of guarantee or otherwise, in some provinces the corporation is required to disclose the financial assistance to its shareholders after such assistance is given.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

This is not the case for corporations incorporated federally or under the laws of most provinces. However, the corporate laws in a few Atlantic Provinces and in two territories continue to prohibit financial assistance to members of an intercompany group if there are reasonable grounds to believe that the corporation would be unable to meet prescribed solvency tests after giving the assistance, subject to specific exceptions.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No; subject to the provisions of applicable Canadian federal money laundering and anti-terrorism legislation.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Most types of personal property and real property are available to secure lending obligations, subject to certain limitations by contract (e.g. contractual restrictions on assignment) or by law (e.g. government receivables, permits, licences and quotas).

Provincial legislation generally governs the creation and enforcement of security. All Canadian provinces (except Québec) have adopted comprehensive personal property security acts (PPSAs) conceptually similar to Article 9 of the United States Uniform Commercial Code (UCC). The PPSAs govern the creation, perfection and enforcement of security interests in a debtor's personal property, and create a scheme for determining the priority of competing interests in the same collateral. The PPSAs apply to any transaction that in substance creates a security interest in personal property, regardless of the form of document used to grant the interest.

Québec, Canada's only civil law jurisdiction, has a European-style Civil Code (the Civil Code of Québec) that governs the creation and enforcement of security on movable (personal) and immovable (real) property.

Certain types of property continue to be subject to additional federal registration and filing regimes (examples include intellectual property and assets in shipping, aircraft and railways). The federal Bank Act also has a special security regime available as an option available only to federally chartered banks for certain classes of debtors and collateral.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

A general security agreement (GSA) can be and often is used to grant security over all of the debtor's present and after-acquired personal property of every type and description. Separate agreements are not required for each type of asset. The GSA or other security agreement must contain a description of the collateral sufficient to enable it to be identified. However, a GSA typically does not extend to real property and separate requirements apply to registration and documentation of security against land, as described under question 3.3 below.

In most cases, the secured party perfects the security interest by registering a financing statement under the PPSA filing regime in the applicable province. Where the financing statement should be registered depends on the type of collateral. In general, security interests in most tangible personal property are registered in the province in which the collateral is located at the time of attachment. Security interests in most intangibles and certain types of goods normally used in more than one jurisdiction must be registered in the province in which the debtor is deemed to be located under the relevant debtor location rules. Except in Ontario, British Columbia and Saskatchewan, a debtor with multiple places of business is deemed to be located at its "chief executive office". Under amendments to Ontario's PPSA that came into force on December 31, 2015, amendments to

British Columbia's PPSA that came into force on June 1, 2019 and amendments to Saskatchewan's PPSA that came into force on June 22, 2020, most debtors are deemed to be located in the jurisdictions in which they were incorporated or organised, similar to the more generally applicable debtor location rules under Article 9 of the UCC.

The hypothec, Québec's only form of consensual security, may be granted by a debtor to secure any obligation, and may create a charge on existing and after-acquired movable (personal) or immovable (real) property, although there are certain additional formalities that must be met when taking security on immovable (real) property. It may be made with or without delivery, allowing the grantor of the hypothec to retain certain rights to use the property. In most cases, a hypothec must be published (registered) in Québec's Register of Personal and Movable Real Rights in accordance with applicable formalities in order to enable it to be set up against third parties (i.e., perfected).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

A lender may take collateral security over land or real property by way of a mortgage of the land, a mortgage of lease, a debenture, or, if the real property charged is in Québec, an immovable deed of hypothec. Interests in real property are registered in the land registry system of the relevant province. In Québec, the immovable hypothec is usually registered by a Québec notary in accordance with applicable formalities.

It should be noted that a higher rate of interest on amounts in arrears secured by a real property mortgage may be unenforceable under the Interest Act (Canada).

The procedure for taking security over plant, machinery and equipment that constitutes personal property under the PPSA or movables under the Civil Code of Québec is described in question 3.2 above.

Personal property may include "fixtures" (goods that become affixed to real property), but if the security interest has not attached prior to affixation, the creditors registered against the land gain priority, with limited exceptions. What constitutes a fixture is a factual question and the common law has taken a contextual approach. To protect the priority of its interest in a fixture, a secured party must both 1) perfect its security interest under the PPSA, and 2) register its interest in the land registry system. Under the Civil Code of Québec, the rules for determining what constitutes movable or immovable property are different – but the end results are comparable.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. The procedure for taking security over receivables is the same as described in question 3.2 above.

Notice to account debtors is not required to create a perfected security interest in accounts receivable under the PPSA. However, account debtors for the receivables are obligated to pay the receivable directly to the secured party only after receiving notice from the secured party that the receivable has been assigned to it. In addition, an absolute assignment of receivables constitutes a "security interest" regardless of whether it secures any obligations.

Amendments to the Ontario and Saskatchewan PPSAs that came into force on May 15, 2020 and June 22, 2020, respectively, introduced new provisions distinguishing electronic and physical chattel paper ("chattel paper" meaning a record that evidences both a monetary obligation and a security interest in or a lease of specific goods, such as leases for personal property, chattel mortgages and conditional sales contracts). With regard to electronic chattel paper, these new provisions provide a regime for conflict of laws, attachment, perfection and priority, resulting in electronic chattel paper being treated similarly to other forms of intangible collateral.

Under the Civil Code of Québec, if assigned receivables constitute a "universality of claims", the assignment must be registered for such assignment to be set up against third parties (i.e. perfected). However, account debtors must still be notified of such assignment before an account debtor is obligated to pay the receivable directly to the secured party. If the receivables do not constitute a universality of claims, the assignment may be perfected with respect to Québec obligors only by actual notice of the assignment to such obligors.

Under Canadian federal legislation, subject to prescribed exceptions, receivables owed by the federal government can be assigned only absolutely (not as security) and only with appropriate notice to the appropriate official of the government of Canada, which must be acknowledged. Some provinces have similar legislation covering receivables owed by the provincial government. In Canada, asset-based lenders frequently exclude government receivables from the borrowing base.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

The PPSA and Civil Code of Québec permit a lender to take security over deposit accounts. Under the PPSA, deposits in bank accounts are treated as "accounts" or receivables owed by the depository bank to the depositor and under the Civil Code of Québec as claims against the bank. Accordingly, in PPSA jurisdictions, security interests in deposit accounts are perfected by registering a financing statement in the province where the debtor is deemed to be located under the applicable debtor location rules (see question 3.2 above). Traditionally, a bank lender that maintained deposit accounts for its debtor and wished to take security in such accounts would do so by way of set-off and a "flawed asset" approach. However, in light of a Supreme Court of Canada case that poses a risk of recharacterisation, the lender should also register a PPSA financing statement against the debtor.

No PPSA jurisdiction has yet adopted control as a means of perfecting security interests in deposit accounts. However, under the Civil Code of Québec, it is possible to perfect hypothecs over cash deposits in bank accounts (referred to as monetary claims) by "control". Where the creditor is also the account bank, the creditor obtains control by the debtor (i.e. the account holder) consenting to such monetary claims securing performance of its obligations to the creditor. Where the creditor is not the account bank, the creditor obtains control by either: (i) entering into a control agreement with the account bank and the debtor, pursuant to which the account bank agrees to comply with the creditor's instructions, without the additional consent of the debtor; or (ii) becoming the account holder.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

A security interest in shares issued by companies incorporated

in any jurisdiction is typically documented by way of a standalone pledge agreement or included in a general security agreement. While the jurisdiction governing validity, perfection or non-perfection of the pledge will be determined under applicable conflict of laws rules, the security interest may be granted under a document governed by New York or English law, subject to the principles discussed in question 7.1 below.

Under the PPSA and the Securities Transfer Act, 2006 (STA), versions of which are in force in all Canadian PPSA jurisdictions (harmonised legislation is in force in Québec), a secured party can perfect its security interest in shares by registering under the PPSA or by taking control under the STA (or both). An interest perfected by control has priority over one perfected only by registration or simple delivery of the unendorsed share certificates.

Shares may be either certificated or uncertificated. For certificated shares, taking physical possession of the share certificates, together with a suitable endorsement (which can be on a separate instrument such as a stock power of attorney), meets the STA requirement for control. For uncertificated shares, control is obtained by being registered as the shareholder or through a control agreement with the issuer. Control over securities held indirectly through securities accounts can be achieved by other means (for example, a control agreement with the relevant intermediary).

It should also be noted that under securities legislation, a private company's constating documents must include a restriction on the right to transfer its shares. This restriction usually states that each transfer of the company's shares requires approval by the company's directors or shareholders.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. The procedure is generally the same as described in question 3.2.

The security interest may be perfected by registering a financing statement in the province or territory in which the inventory is situated at the time the security interest attaches, except that inventory of a type normally used in more than one jurisdiction that is leased or held for lease by the debtor to others requires registration in the province in which the debtor is deemed to be located.

The purchase of inventory is often financed by way of a purchase money security interest (or PMSI). A PMSI in collateral is, in substance, a security interest given by either the seller or a third party to finance the purchase of the collateral by the debtor. The PPSA provides that a PMSI in inventory and other types of collateral (other than investment property or its proceeds) have priority over any other security interest in the same collateral given by the same debtor (even if that other security interest was registered first) so long as certain timing and (and, in the case of inventory) third-party notice requirements are satisfied. The Civil Code of Québec does not offer a comparable approach and subordination or cession of rank is required from any prior ranking secured creditor.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, it can.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Registration fees are payable in connection with the filing of PPSA financing statements, increasing with the length of the registration period. These are relatively modest – for example, in Ontario it is $8.00 for each year of the registration period or $500 for a perpetual registration.

A modest tax is payable upon registering real property security in certain Canadian jurisdictions. The tax is based on a fee and where the face amount of the registration exceeds the value of the lands, one is permitted to pay on the basis of a percentage of the property value.

No Canadian jurisdiction imposes stamp taxes or duties in relation to security. In Québec, if a notarial deed of hypothec is used, the notary will generally charge a fee for execution, keeping it in its notarial records and for issuing copies; however, there is no additional material cost.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The registration requirements in most cases are relatively straightforward and inexpensive. As noted above in question 3.7, a PMSI in inventory requires prior notice to certain secured parties in order to ensure priority.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

For certain special types of regulated property, consents or approvals may be required by governmental authorities or agencies for both the creation and enforcement of security. Governmental licences, permits and quotas are subject to specific regimes requiring notice or consent in many cases. See question 3.4 regarding government receivables.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

A security interest and hypothec in personal property or movable property may secure both present and future advances under a revolving credit facility. Where future advances are made while a security interest is perfected, the security interest has the same priority with respect to each future advance as it has with respect to the first advance, with certain limited exceptions in favour of unsecured execution and other creditors that seize the collateral if the secured party makes the advance after receiving notice of their interests. A security interest in personal property is not automatically discharged by reason of the fact that the outstanding balance under a revolving line of credit has been paid down to zero and subsequently re-advanced.

Generally, advances on a real property mortgage made without actual notice of a subsequent claim will typically have priority over such subsequent claims and, accordingly, mortgages securing revolving credit normally provide that subsequent liens are prohibited. Certain priority exceptions apply such as in respect of construction liens. Real property mortgages securing revolving credit should be properly worded to address situations where the borrowing is fully or partially repaid and thereafter re-advanced.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In Québec, security over immovable property or in favour of a collateral agent on behalf of multiple secured parties (referred to as "hypothecary representative") requires execution of the deed of hypothec before an authorised Québec notary.

Each province has different requirements with respect to real property, including specific registration forms, evidence of corporate authority, affidavits and, in some jurisdictions, originals for registration.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Most Canadian corporations are not subject to such restrictions, except those created under the laws of a few Atlantic Provinces (New Brunswick, Newfoundland and Prince Edward Island) and certain territories (the Northwest Territories and Nunavut). Certain provinces (Alberta, British Columbia, Ontario and Saskatchewan) require that financial assistance be disclosed to shareholders, but failure to disclose does not invalidate the transaction.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. The agency concept is recognised in Canadian common law and agents are commonly used in syndicated lending for both administration of loans and holding collateral security in Canada. Indenture trustees are typically used in public bond transactions.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

For purposes of holding collateral security in the province of Québec, the mechanism commonly used requires the appointment of the collateral agent as a "hypothecary representative", together with a notarial deed of hypothec in favour of such hypothecary representative.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Assignments of debt, guarantees and security can be effected by contract pursuant to a standard assignment and assumption agreement. Where the assignor is also the secured party of record (whether as collateral agent or otherwise), PPSA financing statements (and the Québec equivalent) are typically amended to record the assignment, although such amendments are not required for enforceability (except in Québec). Mortgage or security assignments are required to be filed under the applicable land registry to give effect to the assignment. In the case of Québec, where the security is in favour of the hypothecary representative and there is a substitution of hypothecary representative (as a result of the assignment or otherwise), the new hypothecary representative cannot exercise recourses under the hypothec until such substitution is registered where applicable.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

There are generally no requirements to deduct or withhold tax on payments of interest by a debtor or guarantor (whether by voluntary payment, enforcement or otherwise) made by a domestic debtor or guarantor to domestic lenders.

Conventional interest payments made to arm's length lenders that are non-residents of Canada are generally not subject to Canadian withholding tax, regardless of their country of residence. In addition, conventional interest payments made to certain non-arm's length US resident lenders may qualify for an exemption from Canadian withholding tax under the Canada-US Tax Treaty.

Certain interest payments made in respect of back-to-back loans, including loans between related parties, which are channelled through an independent third-party intermediary, may be subject to Canadian withholding tax.

In the absence of any applicable exemption under a bilateral tax treaty or under the Income Tax Act (Canada), withholding tax on interest payments, such as participating debt interest, may apply at rates of up to 25%.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Generally, there are no material tax or other incentives provided preferentially to foreign investors or creditors and no taxes apply to security documents for the purposes of effectiveness or registration.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

While each lender's tax position must be examined individually, generally a non-resident lender's income should not be taxable in Canada solely because of a single secured loan transaction in the absence of a fixed presence in Canada or other connecting factors.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

(See question 3.9 for a discussion of the relevant filing and notarial fees.) There are no stamp taxes, registration taxes or documentary taxes that are generally applicable in connection with authorisation, delivery or performance of loans, guarantees or security.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Thin capitalisation rules under the Income Tax Act (Canada) determine whether a Canadian corporation may deduct interest on the amount borrowed from a "specified non-resident shareholder" of the corporation or from a non-resident person who does not deal at arm's length with a "specified shareholder" (collectively, "specified non-residents"). A "specified shareholder" of a corporation is, in general terms, a person who, either alone or together with persons with whom they do not deal at arm's length, owns 25% or more of the voting shares, or owns 25% or more of the fair market value of the issued and outstanding shares, of the corporation.

Under the thin capitalisation rules, Canadian corporations are effectively prevented from deducting interest arising in respect of the portion of loans from specified non-residents that exceeds one-and-a-half times the corporation's specified equity (in highly simplified terms, retained earnings, share capital and contributed surplus attributable to specified non-residents). In addition, any interest expenses that are disallowed under these rules are deemed to be dividends paid to the lender for non-resident withholding tax purposes, and are subject to withholding tax.

The thin capitalisation rules may also apply in respect of interest paid or payable on back-to-back loans. However, most traditional forms of commercial collateralisation or guarantees should not attract the application of these rules, especially where any loans made by the third party are clearly made from the third party's own sources.

The thin capitalisation rules further apply (with appropriate modifications) to (i) Canadian resident trusts, (ii) non-resident corporations or trusts that carry on business in Canada (in respect of loans that are used in the course of that Canadian business), and (iii) partnerships in which a Canadian resident corporation or trust or a non-resident corporation or trust is a member.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Subject to certain exceptions and conditions, Canadian courts will recognise and apply the parties' choice of governing law if it is specifically pleaded and proven by expert testimony.

Canadian courts will not apply the foreign law if the choice of law is not *bona fide* or is contrary to public policy, or if so doing would be considered enforcement of foreign revenue, or expropriatory or penal law. Additionally, Canadian courts will apply Canadian procedural law and certain provincial and federal laws that have overriding effect, such as bankruptcy and insolvency statutes, federal crime legislation, employment legislation and consumer protection legislation.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A foreign monetary judgment may be enforced in Canada if the judgment is final and the foreign court properly assumed jurisdiction. As long as these requirements are met, a Canadian court will not examine whether the foreign court correctly applied its own substantive and procedural laws.

In considering the issue of jurisdiction, Canadian courts will apply their own principles of jurisdiction. Generally, a contractual submission to the jurisdiction of the foreign court will be sufficient, but in the absence of such submission, the Canadian court will examine whether there was a "real and substantial connection" between the foreign court and the cause of action or the defendant. While the test is often applied generously and flexibly by the courts, a fleeting or relatively unimportant connection will not support a foreign court's assumption of jurisdiction.

There are certain limited defences which preclude recognition related to circumstances under which the foreign judgment was obtained (such as by fraud or in a manner breaching principles of natural justice) and whether there is any reason it would be improper or contrary to public policy to recognise the foreign judgment. In practice, these defences rarely succeed.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

a) In Ontario, if no defence is filed in response to a claim, default judgment may be obtained between 20 and 60 days after the claim has been served on the defendant, depending on where service is effected. After any judgment is obtained, and subject to it being stayed by the filing of a notice of appeal, enforcement proceedings may be commenced immediately.
b) An application hearing to enforce a foreign judgment in Ontario may generally be obtained within approximately two to three months.

Procedural and substantive law differs by province, but the timing described above is similar in most other provinces.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

A secured creditor must give the debtor reasonable time to pay following demand, before taking action to enforce against its collateral security (even if the debtor purported to waive these rights).

Where a secured creditor intends to enforce security over substantially all of an insolvent debtor's inventory, accounts

receivable or other property used in relation to the debtor's business, in addition to delivering a demand, the secured creditor must also deliver a notice of intention to enforce security in the form prescribed under the Bankruptcy and Insolvency Act (BIA) at least 10 days before such enforcement, unless the debtor consents to an earlier enforcement. A slightly longer notice period may be required if collateral is located in the Province of Québec.

If a secured creditor intends to deal with the collateral itself or through a privately appointed receiver (where applicable), it must also give advance notice to the debtor and other interested parties of its intention to dispose of the collateral or accept the collateral as final settlement of the debtor's obligations. This notice period is typically 15–20 days depending on the applicable PPSA and can run concurrently with the BIA enforcement notice.

Although there is no requirement for a public auction, a secured creditor (and any receiver) must act in good faith and in a commercially reasonable manner when selling or otherwise disposing of the collateral. However, if a lender wishes to buy the collateral, it may only do so at a public sale, unless otherwise permitted by a court. Generally speaking, no regulatory consents are required to enforce on collateral security.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

To maintain an action in certain provinces, foreign lenders may be required to become extra-provincially registered.

There are no specific restrictions on a foreign lender's ability to enforce security in Canada. However, if the lender chooses to exercise those remedies to either foreclose on the collateral security or to credit-bid its debt, such that the foreign lender ends up owning the debtor's Canadian assets, the foreign lender may be subject to restrictions imposed by the Investment Canada Act or the Competition Act.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, a stay of proceedings may affect the rights of secured and unsecured creditors in some circumstances to the extent set out in question 8.1.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Provincial arbitration acts provide for the enforcement of arbitral awards by application to the court. Canadian courts will not re-examine the merits of an arbitral award; however, the award may be set aside on specified grounds including, but not limited to, an invalid arbitration agreement, an award outside of the jurisdiction of the arbitrator, or a reasonable apprehension of bias on the part of the arbitrator.

The Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the UNCITRAL Model Law on International Commercial Arbitration have been adopted in all Canadian provinces and provide rules for the enforcement of international arbitral awards. Subject to limited grounds on which enforcement of an international arbitral award may be refused, the awards are generally enforceable in Canada.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy and insolvency in Canada are primarily governed by two federal statutes: the BIA; and the Companies' Creditors Arrangement Act (CCAA). The BIA provides a comprehensive liquidation scheme for companies and individuals, along with a streamlined reorganisation regime. The CCAA is Canada's large company reorganisation statute. Although some aspects of creditors' rights are determined by provincial statutes, bankruptcy and insolvency law is mostly uniform across Canada. Insolvency proceedings under the BIA or CCAA will result in the imposition of a stay of proceedings either by a Canadian court or pursuant to the relevant statute.

Under the BIA liquidation proceedings, the automatic stay of proceedings imposed upon commencement will not prevent a secured creditor from realising or otherwise dealing with its collateral. By contrast, in a court-appointed receivership (an alternative form of liquidation proceeding governed by the BIA), receivership orders routinely contain language staying the actions of secured creditors.

If a debtor files a notice of intention to make a proposal (NOI) or a proposal to creditors under the BIA (a reorganisation proceeding), a secured creditor's enforcement rights will be automatically stayed during the reorganisation proceeding, unless: (i) the secured creditor took possession of the collateral before the filing; (ii) the secured creditor delivered its BIA enforcement notice more than 10 days prior to the filing of the NOI; or (iii) the debtor consents to the secured creditor exercising its enforcement rights.

Reorganisation proceedings under the CCAA are commenced when an initial order is granted by the court. The CCAA explicitly empowers a court to grant a stay of proceedings against the debtor on any terms that it may impose. The stay provision in the CCAA initial order typically prohibits secured creditors from enforcing their security interests against the debtor's property during the proceeding.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

a) Avoidance actions

Under the BIA and the CCAA, certain transactions, including the granting of security, the transfer of property and other obligations are voidable if incurred during specified pre-bankruptcy time periods. Subject to certain conditions and exemptions, if such transactions are made with a view to giving one creditor a preference over others, they may be set aside if entered into during the period that is: (i) three months before the initial bankruptcy event for transactions at arm's length; and (ii) one year before the initial bankruptcy event for transactions not at arm's length.

Transfers of property (or services sold), in which the consideration the debtor receives is less than the fair market value, subject to certain other conditions and exemptions, may be set aside under the BIA or CCAA if entered into during the period that is: (i) one year before the initial bankruptcy event for transactions at arm's length; and (ii) five years before the initial bankruptcy event for transactions not at arm's length.

There is also provincial legislation providing for setting aside other fraudulent conveyances or preferential transactions.

b) Statutory priority claims

In Canada, a number of statutory claims may "prime" or take priority over a secured creditor. Priming liens commonly arise from a debtor's obligation to remit amounts collected or withheld on behalf of the government. Such amounts include unremitted employee deductions for income tax, government pension plan contributions, government employment insurance premiums and unremitted federal goods and services taxes, provincial sales taxes, municipal taxes and workers' compensation assessments. In Ontario, statutory deemed trusts may give rise to a priority claim for certain unpaid claims of employees, including, in some circumstances, a deemed trust arising upon wind-up of a defined benefit pension plan for any deficiency amounts. In addition, there are a number of statutes that create priming liens in specific industries (for example, repair and storage liens, construction liens and brokerage liens). These priming liens may attach to all of the property of the debtor. In some cases, the priority of statutory claimants and secured creditors is sometimes reversed by the commencement of an insolvency proceeding against the debtor.

c) Priority claims – insolvency

An insolvency proceeding in respect of the debtor may give rise to a number of additional liens that would rank in priority to a secured creditor's claims.

The BIA provides employees of a bankrupt employer or an employer in receivership with a priority charge on the employer's "current assets" for unpaid wages and vacation pay (but not for severance or termination pay) for the six-month period prior to bankruptcy or receivership to a maximum of $2,000 per employee (plus up to $1,000 for certain travelling expenses). The priority charge ranks ahead of all other claims, including secured claims, except unpaid supplier rights.

The BIA also grants a priority charge in bankruptcies and receiverships for outstanding current service pension plan contributions, subject only to the wage earners' priority. The pension contribution priority extends to all assets, not just current assets, and is unlimited in amount.

The pension charge secures: (i) amounts deducted as pension contributions from employee wages but not contributed to the plan prior to a bankruptcy or receivership; and (ii) amounts required to be contributed by the employer to a pension plan for "normal costs". The charge does not extend to unfunded deficits arising upon a wind-up of a defined benefit plan and should not include scheduled catch-up or special payments required to be made by an employer because of the existence of a solvency deficiency.

The CCAA and the reorganisation provisions of the BIA expressly prohibit a court from sanctioning a proposal, compromise or arrangement or a sale of assets, unless it is satisfied that the debtor has arranged to pay an amount equal to the amounts secured by the wage and pension priority charges discussed above.

d) Priority claims – court charges

In CCAA and BIA reorganisations, debtors may obtain interim financing (often referred to as debtor in possession (DIP) financing). Both the CCAA and the BIA expressly authorise the court to grant fresh security over a debtor's assets to DIP lenders in priority to existing security interests up to a specified amount approved by the court.

In addition to the priming liens noted above, in a CCAA or BIA reorganisation, the court has the authority to order priming charges to secure payment of directors' post-filing liabilities and to secure the fees and disbursements of experts, court-appointed officials and certain other "interested parties" in the court's discretion. The court may also order priming charges to secure payment to designated "critical suppliers", typically restricted to securing payment for post-filing supply.

The priority of the DIP charge, directors' charge, expense charge and any critical supplier charge in respect of the debtor's assets is determined by the court.

e) Unpaid suppliers' rights

The BIA provides certain unpaid suppliers with a right to repossess goods sold and delivered to a purchaser within 30 days before the date of bankruptcy or receivership of such purchaser. The unpaid supplier's right to repossess goods effectively ranks ahead of a secured creditor.

An unpaid supplier claim is rarely successful as the supplier has the burden of demonstrating that all requirements have been met, including: (i) that the debtor has possession of the goods; (ii) that the goods are identifiable; (iii) that the goods are in the same state; and (iv) that the goods have not yet been sold.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Banks (including the Canadian business of foreign banks authorised to do business in Canada), insurance companies and trust corporations are excluded from the BIA and CCAA and their wind-up is governed by the Winding-Up and Restructuring Act (Canada). The BIA and CCAA also exclude railway and telegraph companies. However, in a recent case, a court granted a railway company relief under the CCAA.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Upon default, a secured creditor may exercise "self-help" remedies to take possession and control of collateral individually or through the appointment of a private receiver (if provided in its security documents). Secured creditors may also seek court appointment of an interim receiver to preserve and protect collateral on an expedited basis.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The submission by a party to the non-exclusive jurisdiction of the courts of a foreign jurisdiction should be recognised as valid, provided that service of process requirements are complied with. The submission by a party to the exclusive jurisdiction of the courts of a foreign jurisdiction is generally recognised unless there is "strong cause" not to do so.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

The State Immunity Act (Canada) governs sovereign immunity of foreign states and any separate agency of a foreign state (e.g. state trading corporations). Private corporations that are not "organs" of a foreign state are not entitled to sovereign immunity.

Sovereign immunity may be waived if the state or agency submits to the jurisdiction of the Canadian court by agreement, either before or after commencement of the proceedings. Sovereign immunity is subject to certain exceptions (e.g. commercial activities and property damage actions, terrorist activities and certain maritime claims).

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no specific eligibility requirements for lenders solely as a result of entering into a secured lending transaction as lender or agent.

Under the Bank Act (Canada), a "foreign bank" is generally not permitted to engage in or carry on business in Canada except through a foreign bank subsidiary, an authorised foreign branch or other approved entity. A "foreign bank" is broadly defined in the Act and includes an entity incorporated or formed by or under the laws of a country other than Canada that (i) is a bank under the laws of a foreign country in which it carries on business or carries on business in a foreign country which would be considered the business of banking, (ii) engages in the business of providing financial services and uses the word "bank" in its name, (iii) is in the business of lending money and accepting deposit liabilities transferable by cheque or other instrument, (iv) engages in the business of providing financial services and is affiliated with a foreign bank, or (v) a foreign institution (that is not captured by the criteria in (i) to (iv) above) that controls a foreign bank or a Canadian bank. A "foreign institution" means an entity not incorporated in Canada that is engaged in the business of banking, the trust, loan or insurance business, the business of a cooperative credit society or the business of dealing in securities or is otherwise engaged primarily in the business of providing financial services.

However, the Bank Act would not prohibit a foreign bank from making a loan to a Canadian borrower as long as the nature and extent of its activities in Canada do not amount to engaging in or carrying on business in Canada. There is uncertainty about the exact boundaries of the general prohibition against engaging in or carrying on business in Canada. The Act itself does not provide specific guidance on the factors that the main bank regulator – i.e. Office of the Superintendent of Financial Institutions (OSFI) – may take into account in determining whether a foreign bank is engaging in or carrying on business in Canada. OSFI will generally assess the particulars of each case against factors comparable to those considered by judicial bodies in interpreting the concept of "carrying on business in Canada" under statutes such as the Income Tax Act, keeping in mind that the policy considerations under other statutes may not be the same as under the Bank Act.

A non-bank lender may be required to obtain an extra-provincial licence in each province in which it is considered to be carrying on business under provincial corporate law. Such determination may vary somewhat in each province; however, similar factors to those above will be relevant. A corporation which owns or leases real property in, or has an employee or agent that is resident in, such province will generally be considered to be carrying on business in that province.

In the case of either a bank or non-bank lender, a loan transaction involving a Canadian borrower would not be void or voidable by reason of such lender's failure to comply with applicable regulatory requirements in Canada.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

As noted in question 3.6, control of certificated securities for perfection purposes may be obtained by taking physical possession of share certificates together with a suitable endorsement. Possession of the certificate and the endorsement must be physical possession of the original document. Possession of an electronic copy of the certificate or the endorsement will not constitute control. As a result of COVID-19, transaction practices have varied. In some cases, closings have proceeded with electronic copies of documents together with perfection by registration while delivery of original signed copies is postponed to allow parties time to arrange physical delivery of originals as and when circumstances permit. Alternatively, the issuer of the pledged securities may issue its securities in uncertificated book-based form and enter into a control agreement with the secured party.

In certain provinces, affidavits or commissioned original documents are required in respect of a real property registration. The applicable governing authorities have released instructions on the electronic commissioning of such documents. Typically, such authorities now permit a commissioner (or lawyer) to conduct a virtual commissioning (i.e., executing a document under oath) via video-conferencing tools whereby the commissioner administers the oath and witnesses the execution of the document via live video feed. The signatory must then deliver the original signed document to the commissioner and the commissioner will then complete the jurat and fully commission the document. Once fully commissioned, the commissioner will then submit the fully executed and commissioned document to the applicable registrar for registration. Certain provinces require that the virtual commissioner be a commissioner of that specific province.

In the Province of Québec, a hypothec in favour of a collateral agent needs to be received by a notary. This would typically require all the signatories to sign before and in the presence of the notary. Indeed, it was already the established practice to have enabling corporate resolutions of a grantor expressly authorise a representative – for instance Counsel to the grantor – to sign for and on behalf of the grantor, thus facilitating signing "before" the notary. As a result of COVID-19, some notaries now accept a "DocuSign" type electronic signature in connection with video-conferencing tools. Alternatively, the practice has developed for the grantor's enabling corporate resolutions to also expressly authorise a colleague of the notary to sign for and on behalf of the grantor and for the collateral agent

to grant a mandate (or power of attorney) to expressly authorise a colleague of the notary to sign for and on behalf of the collateral agent. This is proving to be very flexible and efficient and will likely continue after COVID-19.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The Criminal Code (Canada) makes it a criminal offence to receive interest at a criminal rate, defined as an effective annual rate of interest that exceeds 60%. Interest in the Criminal Code (Canada) is broadly defined to include interest, fees, fines, penalties, commission and similar charges and expenses that a borrower pays in connection with the credit advanced. This section has been considered almost exclusively in civil (not criminal) cases where the borrower seeks to avoid repayment by arguing that the contract was illegal. Courts have struggled with deciding which, if any, contractual provisions should be enforced when a contract imposes a criminal rate of interest.

Note

Please note that the answers in this chapter are up to date as of January 8, 2021. Readers are cautioned against making decisions based on this material alone. Rather, any proposal to do business in Canada should be discussed with qualified professional advisors.

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Cayman Islands

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The Cayman Islands continues to be a jurisdiction of choice for the establishment of investment funds, portfolio investment companies and corporate vehicles, each of which utilise secured lending arrangements in a variety of forms. We have seen a significant uptick in the use of investment fund holding entities structured as orphan vehicles as lenders are looking to address US bankruptcy concerns. The robust and creditor-friendly legislation in the Cayman Islands provides counterparties with significant comfort in secured lending transactions, which continues to make the Cayman Islands the jurisdiction of choice for many financial institutions. We continue to see an increase in the use of hybrid and NAV facilities in both the private equity and hedge fund space. Exempted companies and exempted limited partnerships are still the most popular entities across all business areas, but we also see an increasing use of limited liability companies as a result of advantageous hybrid features taken from both the company and exempted limited partnership regimes.

The global regulatory shift has enforced the position that the Cayman Islands is a leading, well-respected and relied upon jurisdiction for many lending houses and financial institutions in all fund financing and secured lending transactions.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The most significant lending transactions continue to occur in the investment funds space, especially to Cayman Islands domiciled private equity funds. These transactions tend to be governed by New York and English law finance documents with security taken over Cayman Islands assets being governed by both Cayman Islands law and non-Cayman Islands law. Although the courts in the Cayman Islands generally recognise foreign law documents, lenders often prefer, for commercial purposes, to have dual Cayman Islands law-governed security.

The main types of security are, in the case of funds established in the form of exempted limited partnerships, exempted companies and limited liability companies, security over capital calls (the right to call such capital and the right to receive the proceeds of such calls) and, more generally, security over Cayman Islands equity interests, either in the form of registered shares or exempted limited partnership interests. This is particularly common where there is a "master-feeder" structure or underlying blocker entities are used to hold assets and those structures are looking to utilise subscription and hybrid facilities.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, a company can grant a guarantee in these circumstances assuming there is sufficient commercial rationale and benefit to the company.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

The directors of the company providing a guarantee must ensure that any proposed transaction is in the best interests of the company as a whole. Guarantee arrangements may be construed as not being in the best interests of a company (and not for the company's corporate benefit) if the granting company receives no commercial benefit from the underlying financing arrangements.

The directors of the company giving the guarantee should approve the terms and execution of the guarantee by way of board resolution in accordance with the company's articles of association. If there is any question of lack of corporate benefit or a potential breach of director's duties, it is recommended that the company also obtain a shareholders' resolution approving the grant of the guarantee.

2.3 Is lack of corporate power an issue?

In accordance with the Companies Act (2021 Revision) ("**Companies Act**"), the lack of capacity of a company to enter into a transaction by reason of anything in the company's memorandum will not affect the validity of the transaction. However, where the company is acting without the necessary capacity, shareholders may issue proceedings prohibiting the company from performing its obligations under the transaction (including disposing of any property) and proceedings may be brought against present and past directors or officers of the company for loss or damage caused by them binding the company in this manner, contrary to the objects in the memorandum.

If a shareholder brings proceedings to restrict the company from performing its obligations, we believe such action would not affect the other party's rights under the transaction. If the company fails to perform, the other party would have the usual remedies.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Subject to any licensing restrictions that may apply to a regulated entity, no authorisations or consents are required by law from any governmental authorities or agencies or other official bodies in the Cayman Islands in connection with the grant of a guarantee. In addition, it is not necessary to ensure the enforceability or admissibility in evidence of a guarantee that any document be filed, recorded or enrolled with any governmental authority or agency or any official body in the Cayman Islands.

The directors of the company giving the guarantee should approve the terms and execution of the guarantee by way of board resolution in accordance with the company's articles of association. If there is any question of lack of corporate benefit or a potential breach of director's duties, it is recommended that the company also obtain a shareholders' resolution also approving the grant of the guarantee.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no legislative restrictions imposed on the amount of any guarantee due to net worth or the solvency of a company. However, the directors of a company should, as part of fulfilling their fiduciary duties, consider the terms of any guarantee, particularly in the context of the company's asset base.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control regulations imposed under Cayman Islands law that would act as an obstacle to enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are no legislative restrictions on the form of collateral and, accordingly, all property of a company is potentially available as security for lending obligations.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is possible for security to be taken by means of a general security agreement, such as a debenture, over a range of asset types. The main types of security under Cayman Islands law are mortgages (legal and equitable), charges (fixed and floating), liens and assignments of rights by way of security (albeit that this is deemed to be a form of mortgage). Formalities and perfection of such security interests will depend upon the nature of the underlying collateral and the applicable *lex situs* of such collateral.

Special regimes apply to the taking of security over certain assets, including ships, aircraft and land.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over land is usually granted by way of legal or equitable mortgage and by way of fixed charge over plant, machinery and equipment. In relation to chattels, security can also be created by a conditional bill of sale, which must be recorded in accordance with the Bills of Sale Act (2016 Revision).

A legal mortgage is granted by execution of a mortgage agreement between the mortgagor and the secured creditor. The terms of the mortgage will vary, but essentially a mortgage (i) requires transfer of legal title in the land to the secured creditor, subject to a requirement to re-transfer the land upon satisfaction of the underlying secured obligations, and (ii) grants the secured creditor certain powers to deal with the land upon a default.

An equitable mortgage can be created by (i) the execution of an equitable mortgage, (ii) an agreement to create a legal mortgage, (iii) a transfer of land which is not perfected by registering the secured creditor in the Land Registry in accordance with the Registered Lands Law, and (iv) the deposit of the relevant title deeds by way of security.

Fixed and floating charges are usually evidenced by an agreement between the parties reflecting the grant of the security interest and setting out the commercial terms.

A company must make an entry in its register of mortgages and charges in respect of any security interest created by it in order to comply with section 54 of the Companies Act. A Limited Liability Company (an "**LLC**") must make an entry on its register of mortgages and charges in a similar manner to an exempted company incorporated or referenced under the Companies Law, in accordance with Section 62(1) of the Limited Liability Companies Act (2020 Revision) (the "**LLC Act**"). However, failure to comply with these requirements does not invalidate the security interests created by either a company or LLC.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Receivables arising under contract are examples of "choses in action", being a right which can only be asserted by bringing an action and not by taking possession of a physical thing. Receivables can be mortgaged or charged where that mortgage or charge takes the form of an assignment with an express or implied provision for reassignment on redemption. If a chose in action is charged, the charge can be either fixed or floating.

An assignment can be either legal or equitable, depending on the circumstances. The key requirements of a legal assignment are that it is: (i) an absolute assignment of the whole of a present (not future) chose in action; and (ii) the assignment must be both in writing and signed by the assignor and notified in writing to the debtor. An equitable assignment generally only relates to part of a chose in action and/or does not involve the notification of the debtor.

A company and LLC must make an entry in its register of mortgages and charges in respect of any security interest created by it. See question 3.3 above.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A security interest over cash deposits is most commonly created by either a fixed or floating charge, depending on the commercial

intention of the parties and the level of control maintained over such cash deposits. The secured creditor should ensure that there is an agreement (usually a deed). Cash deposits are classified as choses in action. Accordingly, the analysis in question 3.4 above applies.

In accordance with Cayman Islands conflict of law rules, the appropriate law to govern any security over cash deposited with a bank will be the law applicable where the bank is located (or the location of the bank branch with which the deposit is made).

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Security over shares in Cayman Islands companies, where the register of members is maintained in the Cayman Islands, is usually taken in the form of a legal or equitable mortgage, depending on whether the secured party wishes to take legal title to the shares prior to a default of the secured obligation. Different rules may apply if the register of members is maintained outside of the Cayman Islands or if the shares are in bearer form.

In accordance with Cayman Islands conflict of law rules, the appropriate law to govern any security over registered shares in a Cayman Islands company is determined according to the law applicable to the location of the register of members. Whilst it is possible to grant security over shares as a matter of other laws, enforcement of such security may prove problematic or difficult.

It is not possible to pledge registered shares under Cayman Islands law because title to the shares cannot be transferred by physical delivery. Any grant of security over registered shares that is called a "pledge" will typically fall into one of the mortgage categories, depending on its terms, or it may be entirely ineffective.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security can be taken over inventory or stock by way of a fixed or floating charge. A floating charge is more common given the changing nature of inventory in the usual course of a grantor's business.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A company can grant a security interest in order to secure its obligations as a borrower under a credit facility or as a guarantor of the obligations of other parties (see Section 2). Usual fiduciary duties applicable to directors' actions will apply in each case.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

No stamp duties or other similar taxes are payable, unless the applicable security document is executed in or brought into the Cayman Islands. The amount of any applicable stamp duty will vary depending on the type of security document and the identity of the assets subject to the security interest. Unless the document needs to be executed in the Cayman Islands, it is common practice to execute documents outside of the Cayman Islands so that stamp duty is not levied. Court fees (of a nominal value) will fall due as part of any enforcement process.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

A company must make an entry in its register of mortgages and charges in respect of any security interest created by it in order to comply with section 54 of the Companies Act (2021 Revision). An LLC must make an entry on its register of mortgages and charges in a similar manner to an exempted company incorporated or referenced under the Companies Law, in accordance with Section 62(1) of the LLC Act. This step is usually undertaken by the registered office service provider of the company or LLC and can be completed in a very short time period.

Charges over certain assets, such as land, intellectual property rights, ships and aircraft, need to be registered at other specialist registries related to the asset in question.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Subject to any licensing restrictions that may apply to a regulated entity, no authorisations or consents are required by law from any governmental authorities or agencies or other official bodies in the Cayman Islands in connection with the grant of a security interest.

The directors of the company (or manager, as the case may be) or of an LLC granting the security interest should approve the terms and execution of the security document by way of board resolution in accordance with the company's articles of association or LLC's limited liability company agreement. If there is any question of lack of corporate benefit or a potential breach of directors' duties, it is recommended that the company also obtain a shareholders' resolution approving the grant of the security interest.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no special priority concerns regarding a revolving credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

A number of key documentation issues exist, each of which depend on the form of the security document, whether the document contains a power of attorney and if the document is to be executed by way of deed. The key issues of note are: (i) an agreement to create a legal mortgage over land should be executed and delivered as a deed; (ii) a legal assignment must be in writing and signed by both parties; (iii) any power of attorney or security document containing a power of attorney must be executed by

way of a deed to ensure compliance with the Powers of Attorney Law (1996 Revision); and (iv) where a deed is required, the relevant execution formalities are set out in the Companies Act and the LLC Act.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company
No, there are no legislative prohibitions or restrictions under Cayman Islands law equivalent to the English law financial assistance rule.

(b) Shares of any company which directly or indirectly owns shares in the company
No, there are no legislative prohibitions or restrictions under Cayman Islands law equivalent to the English law financial assistance rule.

(c) Shares in a sister subsidiary
No, there are no legislative prohibitions or restrictions under Cayman Islands law equivalent to the English law financial assistance rule.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Cayman Islands law recognises the role of an agent or trustee, acting on behalf of all lenders, assuming the transaction documents provide for the relevant trust mechanics and the trust is properly constituted.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

There are no special requirements under Cayman Islands law to make the loan and guarantee enforceable by Lender B, provided that the novation/transfer mechanics in the applicable facility agreement are adhered to as a matter of the applicable governing law.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

The Cayman Islands currently have no form of income, corporate or capital gains tax and no estate duty, inheritance tax or gift tax. Accordingly, no taxes, fees or charges (other than stamp duty) are payable either by direct assessment or withholding to the government or another taxing authority in the Cayman Islands under the laws of the Cayman Islands.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no tax incentives or other incentives under Cayman Islands law. See question 6.1.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No income of a foreign lender will become taxable in the Cayman Islands.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Other than, potentially, the payment of stamp duty and applicable court fees on enforcement, no other significant costs should be incurred by foreign lenders in the grant of any loan or the taking of the benefit of any guarantee or security interest.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Assuming that the lenders are not connected to the borrower, in principle there are no adverse consequences if the lenders are organised in a jurisdiction other than the Cayman Islands.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The courts of the Cayman Islands will observe and give effect to the choice of the applicable governing law (the "**Relevant Law**") of a contract assuming that the choice of the Relevant

Law as the governing law of the applicable contract has been made in good faith and would be regarded as a valid and binding selection which will be upheld by the courts of that jurisdiction and any other relevant jurisdiction as a matter of the Relevant Law and all other relevant laws.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Assuming that the choice of the Relevant Law (as defined in question 7.1 above) as the governing law of the applicable contract has been made in good faith and would be regarded as a valid and binding selection which will be upheld by the courts of the applicable jurisdiction (the "**Relevant Jurisdiction**") and any other relevant jurisdiction (other than the Cayman Islands) as a matter of the Relevant Law and all other relevant laws (other than the laws of the Cayman Islands), then although there is no statutory enforcement in the Cayman Islands of judgments obtained in the Relevant Jurisdiction, a judgment obtained in such jurisdiction will be recognised and enforced in the courts of the Cayman Islands at common law, without any re-examination of the merits of the underlying dispute, by an action commenced on the foreign judgment debt in the Grand Court of the Cayman Islands, provided such judgment is given by a foreign court of competent jurisdiction and is final, for a liquidated sum, not in respect of taxes or a fine or a penalty, and was not obtained in a manner, and is not of a kind, the enforcement of which is contrary to the public policy of the Cayman Islands.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Timing of any litigation will inevitably be dependent on a large number of variable factors (such as location of the defendant, defences raised, complexity of the proceedings and resistance to enforcement). Assuming the defendant is in the Cayman Islands and the matter is straightforward and uncontested, it is possible to obtain default or summary judgment within a short time period. Assuming there is no resistance to enforcement, it may be possible to complete the process in six months. If the defendant is outside the jurisdiction, the process may take substantially longer. The timing for enforcement of a judgment is also dependent on a number of variable factors. It may be possible to complete the process in two to three months, but it could take substantially longer.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

While there are no legislative requirements for a public auction or similar process in the Cayman Islands, liquidators owe fiduciary duties to the creditors and shareholders of a company to recover the best price possible (usually market value) for all assets of a company upon a liquidation. Recent case law has set a precedent for this in the case of enforcement over land located in the Cayman Islands. Receivers owe their primary duty to the secured party and will seek to recover sufficient funds to repay the debt due; however, they also have a duty to the obligor to recover the best price reasonably obtainable on a sale of the secured assets. Accordingly, public auction or a similar process may be appropriate in certain circumstances. Certain consents may also be required from the Monetary Authority if the obligor is a regulated entity.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

There are no legislative restrictions on foreign lenders filing suit against a company in the Cayman Islands, assuming that they can establish that the Cayman Islands court has jurisdiction over the suit. There are no legislative restrictions applicable to foreclosure on collateral security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

No formal corporate rehabilitation procedure exists under either the Companies Act or the LLC Act, as is the case in England and Wales (administration) or in the United States (Chapter 11), that would give a company or LLC the benefit of moratorium provisions in the payment of its secured debts. Each of a Cayman Islands company and LLC can be subject to voluntary or involuntary winding up proceedings under the Companies Act, although it is possible for a court to appoint a provisional liquidator after the presentation of a petition for the winding up of a company or LLC but before an order for the winding up of the company or LLC is made where, for example, there is an immediate need to take actions to safeguard assets for creditors. There is also a growing practice in the Cayman Islands for provisional liquidators to be appointed with the principal objective of preparing a scheme of arrangement with the aim of avoiding a formal winding up (see further below). While there is an automatic stay of proceedings against the entity when an order for winding up has been made and on the appointment of a provisional liquidator, the stay does not prevent a secured creditor from enforcing its security interest.

Court-supervised debt restructurings are implemented through a scheme of arrangement. A scheme of arrangement involves a compromise or arrangement between a company and its creditors and/or members. In an insolvency or potential insolvency situation, schemes are principally used to: (i) restructure the company's debts when the company is in financial difficulties, with a view to the company continuing its operations (either on a stand-alone basis or within provisional liquidation proceedings); or (ii) reach a compromise with creditors following commencement of liquidation (the scheme being used as the mechanism for making distributions in the liquidation). No protection from creditor action is afforded if a scheme of arrangement is used outside of liquidation or provisional liquidation proceedings. Where there are different classes of creditors involved, each class is required to hold separate meetings to vote on the scheme proposals. The scheme will be approved by the company's creditors if a majority (i.e. over 50%) in number,

representing 75% in value of each class of creditors, present and attending, either in person or by proxy, vote in favour of the scheme. Once approved, the scheme will be required to be sanctioned by the Court and delivered to the Registrar of Companies to become binding on all affected parties, regardless of whether and how they voted at the class meeting(s). A scheme of arrangement is broadly analogous to a plan of reorganisation in a Chapter 11.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The courts of the Cayman Islands will recognise and enforce arbitral awards made pursuant to an arbitration agreement in a jurisdiction which is a party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "**New York Convention**").

Although there is no statutory enforcement of arbitral awards made in jurisdictions not party to the New York Convention, the courts of the Cayman Islands will recognise and enforce such arbitral awards provided that (a) the parties have submitted to the arbitration by an agreement which is valid by its governing law, and (b) the arbitral award is valid and final according to the law which governs the arbitration proceedings. The arbitral award will not be regarded as final by a Cayman Islands court unless the arbitral tribunal has disposed of all the issues itself. A Cayman Islands court will not, however, recognise or enforce such arbitral awards if: (a) under the submission agreement and the law applicable thereto, the arbitrators have no jurisdiction to make the award; (b) it was obtained by fraud; (c) its recognition or, as the case may be, enforcement would be contrary to public policy; or (d) the proceedings in which it was obtained were opposed to natural justice.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In accordance with the Companies Act, when a winding up order is made or a provisional liquidator is appointed, no suit, action or other proceedings, including criminal proceedings, shall be proceeded with or commenced against the company or LLC except with the leave of the court and subject to such terms as the court may impose. This prohibition in our view extends to judicial proceedings and does not include security enforcement methods which do not require an order of the court in the Cayman Islands. Furthermore, subject to any debts preferred by law, each of the Companies Act and the LLC Act provide that secured creditors may enforce their security notwithstanding that a winding up order has been made in respect of the applicable company or LLC.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The enforceability of any security document will be subject to general insolvency rules applicable to companies and LLCs in the Cayman Islands including voidable preferences and transactions effected at an undervalue.

A secured party holding a fixed charge will, notwithstanding that a winding up order has been made, be entitled to enforce his security without the leave of the Cayman Islands court and without reference to the liquidator. However, if the security created by the relevant security document is treated as a floating charge, then debts preferred under Cayman Islands law will have priority over the secured party on a liquidation of the company or LLC.

In addition, subsequent purchasers, mortgagees, chargees, lienholders and execution creditors in respect of the assets subject to the floating charge are likely to have priority over the secured party, although this will depend upon such factors as the terms of the floating charge, in particular the scope of any restrictions, whether any subsequent purchasers, mortgagees or chargees have knowledge of any restrictions and the circumstances in which any subsequent transactions arise.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Neither companies nor LLCs incorporated in the Cayman Islands are excluded from proceedings under the Companies Act, the LLC Act or any other applicable laws or regulations.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The Companies Act provides that, at any time after the presentation of a winding up petition and before a winding up order has been made, the company or any creditor or contributory may (a) where any action or proceeding against the company, including a criminal proceeding, is pending in a summary court, the Cayman Islands court, the Court of Appeal or the Privy Council, apply to the court in which the action or proceeding is pending for a stay of proceedings therein, and (b) where any action or proceeding is pending against the company in a foreign court, apply to the court for an injunction to restrain further proceedings therein, and the court to which application is made may, as the case may be, stay or restrain the proceedings accordingly on such terms as it thinks fit. On a voluntary winding up, there is no automatic moratorium. The Cayman Islands court does, however, have discretion to impose a moratorium on a blanket or a case-by-case basis. In practice, the court would only exercise its discretion if there was any doubt about the company's solvency.

As set out in question 7.6, a creditor of a company or LLC may have a compromise or arrangement imposed upon him under the Companies Act if a majority in number representing three quarters or more in value of the creditors (or class of creditors including the affected creditor) have approved the compromise or arrangement and it has been sanctioned by the Grand Court of the Cayman Islands. Although this is not a mandatory insolvency provision, it is a circumstance in which a creditor of a company or LLC may be made subject to an arrangement or compromise affecting his rights without his consent. It would not, however, affect the enforcement of security rights.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The submission by a company or LLC in a security document to the jurisdiction of the courts of a particular jurisdiction will be

legal, valid and binding on the company or LLC assuming that the same is true under the governing law of the security document and under the laws, rules and procedures applying in the courts of that jurisdiction.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Companies and LLCs can, as a matter of contract, waive immunity for any legal proceedings in the Cayman Islands. However, subject to certain exceptions, companies may receive the benefit of sovereign immunity under the State Immunity Act of the United Kingdom, which has been extended to the Cayman Islands by statutory order.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licensing or eligibility requirements under Cayman Islands law for lenders to a company or LLC. Assuming that the lenders are not incorporated in or registered under Cayman Islands law and all the activities of such parties have not been and will not be carried on through a place of business in the Cayman Islands, then the lenders will not be required to be licensed in the Cayman Islands solely in order to provide a loan to a company or LLC. Any lenders that are incorporated or registered in the Cayman Islands or otherwise carrying on business in the Cayman Islands will be required to register and be licensed, as applicable, in accordance with Cayman Islands law.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

Execution and delivery requirements by a Cayman Islands entity or Cayman Islands-governed document have not been impacted; the use of electronic signatures is usual practice and delivery of original documents are not required, unless otherwise expressly provided for in such entity's constituent documents or the transaction documents. If certain deliverables are required to be certified by a Cayman Islands notary, such notary may adhere their stamp to the document by electronic means. Given that the Cayman Islands has been executing and delivering documents by electronic means for a number of years, the transition to the virtual world has been relatively seamless. We do not anticipate there to be any challenges with the execution and delivery requirements in the coming months and beyond.

In addition, given COVID-19, the Cayman Islands Government has reacted to the impact of social distancing measures by introducing the Notaries Public (Virtual Conduct of Notarial Acts) Regulations, 2020 (the "**Regulations**"). These Regulations permit the use of audiovisual communications technology in connection with notarial acts and will initially be in effect for two years. Pursuant to the Regulations, the primary signatory may now, provided that the primary signatory is physically located in the Cayman Islands at the time they apply their own signature, appear before a Cayman Islands notary public via audiovisual communications platforms such as Zoom or Skype. Upon receipt of an electronic copy of the executed document, the notary public may then apply their seal to, and sign, the electronic copy of the document before returning this notarised copy to the primary signatory.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

No material considerations need to be taken into account other than those described above.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Throughout 2020, both legal and regulatory trends and developments in the local lending market were mainly aimed at mitigating adverse economic effects caused by the COVID-19 pandemic. Some of these measures are as follows:

- A package of countercyclical measures enacted in March 2020 by the Chilean Financial Market Commission (*Comisión para el Mercado Financiero*, "CMF"), destined to introduce more dynamism into the local economy and favour lending flow.
- A transitory reduction of the stamp tax rate to 0%, applicable to documents evidencing loans granted until September 2020.
- A new law on financial portability, which allowed individuals and small enterprises to freely transfer their financial products between local lending entities, reducing costs and times involved therein.
- A recent amendment to the Foreign Exchange Regulations Compendium issued by the Central Bank of Chile, by means of which this regulator allowed, among other transactions, the granting of loans denominated in CLP, by individuals or entities domiciled or resident in Chile, to individuals or entities domiciled or resident abroad, and vice versa.

According to the CMF, the number of borrowers in the supervised lending industry (including banks, loans and savings cooperatives and banking supporting companies), decreased from 6,523,076 to 5,407,836 within the period November 2019–June 2021. This decrease may be explained by a number of different factors, including an unemployment rate increase (although nearly ⅓ of all lost job positions have been recovered, current calculations show) and tighter credit access conditions set by local banks during the third quarter of 2020.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

There is no separate information pertaining to local lending transactions but, generally speaking, the largest sector of borrowers is real estate developers, followed by commerce (retail) and construction.

Nonetheless, in the last two years, Carey has advised, among others, the following clients in significant lending transactions:

- Mainstream group, in a USD 620 million project finance granted by Inter-American Investment Corp., CaixaBank, DNB ASA, KfW IPEX-Bank and Mitsubishi UFJ Financial Group, for the construction and development of a portfolio of five renewable energy projects.
- The Bank of Nova Scotia, in a USD 165 million financing granted to Corporación del Cobre (CODELCO).
- A USD 100 million "green loan" granted to CMPC, to finance environmentally friendly initiatives.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Following certain corporate requirements depending on the type of company involved, provided the guarantor benefits somehow from these operations, and subject to applicable insolvency, moratorium or similar laws relating to or affecting creditors' rights generally, and general principles of fairness (regardless of whether it is considered in a proceeding in equity or at law), there are no restrictions for this type of guarantee.

Additionally, under Chilean general banking law, banks are not authorised to grant mortgages or pledges over their own physical assets, unless to guarantee payment of the purchase price thereof. Considering this, it has been construed that banks can provide guarantees over financial assets subject to certain restrictions regulated by the CMF.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Under the Chilean Corporations Law, directors of corporations are jointly and severally liable for any damages caused to shareholders for their negligent or malicious actions, making it highly

unlikely that the approval of a board would be secured for such a disadvantageous operation. Should the agreements cause the company's insolvency, there are actions for revocation which apply once the reorganisation or liquidation procedures have started, according to Chilean insolvency law. Among the agreements that can be revoked are any pledge or mortgage granted by the insolvent company within a year before the insolvency proceedings (to guarantee debts previously acquired), and any act or agreement (including granting guarantees) entered into within two years before the insolvency proceedings, provided that (i) the counterparty knew of the company's poor state of business, and (ii) the agreement has caused damage to the other creditors, where damage means that the terms and conditions were distant from the market's at the time of the agreement. On the other hand, article 2,468 of the Chilean Civil Code grants the creditors of an insolvent debtor the right to request the revocation of certain agreements entered into by such debtor (*acción pauliana*), provided that: (i) the transaction causes damages to the creditors (the transaction executed increased the insolvency of the debtor); (ii) the debtor was aware of its poor business condition at the time of entering into such act or contract; and (iii) in case of an onerous act or contract, the counterparty of the debtor was also aware of the poor business condition of the debtor.

2.3 Is lack of corporate power an issue?

Yes. The Chilean Civil Code establishes in articles 2,151 and 2,160 that the principal shall not be obliged toward third parties by acts or agreements entered into by its agent if (i) the latter did not mention that he was acting on behalf of the principal, and (ii) the agent acts beyond the limits of its mandate. Ratification by the principal of the non-empowered actions may be a solution for the lack of corporate power.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

There are no governmental approvals required, but, depending on the company's structure, the value and the type of guarantee, there are certain corporate consents which are required. If the guarantor is a corporation, in order to guarantee third-party obligations (unless the guaranteed obligations belong to a company that is a subsidiary of the guarantor, in which case the Board's approval suffices, and also with an exception for lender banks) and also if the value of the guaranteed obligations exceed 50% of the guaranteeing corporation's assets, an extraordinary shareholders' meeting must be called in order to grant approval.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No. Nevertheless, any operation executed between related parties needs to be for the company's benefit, complying with the market's standards for price, terms and conditions, and also the required approval if the guaranteed value exceeds 50% of the guarantor's assets, as explained above.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control regulations. Payment in foreign currency is possible if the parties have agreed such form of payment. In order to enforce a guarantee (as an accessory obligation), it is required that the secured obligations comply with certain requirements, and in case of obligations governed by foreign law and subject to foreign jurisdiction, *exequatur* procedures have to be conducted. Subject to Law No. 18,010 regarding lending operations, transactions agreed in a foreign currency shall be payable according to the seller exchange rate applicable on the date of payment, which must be certified by a Chilean commercial bank. Please refer to our answers to questions 7.2, 7.3 and 7.7 in regard to the enforcement of foreign judgments procedure.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Securities can be classified into two main groups: (i) guarantees over assets or rights *in rem*; and (ii) personal guarantees.

(i) **Guarantees over assets**: There are guarantees over moveable assets (pledge agreements) and guarantees over real estate, vessels and aircraft (mortgage agreements).

(a) **Guarantees over moveable assets**:

- **Civil pledge**: This has a wide scope, as it may apply to any moveable property, including all kinds of personal rights and credits. Any obligation may be secured by this pledge, including obligations to act, or to refrain from acting. However, it is not commonly used, as the pledgor must deliver the pledged asset, losing the ability to use and enjoy it.
- **Commercial pledge**: This aims to secure commercial obligations. Though it is very similar to the civil pledge, unlike the latter, the material possession by the pledgee is not required, as it may be delivered to a third-party bailee. It is not possible to secure future obligations – only currently existing and determined obligations – and its only requirement is that the material possession of the pledged property is not held by the pledgor. The Commerce Code requires certain formalities for granting the pledge in order for the pledgee to be able to exercise its right to be paid preferentially: (i) the execution of the pledge agreement by means of a public deed, or by private instrument entered into a Chilean Notary Public's registry; (ii) the amount of the debt secured and the pledged asset must be defined in the agreement; and (iii) for a pledge granted over a credit, the debtor of the credit must be notified not to make any payment under the pledged credit but to the creditor.
- **Banking pledge over securities**: This may be granted over bearer securities of any kind in favour of banks and other financial institutions, even those that are foreign. This pledge may secure all current or future obligations of the pledgor with the pledgee. It only requires the handing over of the instrument by the pledgor to the pledgee. Credits payable to the order (i.e., not in bearer form) must be endorsed as a guarantee to the pledgee. Finally, shares shall be pledged by means of a public deed or private instrument, which must be notified to the issuer by a Notary Public. This pledge does not allow the pledgor to remain in material possession of the pledged assets. It is worth noting that the Constitutional Court of Chile ruled in one case that this procedure was not compliant with the due process constitutional protection, thus it declared the same unconstitutional. This is not a general ruling, but it may show a tendency.

- **Pledge without conveyance** ("**PwC**"): This allows any kind of corporeal or incorporeal, present or future, moveable assets to be pledged in order to secure own or third-party obligations, present or future, irrespective of whether such obligations are determined or undetermined at the time of the pledge agreement. It must be executed either by means of a public deed or a private instrument, with the signatures of the appearing parties authorised by a Chilean Notary Public, before the instrument is entered into a Chilean Notary Public's registry. The PwC agreement must contain at least the following references: (i) the identities of the parties; (ii) the existing secured obligations or the specification that the pledge secures present and future obligations (*cláusula de garantía general*); (iii) the identification of the pledged assets; and (iv) the determined or undetermined amount to which the pledge is limited or the extent to which the pledge secures several obligations, if applicable. The PwC agreement must be registered in a special registry called the Pledge without Conveyance Registry. Upon its registration, the pledge without conveyance is enforceable upon third parties.
- **Pledge over deposited securities**: A new pledge was created at the end of 2016 to simplify the pledging of securities deposited with depository entities. The latter shall need to enter into a master agreement with all depositors to allow this type of pledge.

(b) **Guarantees over real estate**:

- **Mortgages**: Granted by means of a public deed, a mortgage allows not only existing and determined obligations but present and future obligations of the borrower (*cláusula de garantía general*) to be secured. Mortgages are perfected by means of registration in the corresponding Mortgage Lien Registry. Generally, the mortgage deed will also contemplate a prohibition to transfer, convey and enter into acts or contracts with respect to the mortgaged property.

  Likewise, mortgages can be granted over mining concessions and water rights, which need to be registered in the same manner in the Custodian of Mines' Registry or the Real Estate Registrar Property Registry, as appropriate.
- **Guarantees over vessels and aircraft**: Mortgages can be granted over vessels and aircraft fulfilling certain requirements, such as the vessel or aircraft being duly registered in the corresponding Registry and the agreement being granted by means of a public deed.

(ii) **Personal guarantees**: The most common personal guarantees in Chile are sureties (*fianzas*) and joint and several guarantees (*fianzas y codeudas solidarias*). By means of sureties, one or more third parties are bound to pay the debtor's obligation in the event such debtor does not pay the secured obligation. By virtue of joint and several guarantees, the liability for default is enforceable directly against all of the debtor(s) and guarantors as a group or against any one of them as an individual at the choice of the enforcing creditor. The main characteristic of the joint and several guarantees is that guarantors become equally liable to the creditor, just as the primary debtor. Therefore, they are not entitled to request that (i) the debt be claimed first from the borrowers and only if they do not pay, then be collected from them, and (ii) the debt be divided equally or proportionally among the various guarantors. Under Chilean law, guarantees are an accessory to the main obligations and cannot exceed the amount of such obligations. This is expressly regulated for sureties, where it is stated that they cannot exceed the main obligation being guaranteed and cannot be granted in terms more onerous than those of the main obligor, but can be granted in terms more effective (like securing its obligations as guarantor through a mortgage, for example). The Chilean Civil Code does not provide for any formalities at all to grant sureties but if the obligation intended to be secured is a commercial obligation, it must be granted in writing. Where the guarantor of a surety and a joint several co-debt is an individual married under joint ownership of the matrimonial estate (*sociedad conyugal*), the prior spouse's consent is required.

(iii) **Conditional assignments of rights**: This is a widely used tool in Chile to safeguard creditors' rights in an event of default.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is not possible to dispose or grant a security over all of an entity's assets. The guarantee document must clearly identify which assets are being pledged (or mortgaged). Additionally, each type of security requires specific formalities for perfection (see our answer to question 3.1 above). The most advisable manner is to have an agreement for every type of asset, since each has a different registration process.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Please refer to the answer to question 3.1.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. Please refer to the answer to question 3.1, since the receivables are credits.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, it can be taken either by means of a commercial pledge or a PwC. The procedure is briefly explained in the answer to question 3.1.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes. All the pledges set forth by Chilean law can be granted over shares. Please refer to our answer to question 3.1. The Chilean Corporations Law states that any liens or rights *in rem* over shares of a company must be notified by a minister of faith, who must leave a record thereof in the company's shareholders' registry.

Shares can be issued either in certificated form, or dematerialised in case of corporations and companies limited by shares.

According to the Chilean Civil Code, assets located in Chile are subject to Chilean law, and hence the pledge shall be granted in accordance with Chilean law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. Please refer to the answer to question 3.1.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, it can. Please refer to our answer to question 2.4 above.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

It mainly depends on the kind of collateral the company is granting. Except for civil and commercial pledges, all other collateral agreements must be executed by means of a public deed or by a private document which must be authorised and registered by a Notary Public. Therefore, notarisation expenses are common to all kinds of collateral over all kinds of assets.

In case of mortgages, as mentioned above, the agreement has to be registered in the relevant Mortgage Lien Registry and in the Prohibitions Registry of the Real Estate Custodian, which charges a fee as well.

In case of a PwC, it is necessary to register it in the PwC Registry, which also charges a fee. If a PwC is granted over shares which are deposited in the Central Securities Deposit, these must be registered in an electronic pledge registry, which also charges a fee for its services.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

No, expenses are generally not material, and in general, procedures do not take long, although it depends on the registrar and workload at the time of the registration request. The PwC Registry charges a fixed fee of CLP 40,000 (approx. USD 50) for each such registration.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No, there are not.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Yes; please refer to the answers above. In case of the execution of foreign agreements in Chile, documents must be apostilled (or legalised, if it was extended in a country that is not a member of the Apostille Convention), and if not in Spanish, they shall need to be translated to be presented in courts.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company
There are no such prohibitions or restrictions under Chilean law, except for the requirements mentioned in our answers to questions 2.4 and 2.5.

(b) Shares of any company which directly or indirectly owns shares in the company
There are no such prohibitions or restrictions under Chilean law, except for the requirements mentioned in our answers to questions 2.4 and 2.5.

(c) Shares in a sister subsidiary
There are no such prohibitions or restrictions under Chilean law, except for the requirements mentioned in our answers to questions 2.4 and 2.5.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. Their appointment requires the existence of at least two creditors, who may allow the authorities to manage the collateral as well as enforcement and release of the same in case of an event of default, among other duties and attributions. In the case of a single lender, it can also issue a mandate for a local entity/person to act on its behalf, serving the same purpose as a collateral agent with the same powers, although in this case, such mandate will be subject to general rules, but not to the simplified granting and collateral management provisions applicable to the security agent pursuant to Chilean law.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Yes. Individual lenders can also issue a mandate for a local entity/person to act on their behalf, serving the same purpose as a collateral agent with the same powers.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Yes. Under the Chilean Civil Code, it is necessary to duly notify the credit assignment to the debtor, and for the debtor to accept it. Otherwise, the assignment cannot be enforced against the debtor or third parties.

Regarding the guarantees, the Chilean Civil Code provides that assignment of credits encompasses assignment of guarantees securing the same, by operation of law.

In all such cases, if there is a foreign lender lending to a Chilean, the changes must be reported to the Central Bank of Chile.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) As a general rule, interest paid by Chilean taxpayers to foreign lenders is subject to a 35% withholding tax. However, a reduced 4% tax rate is applicable to certain interest payments (see question 6.2). The above is notwithstanding the existence of double taxation treaties. The payment of interest by Chilean taxpayers to domestic lenders is not subject to withholding tax.

(b) Payments of interest abroad upon enforcement of a guarantee could be subject to withholding tax depending on the reimbursement rights that the guarantor has against the main obligor.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Interest paid to foreign banks or foreign financial institutions complying with the requirements set by Chilean tax legislation benefit from a reduced withholding tax rate of 4%. Interest payments to foreign individuals resident in a country where there is a tax treaty in place with Chile may also benefit from a reduced withholding tax rate.

Stamp tax applies to documents evidencing indebtedness for borrowed money, including loan documents, notes and bond issuances. The tax is applied over the principal amount of the loan and its current rate is 0.066% of the principal amount multiplied by the number of months-to-maturity of the loan, with a maximum of 12 months (i.e., 0.8%). In case of loans payable on demand, the applicable rate is 0.332%.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No, it will not.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are transactional fees and translation costs, but as explained in our answer to question 3.9, they are not significant.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Under Chilean income tax law, thin capitalisation rules are triggered when a Chilean-resident taxpayer pays interest or other financing expenses (e.g., services, commissions, expenses reimbursements) to a related party abroad under a withholding tax rate of less than 35%. Per the thin capitalisation rules, any interest (or similar) payments made abroad to a related party and attributed to excessive indebtedness are subject to a 35% tax payable by the debtor. The withholding tax applicable to the payments made by the Chilean resident taxpayer can be used as a credit against such 35% tax.

A taxpayer will be deemed to have "excessive indebtedness" if its total indebtedness (related and non-related) is greater than three times its tax equity at the end of the year when payments were made to related parties.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, taking into consideration the existence of a connecting factor with the parties involved. However, according to article 16 of the Chilean Civil Code and article 105 of the Private International Law Code (the "Bustamante Code"), assets are governed by the *lex situs* (the law of the jurisdiction where the assets are located), thus assets of any kind located in Chile are governed by Chilean laws. In consequence, generally speaking, a choice of law of a court in Chile will be based on the *lex situs* of the charged assets.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Yes. Chilean courts would enforce an English/New York judgment without re-examination of the merits, provided legal requirements are met and there are no public policy considerations and to the extent the judgment complies with a proceeding called "*exequatur*", which must be followed before the Chilean Supreme Court.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a

court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) In general, disputes are resolved in the first instance by a lower court, which may take from two to four years. Rulings and judgments of a lower court may be reviewed in second instance by a Court of Appeals, which may take from one to two years. Beyond that, some remedies may be claimed before the Supreme Court, which may take from one to two years. Therefore, a common civil proceeding may take up to eight years. In addition, enforcement of judgments is generally executed by means of an enforcement proceeding, which may take around one year.

(b) The *exequatur* proceeding itself may usually take around six to eight months. Once the *exequatur* is obtained, the enforcement proceeding may usually take around one year, although we have obtained payment in a New York-issued ruling in a three-month period.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Yes. The enforcement of collateral security located in Chile must be made in Chile, before the competent Chilean court, in accordance with the rules for the so-called summary proceeding (*juicio ejecutivo*) contained in the Chilean Code of Civil Procedure. This procedure provides a very brief discussion stage, a stage of liquidation and subsequent public auction, which is held by auctioneers appointed by the court. This last stage can take a long time and the proceeds of the auction may be different from the expected ones.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No, they do not.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes. According to Chilean insolvency law, during a term of 30 days as of the legal notice of the reorganisation resolution which appoints a supervisor for the insolvency proceeding ("Veedor"), the debtor will be protected by the Insolvency Financial Protection (*Protección Financiera Concursal*), during which neither the declaration nor the initiation of a liquidation proceeding against the debtor or foreclosures can take place, nor may individual foreclosures, any kind of executions or restitutions in lease trials be initiated and, among others, all agreements executed by the debtor will maintain their effectiveness and payment conditions. The credits that contravene this restriction will be postponed in payment until all of the creditors have been paid off. This 30-day period may be extended under certain circumstances for two more 30-day periods. Nonetheless, personal guarantees issued by third parties can be foreclosed.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Foreign arbitral awards are recognised and enforced in Chile, subject to an *exequatur* from the Supreme Court, which will be granted provided legal requirements are met and there are no public policy considerations, without re-examination of the merits.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Please see our answer to question 7.6 above.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

According to Chilean insolvency law and the Chilean Civil Code, there is a scale of preference, according to which debts are paid. The first class, which includes judicial costs, administrative and liquidation fees, labour wages, severance payments and surcharge and withholding taxes, has preference over all other credits. The second class includes the rights of the pledgee over the pledged asset. Mortgagees prefer every other credit, including first class credits, over the mortgaged asset; nevertheless, if there are not enough assets to cover the debts, the first class gives preference to the mortgagee over the mortgaged asset.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Banks, and the Republic and its agencies and municipalities, are excluded. Mutual, investment and pension funds are deemed a created patrimony that adopt an independent existence from their owner in order to serve a particular and autonomous purpose; thus they are not considered a legal entity. Their managers (corporations) might be declared insolvent.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

No, there are not.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, it is. Nonetheless, the Republic and its agencies and the Central Bank of Chile have certain restrictions and sometimes they may not submit to a foreign jurisdiction.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, it is. Nonetheless, the Republic and its agencies have certain restrictions and sometimes they may not waive sovereign immunity.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licence or permission requirements to perform lending operations in Chile.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

Due to the formalities required in Chile for the execution of certain documents or perfection of contracts, and the rigid structure by which notaries and public registrars need to abide, the COVID-19 pandemic added significant constraints and delay in closing transactions, as those institutions had to reduce their working hours and apply strict protocols, which in turn led to the accumulation of pending requests. Furthermore, the requirement in certain cases for personal appearance before notaries in order to execute public deeds, and the quarantine declared in certain areas of the country, made the signing process even more difficult.

The Santiago Court of Appeals has recently issued a resolution clarifying what flexibilities notaries may or may not have/implement in their jurisdictions, such as:

(i) clarifying that notaries may use advanced electronic signature devices as long as it is personal and non-transferable, on the days and hours of operation of their notarial office and in relation to verified actions within their jurisdictional territory, in strict compliance with the law and resolutions issued by the Supreme Court of Chile on the matter;

(ii) regarding the authorisation of public deeds, the notary may only authorise signatures stamped in his presence;

(iii) the signatures that the grantors stamp on private instruments may be authorised by the notary when it is done in a semi-present way or by telematic means, provided that the remote identity verification is done in a way that guarantees that the notary can attest to the knowledge of or the identity of the signatories;

(iv) regarding authorisation of signatures stamped on private instruments, in a remote manner, whose authenticity is confirmed by the notary, one should note the following: (a) the use of databases or technological platforms to verify the identity of the signatories or the authenticity of their signatures is permitted, provided that they are of an official nature or that they belong to the notary's office and are of its sole responsibility; and (b) the redirection or derivation of this kind of procedure to private and external platforms or databases is prohibited; and

(v) the authorisation of electronic signatures stamped on bills of exchange or promissory notes, or on endorsements or protests, is not permitted.

In any case, it is clarified that the exercise of notarial functions, whether in person or online, can only be carried out within the territory for which the notary has been appointed.

We expect the same hurdles experienced in 2020 to repeat in 2021 (at least during the first half of the year) as a second wave of COVID-19 is hitting the country, although the experience gained in 2020 means that the extra time required to close deals is accounted for and anticipated when establishing deadlines.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

There are regulations for the prepayment for local loans, which are not applicable to cross-border loans. Additionally, there is no interest rate limit for loans granted to Chileans by foreign or international financial institutions or banks.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

As with all other sectors and practically all aspects of life, the developments on the Croatian lending market in the past year were significantly influenced by the global COVID-19 pandemic and its effects on the economy.

The lending market has been experiencing growth in corporate and retail lending for several years in a row owing to increased liquidity and facilitated conditions. The interest rates in 2019 and the beginning of 2020 were at a record low (2.9% for residential loans, 6.1% for general-purpose cash loans, 2.1% for long-term corporate loans). Because of the accelerated growth of general-purpose cash loans, the Croatian National Bank issued a recommendation in 2019 prescribing criteria for loan approval. Further growth together with looser criteria for approving consumer loans may have led to an increase in non-performing loans ("NPLs") in case of unfavourable economic conditions, which is precisely what the year 2020 brought.

Corporate loans grew as expected in March and April 2020 during the first nationwide lockdown, while the number and the total amount of consumer loans stabilised as citizens naturally reduced their applications for loans in times of decreased economic activity and general uncertainty.

Various relief measures in the banking sector were launched throughout the year, some of them still active. Commercial banks offered a moratorium on loan payments, special loans and restructuring of existing loans. To maintain their working capital, the affected micro, small and medium-sized enterprises could benefit from so-called "corona-loans", special liquidity loans from the Croatian Bank for Reconstruction and Development and HAMAG-BICRO (the Croatian agency for small and medium-sized enterprises, innovation and investment).

There were over 23,000 new applications for moratoriums, liquidity loans and reprogramming in the beginning of 2021, with a total value of HRK 30.7 billion (EUR 4.06 billion). The majority of applications (88.4%) are moratorium requests, for a total amount of over HRK 27 billion (EUR 3.57 billion) in loans. Two thirds of these applications are from companies. Following the European Central Bank's initiative, the Croatian National Bank extended the "flexible treatment" period to the end of March 2021, during which citizens and companies alike would be able to negotiate their loan terms with banks on an individual basis.

Owing to European regulations, NPLs in Croatian banks formally remain at 5.5%; however, value adjustment costs increased by nearly 4.5% on a yearly basis. It can be expected that a portion of current moratoriums might translate into NPLs in the coming period. The exact number will depend on further global, EU-wide and national economic developments along with other, still unforeseeable factors.

A significant event which should have a positive influence on the national economy was Croatia's admission into the European exchange rate mechanism (ERM II) in July 2020. This major milestone on the country's path of adopting the euro should have tangible direct and indirect benefits for citizens such as a decrease in interest rates and a reduction of the foreign exchange risk.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Significant lending transactions are relatively rare on the Croatian lending market due to the inconsiderable number of larger companies and groups, some of them still government-owned. Major infrastructure projects are not financed by private loans but through EU funds, the European Investment Bank, the European Bank for Reconstruction and Development and the Croatian Bank for Reconstruction and Development programmes. To name a few, the Peljesac Bridge construction drew €357 million from the Cohesion Policy funds, and the LNG Terminal Krk, which commenced operation this year, was granted €101.40 million from the EU Connecting Europe Facility fund.

The HAMAG-BICRO loans (please see question 1.1) were also financed through the European Regional Development Fund. During the scheduled period when they were active, the so-called "corona-loans" were used by over 500 entrepreneurs, in total amounting to over HRK 165 million (EUR 21.8 million).

Probably the most significant event lending-wise in the last few years remains the case of Agrokor. The group, which was one of the largest retail stock companies in South East Europe, nearly went bankrupt in 2017, after they had acquired several large companies (e.g. the biggest Slovenian retail chain, Mercator, valued at €500 million) and failed to negotiate the restructuring of their debt through a syndicate loan from BNP Paribas, Credit Suisse AG, London Branch, Goldman Sachs International and J.P. Morgan Limited.

To protect the sustainability of business operations of systematically important companies, the Croatian parliament adopted a law colloquially named "Lex Agrokor" (the Act on Compulsory Administration Procedure in Companies of Systemic Importance for the Republic of Croatia). It allowed the government to appoint a trustee with the goal of reaching a settlement with creditors and eventually restructuring the company. In the restructuring procedure, existing creditors were given the option of a roll-up structure, allowing old credit to take priority on the basis of new credit. A total of €960 million of fresh capital was attracted by this structure.

In July 2018, a settlement was signed between Agrokor and more than 5,700 of its creditors, making it the largest and most complex settlement in restructuring proceedings in Croatia. The settlement's implementation started in 2019 and resulted in the formation of the Fortenova group, a new concern to take over Agrokor's assets, consisting of a total of 159 subsidiary companies employing 52,000 people. The restructuring is considered to be one of the most successful international restructuring processes in the world, with repercussions on the Croatian banking sector felt to this day.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

A company can guarantee borrowings of its members (downstream guarantees) only in accordance with the capital maintenance principle (see question 2.2); otherwise, it is considered a prohibited distribution.

With regard to joint stock companies ("d.d."), any benefit of the company to its members can be granted only in the form of a dividend or reimbursement for non-monetary capital contributions on arm's-length terms.

There are two exemptions from the prohibited distribution rule that refer to distributions on the grounds of company management agreements and the transfer of profit and loss agreements ("venture contracts"), which are not considered prohibited distributions.

Downstream guarantees are allowed and can also be given as an "additional obligation of the member" provided under the incorporation deed (not applicable for joint stock companies).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

An important principle of the corporate lending framework is the capital maintenance principle. It applies to limited liability companies ("d.o.o."), as well as to joint stock companies. Any distribution for the benefit of the member made contrary to arm's-length terms would be contrary to such principle and therefore prohibited. This means that any distribution (including all benefits and payments under the guarantee) is allowed if made in exchange for full value or with the obligation to return what is received. Establishment of an upstream guarantee would not be prohibited *per se* but only if this resulted in an impairment of the company's assets according to the company's balance sheet (by payment, enforcement, etc.).

The consequence of such prohibited distribution is the obligation of the member to return the received benefit or its personal liability for damage to the company and its creditors ("lifting of the corporate veil"). If the company cannot recover the loss from the member that received the benefit or from the directors, other members may be liable for payment if prohibited distribution disables the company to settle obligations towards the creditors.

Maintenance of the company's capital is the obligation of the management and prohibited guaranteeing/securing may incur personal liability of the directors if a company's assets are impaired due to lack of due care of a prudent businessman.

2.3 Is lack of corporate power an issue?

Any limitations of management (specific conditions, consents, restrictions regarding the type of agreements) to represent the company do not affect the validity of agreements with third parties regardless of whether such limitation is visible on the Company Register.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In general, no governmental or other consents are required for granting guarantees. However, the consent of the Ministry of Finance is required if the Republic of Croatia is the guarantor; i.e., security provider. Possible limitation or special authorisation could be required under the provisions of incorporation deed or internal decisions of the company.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

See question 2.2 regarding the capital maintenance principle.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange controls or similar obstacles to enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

For the purpose of securing lending obligations, available types of collateral, according to Croatian law, are as follows:

- Security over receivables:
  - a pledge; and/or
  - a security assignment ("fiduciary transfer").
- Security over movables:
  - a pledge;
  - a mortgage ("registered security"); and/or
  - a fiduciary transfer of ownership.
- Security over immovables:
  - a mortgage; and/or
  - a fiduciary transfer of ownership.
- Security over shares:
  - a share pledge; and/or
  - a security assignment.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Since the requirements and the procedure for creation, registration and enforcement of security are different for different types of assets, separate agreements for each type are usually required. Croatian law allows the creation of "a floating security" over generic movables. Such security must be sufficiently identifiable since a floating security over all assets of the debtor is not possible.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

There are two types of securities over immovables: (i) mortgage; and (ii) fiduciary transfer of ownership. Both securities are established by security agreement in the form of notarial deed and registration in the Land Registry. Mortgages ("*hipoteka*") are a more common form of security and are an accessory to the underlying receivable, which means they cannot be transferred independently of the receivable they secure. The difference between the mortgage and the fiduciary transfer is that the title of the property does not transfer to the mortgagee, unlike the fiduciary ownership where the ownership is limited and conditional upon the settlement of the secured receivable.

A mortgage over a land plot may exceptionally be extended to movables located on the land plot, such as plant, livestock, machinery and equipment that serve the economic purpose of the building on the land plot.

For security over machinery and equipment, please see question 3.7.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security in the form of a pledge or security assignment (fiduciary transfer of rights) may be established over receivables. Uniform rules apply to security over all property rights, including receivables.

A pledge over receivables is established by two constitutive elements: (i) transfer of the right; and (ii) notification to the debtor. The registration of the security in the Register of Judicial and Notarial Securities Over Movables and Rights does not exclude the obligation of notifying the debtor.

The security assignment is based on the rules governing assignment ("*cessio*") of rights in general. The security becomes perfect when the agreement is concluded. In such case, notification to the debtor is required, but the assignment remains valid even if the debtor is not notified since the notification is not a constitutive element. However, if the debtor was not notified and the security over receivables is not registered or evident from the Register, the debtor is entitled to discharge his obligation by making the payment to the assignor.

Security over rights may be created either independently between the parties or with the involvement of the court or the notary public in the security proceeding. In the case of notarial or judicial security, the security is registered in the Register of Judicial and Notarial Securities Over Movables and Rights.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Cash deposited in bank accounts is considered a receivable against the bank account. However, specific rules apply to financial securities over receivables against bank accounts (cash deposits, credit receivables and financial instruments). The security agreement must be in written form.

There are two types of securities: (i) pledge; and (ii) financial security transfer. The pledge entitles the beneficiary to use and dispose of the deposited cash of the security provider with the obligation to return or replace the security at the latest on the due date for the performance of the obligation covered by the security. The beneficiary of the security transfer has an unlimited right to use and dispose of the deposited cash. The security may be enforced directly by the beneficiary by sale, compensation or seizure.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Collateral security can be created over shares of joint stock companies and limited liability companies.

(i) Joint stock companies have shares that can be in dematerialised or in certificated form (in theory only; they have not been used for many years). Security over certificated shares in bearer form is, from a legal perspective, considered as security over movables and is created by the security agreement and the transfer of possession.

In the case of dematerialised shares, the creation of security requires registration of the security in the Central Depository & Clearing Company ("CDCC"). If dematerialised shares are not registered in the CDCC, security is created by assignment ("*cessio*").

(ii) Security over shares of a limited liability company is created solely by an agreement that does not require notarial form. Registration in the book of shares is required but only has the function of publicity.

The beneficiary of the security does not acquire membership in the company and is only entitled to obtain profit without the right to vote.

Pursuant to the Croatian Private International Law Act, security over shares can be granted based on foreign documents; however, Croatian law applies to the enforcement of such security.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over movables may be established as: (i) a pledge with the transfer of possession; (ii) a mortgage; or (iii) fiduciary transfer of ownership. For the purpose of this question, movables such as vessels and aircraft are not considered inventory.

Security over movables can also be created in the security proceeding before courts or a notary public (see question 3.4).

Securities over movables are not very common in Croatia.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A company can grant a security interest in order to secure (i) its own obligations as a borrower, and (ii) itself as a guarantor of the obligations of other borrowers/guarantors under a credit facility. The latter is only possible if it is not contrary to limitations provided by Croatian company law (questions 2.1 and 2.2).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

With regard to creating security, there are three possible fees depending on the type of asset: (i) fees of the notary public (when the security agreement is in the form of a notarial act);

(ii) registration fees (land registry, notarial and judicial registry, vessel's registry); and (iii) security proceeding fees if the security is created with the involvement of the court or the notary. The notary fees are subject to the value of the security object and prescribed by the notary's tariff. Notary fees can be significant, while registration fees are usually minor.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Filing, notification or registration requirements do not generally involve a significant amount of time (for expenses, see question 3.9). Registration in the land registry may take longer, depending on the court handling the registration.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In general, there is no consent required with respect to the creation of security. The consent may be required for creation of security over shares if provided so by the company's deed of incorporation.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There is no special priority or specific conditions in case the borrowings are secured under a revolving credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

The security agreement should be in the form of a notarial deed or a notarised private document in order to be an enforceable document. It is important that the security agreement contains an *exequendi* clause – consent of the security provider to direct enforcement. Upon the request of the security beneficiary, the notary public issues an enforceability confirmation on the security agreement confirming that the requirements for enforcement are fulfilled.

Regarding the authorisation for any action with regard to creation or the enforcement of the security (except in the court proceeding), a special power of attorney is required and in some cases the power of attorney should be certified by the notary public or accompanied by an apostille.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company
With regard to joint stock companies, Croatian law explicitly provides that an agreement under which the company grants financial assistance to third parties in the form of advance payment, security or loan for acquisition of its own shares is invalid. This does not apply to (i) operation of credit and financial institutions, and (ii) financial assistance for acquisition of shares by the employees of the company.
There is no explicit provision on financial assistance for the acquisition of shares of a limited liability company; however, the general rule of capital maintenance would apply.

(b) Shares of any company which directly or indirectly owns shares in the company
Provision on the invalidity of the agreement explicitly applies to financial assistance for acquisition of shares of the company that owns shares of the company providing financial assistance.

(c) Shares in a sister subsidiary
Provision on the invalidity of an agreement explicitly applies to financial assistance for acquisition of shares of the sister company.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Croatian banks, together with local or foreign banks, have been providing syndicated loans. So, in principle, yes, agents are recognised in practice, although not closely regulated; according to the bylaws regulating credit institutions and official opinions from the Tax Authority, the role of an agent (one of the lenders) is to coordinate all transactions between the lenders and the borrowers, as well as running administrative operations and balance sheets for all lenders. Furthermore, it arises that the agent acts in the name and for the account of other lenders and that he is authorised to collect payments on behalf of all lenders from the borrower. In cases where creditors are joint and several, each of the creditors could enforce the whole claim. The agent, being the debtor itself, could initiate the proceeding; however, success of possible objections from the borrower is uncertain since there is no court practice. Finally, Croatian law does not recognise the concept of trust.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

According to the Croatian Obligations Act, when there is more than one creditor of one claim, if such creditors are joint and several, each of them is entitled to enforce the whole claim and redistribute the collected amount among the creditors. With respect to the secured claim, when security is registered in public registries, only the registered creditor could enforce the security.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

For the loan and guarantee to be enforceable, the loan should

be assigned either by (a) assignment of claim when one claim is transferred from one creditor to another, or by (b) transfer of the contract when all rights and obligations from the contract are transferred from one party to the new party. With respect to the guarantee, when the claim is (a) assigned – all rights including the rights from the guarantee are transferred to the new creditor and enforceable by the new creditor. With respect to the transfer of contract (b), the guarantees would also be transferred and enforceable unless the guarantor objects to guarantee the creditor.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interest paid to foreign lenders (not natural persons) in Croatia are subject to withholding tax. The obligator of withholding tax is the payee – the borrower. Exceptionally, interest paid on loans given by foreign banks or other financial institutions are not subject to withholding tax. Payment of withholding tax by foreign entities is regulated under bilateral treaties or the domestic Income Tax Act. If a bilateral treaty regarding the avoidance of double taxation exists, such treaties would regulate the taxation of interest payable on loans. Depending on each treaty, withholding tax can be reduced or not paid at all. In each case, the certificate issued and notarised by a competent foreign body should be obtained and filed with the tax authority in order that such tax obligation is deduced. If there is an absence of treaties regulating avoidance of double taxation, interest payable on loans is subject to 20% withholding tax. Regarding domestic lenders, there are no special provisions. The profit from the interest, together with the total annual income, is taxed according to annual income tax.

There are no special requirements to deduct or withhold tax from (b) proceeds of a claim under a guarantee or the proceeds of enforcing security.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no special taxes or other incentives provided preferentially to foreign lenders. No taxes apply to foreign lenders with respect to loans, mortgages or other security documents for the purposes of effectiveness or registration. With regard to fees for registration, please see question 3.9.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

A foreign lender would not be taxable in Croatia solely because of a loan or guarantee or grant of security from a company in Croatia.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please see question 3.9.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

In general, there should be no adverse consequences to borrowers in cases where all or some lenders are foreigners.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

As a principle, Croatian courts recognise a foreign governing law in a contract. The parties are free to incorporate a law of any jurisdiction since freedom of choice is one of the cornerstones of conflict of law rules legislation. However, the Private International Law Act provides for certain exceptions to the rule with the purpose of protecting Croatia's public interests. These fall under two general categories: *ordre public* rules and rules of immediate application. The latter are implemented in accordance with Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

Pursuant to the rule of immediate application (Article 13 of the Private International Law Act), the court may apply a provision of Croatian law the respect for which is regarded as crucial for safeguarding the country's public interests, such as political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Different rules apply for recognition of foreign judgments, depending on whether a judgment was given by a court of an EU or a non-EU Member State. Since the United Kingdom is no longer a part of the EU and the transitional period ended on 31 December 2021, it is considered a third country. Therefore, an English court judgment would not be treated as an EU Member State court judgment.

Recognition of a judgment given by a court of an EU Member State is regulated by Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Brussels I bis), which provides that a judgment given in an EU Member State shall be recognised in other EU Member States without any special procedure being required, i.e., without re-examination of the merits of the case.

Recognition of a judgment given by a court of a non-EU Member State (e.g., New York court) is regulated by the Private International Law Act and such judgments are recognised without re-examination of the merits. In the procedure of recognition before the court, the court will only check whether formal requirements are fulfilled, i.e.:

- if such judgment was final in the state of origin;
- whether there was infringement of the party's right to participate in the proceedings;

- whether there is exclusive jurisdiction of Croatian courts;
- whether there is already an existing judgment (*res judicata*); and
- whether the judgment is contrary to the *ordre public*.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The timeframe for the obtainment and enforcement of a judgment depends on certain factors such as the complexity of the case and the promptness of the court, which again depends on the workload of the court, and finally the type of assets – whether bank accounts, movable or immovable property are enforced. For the obtainment and enforcement of a judgment (a), a judgment could be obtained, on average, within three years and then enforced within months (when enforcing bank accounts with sufficient funds) to three years (when enforcing immovables). This would mainly depend on whether an appeal was lodged against the first instance judgment which can prolong the process for approximately one year. For the (recognition) and enforcement of a foreign judgment, (b) could also take from a few months to a few years, again, depending on the type of assets, financial situation of the debtor and the court's workload.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Significant restrictions that may impact the timing and value of enforcement include public auctions – which are mandatory in enforcement proceedings (one to two public auctions for immovables and one auction for movable property). Croatian law does not propose any regulatory consents with respect to enforcement of collateral security.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No special restrictions apply to foreign lenders in the event of (a) or (b). However, where there is no reciprocity, i.e., treaties between the country of the seat of a foreign lender and Croatia regarding proceeding costs, and the foreign lender plaintiff is not a Croatian national or resident, nor a national or resident of another EU or EEA Member State or a member state of such treaty, it could be requested that the foreign lender plaintiff give security for the payment of proceeding costs. Also, if such foreign lender plaintiff does not have its seat or representation (e.g., attorney) in Croatia, they will have to appoint a delivery agent to be served with court documents during the proceeding.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The Bankruptcy Act provides that once pre-bankruptcy proceedings or bankruptcy proceedings are opened, no enforcement proceedings are allowed against the debtor, up to the closure of such proceeding. The proceedings are deemed to be opened once the decree that the proceeding is opened is published on an electronic bulletin board of the court. The moratorium does not apply to enforcement of collateral security if such debtor has the right of separate security (e.g., mortgage on real-estate registered in the Land Registry).

Also, in 2017, the Act on the extraordinary management procedure in companies of systemic importance for the Republic of Croatia (Lex Agrokor) – i.e., companies that employ more than 5,000 workers and have over €1 billion of debt – entered into force. The same rules apply as in the (pre-)bankruptcy proceeding with regard to moratorium and secured claims.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Recognition of foreign arbitral awards is regulated by the Arbitration Act. Croatian courts would recognise and enforce arbitral awards given against the company without re-examination of the merits, subject to the arbitration award not being contrary to the public order and that there is no exclusive jurisdiction of Croatian courts. Croatia is also a party to the Convention on Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention 1958).

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In (pre-)bankruptcy proceedings, creditors with secured claims have preferential status, i.e., they can use their right of "separate settlement". Such creditors have the right for their claim to be reimbursed from the proceeds of sale of their collateral, whereas other creditors with non-secured claims can only be reimbursed from the proceeds of sale from the remainder of other unencumbered assets.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Bankruptcy trustees, as well as creditors, may challenge legal actions taken prior to the opening of the bankruptcy proceedings if such actions are deemed to disrupt the balanced settlement of the creditors, or legal actions that benefit certain creditors (clawback), as follows:

(i) actions taken three months prior to filing a motion for opening a bankruptcy proceeding or after, by which action a creditor was able to settle/secure his claim, can be challenged if such action was taken at a time when the debtor was insolvent and if the creditor was aware of his insolvency or was aware that the bankruptcy proceeding was opened;

(ii) actions which allow one creditor to settle/secure a claim that he is not entitled to/claim that is not due, if such action was taken in the last month before filing a motion for opening a bankruptcy proceeding or was taken two or three months before filing such motion if the debtor was insolvent or when the creditor was aware that such action would damage other creditors;

(iii) actions which directly damage the creditors if such actions were taken three months prior to filing a motion for opening a bankruptcy proceeding and if the debtor was insolvent and the other party was aware of such insolvency or if it was taken after – if the other party was aware of the debtor's insolvency or that the motion was filed;
(iv) actions taken by the debtor in the last 10 years prior to filing a motion for opening the bankruptcy proceeding or after, with the purpose of damaging the creditors if the other party was aware of such intentions of the debtor;
(v) debtor's actions without compensation taken within four years prior to filing a motion for the opening of bankruptcy proceedings; and
(vi) actions by which the shareholder's claim for loan replacing the share capital or other similar claim is secured, when such action is taken five years prior to filing a motion for the opening of bankruptcy proceedings or after, or giving a guarantee for the claim if such action is taken one year before filing the motion for the opening of bankruptcy proceedings.

Employees' claims are considered to be "first class I claims" and have priority over all other claims.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Bankruptcy and pre-bankruptcy proceedings cannot be initiated against the Republic of Croatia, funds financed by the Republic of Croatia, the Croatian Health Insurance Fund, the Croatian Pension Insurance Institute and local and regional self-governing units.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Assets are normally seized in court proceedings.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

A party's submission to a foreign jurisdiction is legally binding unless there is exclusive jurisdiction of Croatian courts for such submission according to the Croatian legislature. According to the Private International Law Act, the parties can choose the forum of a court of a non-EU Member State if there is no exclusive jurisdiction of the Croatian court or a court of an EU Member State. Also, according to Article 25 of Brussels I bis Regulation, the parties can choose, in a written agreement, that a certain court of an EU Member State has jurisdiction and such court would be competent unless the agreement is null and void as to its substantive validity under the law of that Member State.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A party's waiver of sovereign immunity is legally binding and enforceable. Such waiver should always be given explicitly.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Loans can be given by a financial institution ("*kredit*") or by any other natural or legal person ("*zajam*"), wherein the differences between the two, other than the aforementioned entity authorised to give such a loan, are: a *kredit* agreement should always be in writing, and the object of the loan is always money and interest always applies; while a *zajam* agreement is a non-formal contract – the object of the contract can be money or another fungible object, with or without interest. Therefore, under Croatian law, a distinction is made between a lender that is a financial institution and a lender that is a non-financial institution. Pursuant to Croatian banking and financing laws, a bank should obtain a special licence to operate as a bank from the Croatian National Bank. There are no special licensing requirements for other (foreign) legal and natural persons to give loans.

With respect to foreign lenders, i.e., foreign financial institutions, they can give loans in Croatia if such financial institutions are incorporated within the EU and have a subsidiary in Croatia or are authorised to directly operate as financial institutions in Croatia or banks from other countries that have a subsidiary in Croatia.

A *kredit* loan given by a lender without the proper licence would be considered null and void, while the lender or their management could be punished with fines for an offence, depending on each case.

Croatian law does not specifically regulate an agent under a syndicated facility. Consequently, no licensing and eligibility requirements apply.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

During the COVID-19 pandemic in Croatia in 2020, all courts, notaries public and other authorities were working at reduced capacity, depending on the epidemiologic situation in a given period. Only urgent hearings were scheduled at courts, while all other matters faced delays. Original documents were mostly delivered by post or courier services.

To reduce physical contact, lots of communication took place via email or other digital channels, which became more accessible to a large number of people. In some administrative proceedings, copies of the required documents were also accepted.

The COVID-19 situation hastened the implementation of digital signatures in Croatia, which reduced the need for delivery of original documents. The system was already in place, as well as the regulatory framework; however, electronic signatures were not accepted as widely.

Some hearings were performed online and communication with courts was directed to the digital platform *e-komunikacija*. The platform is used by all commercial, municipal and county courts and the High Commercial Court of the Republic of Croatia. It allows lawyers, bankruptcy administrators, notaries public, expert witnesses, court interpreters and natural and legal persons to send submissions to the court, receive communication from the court, have remote access to legal matters in which they act as representatives of a party involved in the proceedings, and receive warnings about initiated bankruptcy proceedings for one of the parties involved.

The adjusted communication system will likely stay in place in 2021.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Most of the relevant and general issues have been covered in this chapter. Possible material considerations that should be taken into account depend on a broad variety of circumstances in each case. Some general considerations while participating in financing in Croatia is that the lending is regulated by the Croatian Civil Obligations Act, which also regulates interest rates. Interest rates depend on the reference rate set by the Croatian National Bank.

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Macesic and Partners assists international clients doing business or looking to invest in Croatia. One of the oldest business-law oriented offices in the country, the firm provides expert assistance in complex, cross-border matters and operates through two offices in Zagreb and Rijeka.

Traditionally best known for maritime law, Macesic and Partners has become increasingly prominent in the financial and corporate sector over the last decade. The firm established long-lasting ties with major international banks, whom they advised as lenders in financings through loan agreements, syndicated loans, re-financings, letters of credit, etc.

Macesic and Partners also have an ongoing cooperation with local banks, mostly providing advice related to financing, regulators' issues, various models of debt collection, bankruptcies, restructuring of companies in difficulties, contracting, etc.

The firm's client base also includes insurance companies, shipowners and corporations, often major international companies with high-profile and high-value matters.

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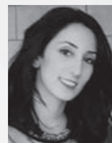

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The COVID-19 pandemic and the relevant decrees to address the negative consequences of it have greatly impacted the Cyprus economy, which was on a solid growth path before the global outbreak. The implementation of precautionary measures, including the restriction of citizens' movements and the temporary closure of enterprises of certain economic activities, have contributed to the slowdown of the economy and the negative growth rate which, as per the official data published by the Cyprus Statistical Service, was estimated at -4.1% during the fourth quarter of 2020 compared to the corresponding quarter of 2019. The negative GDP growth rate is mainly attributed to the following sectors: Hotels and Restaurants; Manufacturing; Transport, Storage and Communication; Wholesale and Retail Trade; Repair of Motor Vehicles; Arts, Entertainment and Recreation; and Other Service Activities.

The Cypriot Government has implemented support schemes for businesses, such as a loan repayments suspension until the end of 2020 and postponement of foreclosures for a period of almost six months to support the economy, society and bank clients.

In addition, Cypriot banks still face the challenge of the high level of non-performing loans (NPLs), although progress has been made in reducing the NPL ratio.

In February 2021, the Cypriot Government announced plans to stimulate the residential real estate sector, offering sponsored lending as part of the support measures to strengthen the economy due to the effects of the spread of the COVID-19 pandemic. More specifically, at its last meeting on 17 February 2021, the Council of Ministers decided to extend and significantly strengthen the two interest rate subsidy schemes for mortgage and business loans.

Regarding support for households, young couples and citizens in general who wish to take out a mortgage loan for the purpose of home ownership, the following were implemented:

(a) A six-month extension of the New Mortgage Interest Rate Grant Scheme from 30 June 2021 to 31 December 2021. That is, the new deadline on which the Licensed Credit Institutions participating in the Plan can approve applications of potential borrowers for inclusion in the Plan is 31 December 2021. The extension has been effective since 17 February 2021.

(b) An increase of the maximum loan amount to €400,000 from the previous €300,000, with immediate effect from 17 February 2021. That is, the total amount of the maximum grant now amounts to €24,000.

The interest subsidy duration is four years from the date of the first disbursement of the loan and the interest rate subsidy amounts to 1.5 percentage points. Therefore, a revised New Mortgage Interest Rate Scheme will be posted.

Regarding the Interest Rate Grant Scheme for New Business Loans, the following were decided:

(a) A six-month extension of the Plan from 30 June 2021 until 31 December 2021, subject to approval by the European Commission, as compatible with the rules of State Aid.

(b) An increase in lending limits for New Business Loans to self-employed persons and companies, subject to approval by the European Commission, as compatible with State aid rules, as follows:
   (i) An increase to €1.8m per self-employed person or company from the current €800,000.
   (ii) An increase to €270,000 per self-employed person or company active in the fisheries and aquaculture sector from the current €120,000.
   (iii) An increase to €225,000 per self-employed person or company active in the primary production of agricultural products from the current €100,000.

(c) The pricing of loans granted through the European Investment Bank, the Cyprus Entrepreneurship Fund and the Pan-European Guarantee Fund may use different Euribor maturities (e.g. one month or three, six or 12 months) instead of pricing with Euribor (six months as defined by the Plan).

The maximum subsidy rate will be four years from the date of the first disbursement as follows:

- In the first two years, the interest rate will be subsidised up to 3.5 percentage points for all companies.
- In the third to fourth year, the interest rate will be subsidised by 2 percentage points for SMEs and 1.5 percentage points for large enterprises.

Conditions apply for eligibility to the Scheme.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Increased availability of leveraged debt deals has had a significant impact on transaction volumes. Other than the Government-sponsored lending deals, lending has been rather low given the effects of the COVID-19 pandemic on global and local business operations. Having said that, the Cypriot Government successfully raised €1bn in February 2021, issuing a five-year Euro Medium-Term Note (EMTN). The debt security sale is part of the planned issuance by the Cyprus finance ministry. EMTNs are designed for repeated sales without requiring complex documentation and registration each time.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, it is possible for a Cypriot company to guarantee borrowings of one or more members of its corporate group, provided (a) its constitutional documents allow it to do so, and (b) it is in the best interests of the Cypriot company to do so and the guarantee is in writing. In approving a corporate guarantee, the Cypriot company's Board of Directors acting in good faith will look for the commercial benefit in the transaction.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

The Board of Directors of a Cypriot company, in evaluating the issuing of a corporate guarantee, are required to act in accordance with their statutory and, more importantly, their fiduciary duties towards the Cypriot company. Though fiduciary duties are not exhaustively listed in Cypriot Companies Law Cap.113 as they are in the equivalent Companies Act in England, they form part of Cypriot Companies Law as longstanding authorities followed and quoted by the Cypriot courts. Therefore, fiduciary duties have been held to include the duty to (i) act in good faith for the benefit of the company, (ii) exercise their powers for the purpose for which they are conferred, (iii) avoid putting themselves in a place where their personal interest is in conflict with the interest of the company, and (iv) exercise reasonable care, skill and judgment.

Where the Board of Directors has approved a corporate guarantee that offers no benefit to their Cypriot company but that is somehow beneficial to the corporate group as a whole, this would be an interesting factor for the court to consider when evaluating possible personal liability of the Directors. In such cases, the Directors are advised to seek ratification of their decision to approve the issue of a corporate guarantee at the company's General Meeting. Acting reasonably, in good faith and in the best interests of the corporate group that includes the company of which they are appointed Directors, would reduce the grounds for arguing that the corporate guarantee is void.

There is limited guidance from the courts on whether the absence (or insufficiency) of corporate benefit could render an otherwise properly issued guarantee void and, consequently, a creditor's right unenforceable. Among other reasons, the burden lies heavily on the Board's decision to approve the corporate guarantee. Therefore, even if the decision was wrongfully made, the Cypriot company, still liable towards the creditors, can pursue a claim at the same time against the Board of Directors for damages acting in breach of their fiduciary duties.

2.3 Is lack of corporate power an issue?

It is important to differentiate between the power granted to a Cypriot company through its Memorandum of Association, which lists the tasks that the company is able to perform, and the authority to act granted to the company's Board of Directors, which is detailed in its Articles of Association. Lack of power to issue guarantees in its Memorandum of Association may render such a guarantee, if challenged, void *ab initio*. In this case, the action would be *ultra vires*, meaning outside the powers of the Cypriot company.

The Board's lack of authority to execute a guarantee can be remedied by a ratification or approval by the General Meeting.

As a means to provide certain protection to *bona fide* third parties, section 33A of Companies Law Cap.113 provides that a company is bound, as against third parties, by acts or transactions of its officers even if they do not fall within the objects of the company (meaning they are *ultra vires*) provided that (i) the third party acted in "good faith", and (ii) the actions in question do not exceed the authority granted by the law or which the law permits to be granted to the officers of the Cypriot company. The fact that the Memorandum and Articles of Association constitute publicly available documents does not create constructive knowledge on the third party of any limitations contained therein.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

A guarantee is required to be in writing, and must apply the requirements of Contract Law Cap.149 for creation of a valid contract. Such requirements include the existence of an offer, acceptance, the intention to create legal relations, consideration and, of course, the capacity to enter into such a contract. In our view, a possible lack of consideration would harm the guarantee, as Cypriot Contract Law does not provide for valid contracts in the absence of consideration; for example, executed as deeds. There is no notion of a deed under Cypriot Contract Law, and there are only specific exceptions to valid contracts without consideration.

Prior shareholder approval is not a requirement for a valid guarantee, depending, however, on the specific regulations of the Cypriot company's Articles of Association. It is advisable for the Board to seek and obtain the approval of the General Meeting when executing a corporate guarantee, especially one that may affect the company.

Stamp duty as per the provisions of the Stamp Duty Law (19/1963), as amended, may be applicable in case the execution of the guarantee relates to assets located in Cyprus or things or matters that will be executed or take place in Cyprus. It represents good legal practice to obtain a preliminary ruling by the Stamp Duty Commissioner as to whether a document satisfies the requirements of the Stamp Duty Law.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no net worth or solvency limitations imposed as a condition before a corporate guarantee can be issued.

Nevertheless, a prudent Board of Directors would consult with the Cypriot company's latest available financial statements to ensure that any guarantee given does not exceed (a) the value of the company's assets, and (b) the value of the primary loan amount, and that it co-exists with the obligation of the borrower.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control restrictions to the enforcement of guarantees in Cyprus. In case no stamp duty has been paid to the guarantee at its execution and within the timeframe provided by the law, then there will be penalties added to the total amount of stamp duty, which must be settled before the guarantee can be adduced as evidence in the Cypriot courts as part of enforcement proceedings.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

As a general rule, any type of property may be used as security for lending obligations. By way of example, such property could be real estate including land and buildings, tangible movable property, which includes plant and machinery, goods, equipment, etc., and financial instruments such as shares and bonds as well as intellectual property, which is a form of intangible movable property.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Given that various assets may be deployed in granting security, it may be advisable for a separate instrument for each asset to be drafted so that registration of that security (and subsequently possible enforcement) is simplified. A general security agreement may be created; in fact, these are frequently created over machinery or plants and equipment, creating fixed and floating charges. However, a security over land is frequently documented in mortgage documents, whereas a pledge or charge over securities represented in share certificates is also documented in a standalone charge instrument.

Each type of security has its own perfection requirements, and this is another reason to have a separate instrument for each type of asset being charged.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral security may be taken over real property (land), plant, machinery and equipment.

A security over real property (land) is often created by way of a mortgage. In order for a mortgage to be valid, it must be made in accordance with the provisions of the Immovable Property (Transfer & Mortgage) Law, Law 9/1965. In accordance with the law, the mortgagee and the mortgagor (or their duly authorised representatives) should attend the relevant District Land Registry and declare the mortgage through an instrument, which should include the details prescribed by the law in the provided form. It is noted that for the transfer of the mortgaged property or registration of any subsequent mortgage, the mortgagee's consent is required as well as a declaration by any transferee/subsequent mortgagee acknowledging the existence of the mortgage. Where the mortgagor is a Cypriot company, the mortgage should also be registered with the Registrar of Companies, otherwise it is rendered void against the liquidator and any creditor of the company.

The most common form of security over tangible assets such as plant, machinery and equipment is the fixed and floating charge, registration of which is required to be made with the Registrar of Companies in order to be valid against the liquidator and any other creditor.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables is possible and is usually made by assignment or fixed or floating charge. The debtor should be notified in case of assignment.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A collateral security may be taken over cash deposited in bank accounts by fixed or floating charge. A fixed charge will be created where the parties agree total prohibition of all dealings and withdrawals without permission of the chargee; otherwise the charge will be floating.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes, it is possible to take collateral security over shares in companies incorporated in Cyprus, both where the shares are represented in certificated and dematerialised form. The procedure for taking security over shares of Cypriot companies represented in share certificates includes the following:

(1) The security will take the form of a share pledge represented in a share pledge agreement or a deed of pledge as is most commonly referred to, created by the Cypriot parent company over the shares of the Cypriot target. A pledge, being a possessory security interest, involves the delivery of the share certificates to the pledgee. The creation of the pledge is governed by section 138 of Contract Law Cap.149 and section 90(2) of Companies Law Cap.113.

(2) As per section 138 of Contract Law Cap.149, any agreement for pledge of shares in a Cypriot company should be in writing and signed by the pledgor in the presence of at least two witnesses each having contractual capacity. Additionally, the following requirements as stated in section 138(2) of Contract Law Cap.149 must be satisfied in order for the pledge to be valid and enforceable: (i) notice of the pledge together with a certified copy of the deed of pledge needs to be given by the pledgee to the company whose shares are being pledged; (ii) a memorandum of the pledge is entered in the register of members of the company whose

shares are being pledged in respect of the shares pledged; and (iii) a certificate is delivered to the pledgee by the company whose shares are being pledged confirming that a memorandum of pledge has been entered in its register of members, evidencing the pledge.

(3) Additionally, it is common practice to include a number of additional mechanisms to ensure that the interests of the pledgee are adequately protected and allow for an out-of-court enforcement in case of default. Such mechanisms include the provision to the pledgee of undated executed documents, such as an undated instrument of transfer, undated resignation letters by the Directors, amendment of the Articles of Association of the company, etc. It is also important that the grounds on which the agreement can be enforced are clearly stipulated in the pledge agreement.

On a similar footing, it is possible to create a pledge and charge where the security is granted over shares in companies of a non-Cypriot company but by a Cypriot pledgor (parent company), which is governed by section 90(2) of Companies Law Cap.113 and, in this case, the security requires registration with the Department of the Registrar of Companies to be perfected.

The parties to a pledge agreement in relation to shares over Cypriot company may choose New York or English law as the governing law of the agreement or any other law. However, since the subject matter of the pledge is shares in a Cypriot company, the provisions stated by the Cypriot law described above have to be satisfied in order for the pledge to be valid and enforceable.

Where the company in question is a publicly listed company, a charge or pledge over dematerialised securities should be registered with Central Securities Depository and Central Registry of the Cyprus Stock Exchange.

A pledge over shares in a Cypriot company is subject to stamp duty as per the Stamp Duty Law (19/1963, as amended) and failure to pay stamp duty affects the admissibility of the pledge as evidence before Cypriot courts (and not its validity).

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, and in this case it takes the form of a fixed and floating charge or debenture. A floating charge that crystallises on the occurrence of a specific event is the most common form of security. The security entails the drawing up of a floating charge document, payment of stamp duty as applicable, and registration with the Registrar of Companies as the case may be, so that the floating charge will be binding against the liquidator in the event of the Cypriot company's liquidation.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Generally speaking, a Cypriot company may grant a security interest in order to secure its obligations as a borrower under a credit facility and as guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility agreement, provided that its constitutional documents permit it to do so, there is a commercial benefit to the company, and the company complies with the limitations of the law regarding financial assistance (please see question 4.1 below).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

In accordance with section 90 of Companies Law Cap.113, any charge, assignment or amendment created by a Cypriot company should be registered with the Registrar of Companies in order for the charge to be valid against the liquidator and any creditor of the company. The registration requirements are applicable only in respect to the charges illustrated by section 90(2). It is noted that any pledge over shares in a Cypriot company and agreements for the provision of financial collaterals within the meaning of the Financial Collateral Arrangements Law (Law 43(I) of 2004) are not subject to registration. Further, any charge should be registered with the Registrar within 21 days after the day of its creation (or its assignment or amendment, as the case may be) or within 42 days from the day of creation of charge out of Cyprus (or its assignment or amendment, as the case may be) and involves property that is located out of Cyprus. The fees payable to the Registrar are calculated based on the value of the charge, with the rates being as follows:

- €140 (€0–€17,086.01).
- €240 (€17,086.01–€34,172.03).
- €380 (€34,172.03–€85,430.07).
- €540 (€85,430.07–€170,860.14).
- €640 (over €170,860.14).

A mortgage over immovable property of a company registered in the Republic of Cyprus should be registered with the Registrar within 21 days from the date of registration of the mortgage with the relevant office of the Department of Lands and Surveys of the Republic of Cyprus and must pay a fee of €20 (irrespective of the mortgage value). Such mortgage should also be registered with the Land Registry (please see question 3.3 above) and bears a fee of 1% on the amount advanced under the mortgage.

Stamp duty may also be applicable in accordance with the Stamp Duty Law (19/1963), which provides (subject to certain exceptions) that any document that is specifically set out in Schedule 1 of the law is subject to stamp duty if it relates to any asset that is located in Cyprus or things or matters that will be executed or take place in Cyprus. Stamp duty is paid within 30 days from the date of signing or, in case the signing took place outside Cyprus, within 30 days from the date of its receipt in Cyprus. Schedule 1 provides in detail the rates of stamp duty for each type of document. The rates applicable to agreements in general (including agreements for security of debt) depend on the value of the agreement as follows:

- From €1 up to €5,000, the stamp duty payable is €0.
- From €5,001 up to €170,000, the stamp duty payable is €1.50 for every €1,000.
- From €170,000 upwards, the stamp duty payable is €2 for every €1,000 with the maximum duty payable being €20,000.

Failure to pay stamp duty does not affect the validity of a document but merely its admissibility as evidence before Cypriot courts. Penalties apply for failure to pay within 30 days from the date of signing or receipt of the document in Cyprus.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The filing, notification and registration procedure is quite straightforward and involves the payment of fairly reasonable fees due for registration and issue of the relevant certificates

from the Registrar of Companies. Registration itself may take place in the course of a single day, while the certificate of registration in the case of shares can be issued in a matter of days following filing.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory or similar consents are required; however, this does not refer to regulated entities where additional notifications to the regulating or supervising authorities will most likely be required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No special priority or other concerns apply if the borrowings are secured under a revolving credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

There are specific statutory requirements and formalities with respect to the creation of a pledge of shares as per section 138 Contract Law Cap.149 mentioned above. Powers of attorney usually require the certification of the person who signs by a certifying officer. There is no concept of a deed under Cypriot Contract Law. However, where documents are governed by a law that recognises execution as a deed, or where the parties decide to execute as a deed, the parties affix the company's common seal if they choose to, provided it is done in accordance with the Cypriot company's Articles of Association.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company
Direct or indirect financial assistance in the form granting a loan, guarantee, security or otherwise, for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company, or where the company is a subsidiary company, in its holding company is prohibited under section 53 of the Cypriot Companies Law Cap.113. Following a recent amendment of the said section and the introduction of a "whitewash" provision, financial assistance is permitted where (a) the private company in question is not a subsidiary of a public company registered in Cyprus, and (b) the transaction has been approved by a resolution passed by holders of 90% of the voting share capital of the company in its General Meeting. Moreover, the following exemptions apply:
(i) where the lending of money is part of the ordinary business of a company, the lending of money by the company in the ordinary course of its business;
(ii) the provision by a company, in accordance with any scheme in force at the time, of money for the purchase of, or subscription for, fully paid shares in the company or its holding company, being a purchase or subscription by trustees of or for shares to be held by or for the benefit of employees of the company, including any Director holding salaried employment or office in the company; and
(iii) the giving by a company of loans to persons, other than Directors, *bona fide* in the employment of the company with a view to enabling those persons to purchase or subscribe for fully paid shares in the company or its holding company to be held by themselves by way of beneficial ownership.

Section 53(1) does not apply to private companies where (i) the private company is not a subsidiary of any company that is a public company, and (ii) the relevant action has been approved at any time, with a resolution of the General Meeting that has been passed by a majority exceeding 90% of all issued shares of the company.
In addition, the Articles of the company should also authorise the company to grant financial assistance.

(b) Shares of any company that directly or indirectly owns shares in the company
Please see (a) above.

(c) Shares in a sister subsidiary
Other than a potential prohibition under a company's Articles, there is no such prohibition as per Cypriot law.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. More specifically, the Law Regulating Providers of Administrative Services and Related Matters No. 196/2012 makes it possible, subject to conditions, for a licensed or exempted person to offer trustee services, which applies in the case of entrusting and enforcing loan documentation and collateral security. In this case, the loan and security documentation will be supplemented by the security agency agreement or the escrow agreement, which defines the parameters within which the agent, trustee or escrow will be acting. The agent, trustee or escrow may be a non-Cypriot provider as well.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Any enforcement mechanism, other than recourse to the competent courts, will refer to the contract terms of appointment of an agent, trustee or escrow as mentioned above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction.

If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

No special requirements apply under Cypriot law other than the general contractual provisions in the loan documentation.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interest income is subject to taxation in Cyprus for tax-resident lenders. Where the lenders are foreign, it is important to identify their tax residency, whether it is in Cyprus or the EU, and their connection to their borrower, i.e. if they are related parties. Transfer pricing considerations may also apply. There are no specific deductions or withholding tax on the proceeds of a claim under a guarantee or on the enforcement of security.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no specific tax incentives for foreign lenders at present. Tax incentives apply to all Cypriot tax residents. However, it is a rather important incentive that Cyprus offers a straightforward taxation system with clearly set out taxation rules.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Taxation of income in Cyprus is applicable to Cypriot tax residents or, where a company is not tax resident in the Republic, it is only taxed on income accruing or arising from sources within Cyprus. Interest income may be subject to taxation in Cyprus; however, there is no automatic taxation solely because of a loan to or guarantee and/or grant of security from a company in Cyprus.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Stamp duty is the most significant cost incurred by foreign lenders even though, in our experience, it is usually borne by the borrower as part of the standard loan documentation terms. There are no notary fees as in other jurisdictions.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Cyprus does not apply thin capitalisation rules.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, Cypriot courts will recognise and give effect to a foreign governing law in any action brought in Cyprus before a Cypriot court, by virtue of the Rome I Regulation (Reg. (EC) No. 593/2008) irrespective of the parties' domicile (Regulation (EU) No. 1215/2012). Cypriot courts will enforce a foreign governing law provided that (a) it is pleaded and proved, (b) Cypriot law mandatory provisions are not derogated from the agreement (including penal, revenue and court procedural rules), and (c) it is not manifestly inconsistent with public policy.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Cypriot courts will recognise a judgment of a New York court by application of the Recognition, Enforcement, and Execution of Foreign Judgments Law 121(I)/2000, provided that, for enforcement purposes, an application to the court is received, accompanied by an affidavit. Following the UK's departure from the EU, it is unclear at the time of writing how the recognition and enforcement of judgments will be implemented. As of recently, the recognition and enforcement of judgment was automatic based on the Brussels I Regulation (Reg. (EC) No. 44/2001 and Reg. (EC) No. 1215/2012). The Certain Judgments of Courts of Commonwealth Countries (Reciprocal Enforcement) Law Cap.10, as amended, could be referred to for judgments of the superior courts of the UK. Additionally, there is the 2019 Hague Convention on Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters that could be referred to once in force. Also, we know the UK applied to join the Lugano Convention in April 2020; however, at the time of writing, there is no definite outcome of that application.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The procedure is subject to how soon the case file will be prepared and filed in court and dependent on the court's caseload. Several years would be required before final judgment could be issued.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

No, and this represents one of the reasons why several lenders prefer Cyprus as a legal jurisdiction for the creation and maintenance of collateral security. Enforcement is straightforward as it is governed solely by the terms of the loan and security documentation. There is currently a trend towards challenging unfair contract terms imposed by lending institutions; however, this is being challenged in the context of housing loans especially drawn up in different currencies. Another consideration for lenders is to receive a fair price for the assets being realised and to consider that there is no requirement for any regulatory consents prior to enforcement or otherwise.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No restrictions apply in this respect.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Cypriot courts can order a 95-day moratorium on any enforcement action by creditors, as a means to allowing a debtor to agree an arrangement with the creditors (as per Bankruptcy Law Cap.5). Such arrangement requires the approval of 75% of the creditors in value and, once sanctioned by the court, it is binding on the debtor and all the creditors. It is possible for dissenting creditors to make their case in court.

The bankruptcy and insolvency landscape in Cyprus has significantly improved in recent years, with the introduction of a requirement that all insolvency practitioners are licensed in addition to any existing licence to practise as accountants/auditors or lawyers. With this reform came the introduction of the "examinership" process, which is aimed at evaluating the possibility of reorganising the company's assets and agreeing a restructuring plan. This process entails a four-month moratorium, during which the company is considered to be under the protection of the court and thus immune from creditor action. Where an examiner is appointed and a collateral security exists, the examiner's consent will be required prior to realising the secured assets.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes, it is possible to enforce an arbitral award without re-examining the merits of the case, as Cyprus is a contracting state to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958, provided the requirements of the Convention have been met.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Cypriot Companies Law Cap.113 (sections 202–305), as amended, outlines the procedures for corporate insolvency, reorganisation and voluntary liquidation. It is important to remember that the lender's ability to enforce a secured collateral may be affected mostly by the examiner's consent in case examinership is invoked. Bankruptcy Law Cap.5 should be referred to in cases of corporate insolvency as it offers guidance that may be applicable to legal persons as well as physical persons in the case of insolvent liquidation.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Pursuant to section 301 of the Companies Law, any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company within six months before the commencement of its winding up, shall, within the context of a winding up, be considered a fraudulent preference against its creditors, accordingly, without validity. The court considers the underlying intention of granting a specific creditor preference over others when evaluating the existence of a fraudulence preference. The burden of proof in a fraudulent preference claim lies with the parties that wish to avoid the transaction.

Moreover, section 303 of the Companies Law provides (where a winding up is concerned) that a floating charge on the undertaking or property of the company created within 12 months of the commencement of winding up shall be invalid, unless it is proven that, immediately following the creation of the charge, the company was solvent. The burden of proof rests with the chargee.

Finally, certain claims enjoy preferential treatment in the course of a winding up and rank higher than other debts secured by a floating charge. More specifically, the following hierarchy applies:

- costs of the winding up and preferential claims (including government and local taxes, duties due and payable within 12 months prior to the date of the commencement of liquidation);
- assessed taxes; and
- all sums due to employees, including salaries, accrued holiday pay, deductions from wages, and any possible compensation for injury.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Corporate insolvency applies to all legal entities governed by the Cypriot Companies Law Cap.113.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

In addition to the provisions in the loan documentation, which may include such terms for the secured collateral which allows a trustee on behalf of the lender or the lender itself to seize assets directly, enforcement may include powers of sale, taking possession, and appointment of a manager or receiver.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Provided the choice of law is authorised and recognised by the Cypriot legal system, then yes, such choice of law is binding and enforceable under the laws of Cyprus.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, it is.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

The distinction between a licensed financial institution and a private company lender will be visible on the interest rate applied on a loan to a borrower under market conditions (preventing usury). As per the Cypriot Penal Code, there is a reference rate applied by the Cyprus Central Bank that provides a ceiling to an interest rate. Other than that, a foreign lender that is licensed at its jurisdiction of incorporation or otherwise, is not required to obtain a licence in Cyprus before it can lend funds to a Cypriot borrower.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

The COVID-19 pandemic triggered an increased use of electronic means for the execution and delivery of documents, including loan documentation. Accordingly, we have seen an increased use of the authorised electronic signature, the simultaneous execution of documents in various parts of the world, and the exchange in reliance to precedent that recognises the remote execution and delivery of documents. Moreover, the Department of the Registrar of Companies, which issues company certificates as well as certificates of registration of charges, etc., has widened its online functions, with the ability to apply, submit and request documents online. The COVID-19 pandemic initially slowed down the filing of documents in Cypriot courts, whereas court appearances were initially postponed and considerably reduced. There has been no derogation from formalities required by loan documentation or security documents due to the COVID-19 pandemic. We expect to see a more coherent implementation of electronic means, with the adoption of iJustice as a means of a new way of filing court documents and processing simple court applications with limited physical presence in court. Court hearings, we expect, will continue to require the physical presence of counsel; however, there is now increased reliance on filing written motions in advance of the hearing, subject to court procedure rules, as a means to saving time and helping the overall court hearing process.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

A current trend that may become a material consideration relates to the enforceability of unfair contract terms related to interest rates in a business context (which currently relates to housing loans, as mentioned above). Given the effects of the COVID-19 pandemic on global businesses, curtailing significantly the ability even of the most sophisticated borrowers to meet repayment plans, as well as the effects of Brexit and the volatility of investments, we expect to see updated standard lending terms, which will reflect the current and evolving economic climate.

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S. KOUKOUNIS & PARTNERS LLC is a full-service law firm based in Nicosia, Cyprus. The law firm operates under the supervision and licence of the Cyprus Bar Association. Its partners and associates are all UK-educated lawyers and practise Cypriot law, with a strong focus on Corporate and Commercial, Tax as well as Banking and Financing. Some of the firm's most notable projects include acting as the borrower's counsel in the financing and re-financing of multi-million Euro facilities with international institutional lenders, representing high-tech software companies based in Europe with satellite offices in non-EU jurisdictions, advising Boards of Directors of Cypriot lending institutions in restructuring procedures, and advising end-clients on structuring joint ventures for investments in Cyprus as well as central EU jurisdictions with the use of Cypriot entities.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The effects of the COVID-19 pandemic, the end of the Brexit transition period and the market participants' preparations for the imminent discontinuation of LIBOR have largely dominated the UK loan market landscape of 2020.

COVID-19 has had an unparalleled impact on the UK loan markets during 2020. Borrowers across a range of sectors have been focused on managing their liquidity requirements and have required a host of amendments and waivers under their existing loan documents in respect of the impact of COVID-19 and government lockdowns on their businesses and operations. Many of the usual loan markets transactions were put on hold during 2020 whilst market participants focused on supporting their customers with these issues. The UK government introduced a range of government-backed liquidity schemes for businesses impacted by the pandemic, which the loan markets provided access to at the same time as considering the impact of new legislation introduced to impose moratoriums or other measures to restrict creditors rights, challenging the usual credit metrics applied for lending criteria. Overlaying all of these new issues were the logistical and practical considerations for progressing and executing transactions remotely, with the rise of e-signatures and the use of platforms like DocuSign becoming common features which are likely to remain relevant even after the impact of the pandemic subsides.

The Brexit transition period ended at 11pm (UK time) on 31 December 2020. The European Union (Future Relationship) Act 2020 passed by the UK Parliament just in time on 30 December 2020 implemented the UK-EU Trade and Cooperation Agreement (**TCA**), the post-Brexit trade agreement reached by the UK and the EU on Christmas Eve. The TCA has been implemented by both parties on a provisional basis only until 28 February 2021 as it remains subject to formal ratification by the EU Parliament. A number of EU laws were immediately revoked, or repealed, including the Brussels Recast Regulation (which regulates jurisdiction and the recognition and enforcement of judgments between EU Member States) and the Insolvency Recast Regulation (on insolvency proceedings and the recognition of insolvency proceedings between EU Member States). Other on-shored EU laws have been amended by statutory instrument, mostly to make sure that they work as part of English law rather than EU law. There is material work to be completed in the coming months to ensure that the UK's legal and regulatory framework, and its benefiting from the international network of trade and legal agreements, at least replicates and (perhaps optimistically) improves the pre-Brexit position.

The transition away from LIBOR has gained increasing focus and resource from all major market participants in 2020 as the end of availability of LIBOR in relation to a number of major loan currencies gets nearer. Global financial institutions are dedicating major resources towards the remediation of existing LIBOR transactions and developing the knowhow and systems required to enable the offering of new risk-free rate (**RFR**) products to their clients. In addition to the Loan Market Association publishing a number of updated RFR exposure drafts developed in cooperation with a working group consisting of a range of market participants, 2020 saw the completion of a number of important new loan financings utilising RFR interest rate mechanics with no reference to LIBOR. Although there is still no final consensus on some of the components of the transition to the risk-free rates, we are certainly seeing the forming of a broad market approach on RFR mechanics and their impact on loan documentation in the UK and European markets.

English law continues to be the choice for the vast majority of cross-border European deals (whether or not there is any connection with England): the UK's departure from the EU has no significant effect on English contract law, which does not derive from European law or on the approach of EU Member States or the UK to respecting English governing law clauses. The position in relation to English jurisdiction clauses is more complex, but English jurisdiction clauses nevertheless remain the preferred option for the majority of cross-border deals.

The key priorities of the UK loan market in 2021 are likely to be the nature and speed of recovery from the COVID-19 pandemic and managing the impact of Brexit. As time runs out, readiness for LIBOR transition will also continue to be a major objective and a drain on the resources of market participants. We also anticipate a renewed focus on climate change and sustainable finance is likely to continue to be an increasingly important and developing area of the loan markets in the UK, Europe and globally.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Despite the unprecedented circumstances of the past 12 months, the UK and European loan markets continued to provide substantial liquidity for the biggest global transactions of 2020, demonstrating the depth and resilience of the syndicated loan markets during a particularly challenging year globally. Importantly, English law continues to be the governing law preferred for loan financing transactions of global importance.

The hugely important US$39bn acquisition of Alexion Pharmaceuticals Inc. (Alexion) by AstraZeneca plc was financed by a US$17.5bn committed bridge facility arranged by Morgan

Stanley, JPMorgan and Goldman Sachs. AstraZeneca's position at the forefront of the COVID vaccine development during 2020 and the nature and size of the acquisition meant that this was one of the most high-profile transactions of the year. The financing was also the largest syndicated loan written to date that includes references to RFRs rather than LIBOR. Perhaps appropriately, another of the year's biggest transactions was the acquisition by the German health imaging and medical devices giant, Siemens Healthineers, of the cancer device and software specialist Varian Medical Systems for US$16.4bn. The acquisition was supported by a €15.2bn bridge loan underwritten by JPMorgan Chase and UBS with the purchase price intended to be funded primarily by a bond issuance and capital increase.

British American Tobacco raised US$8.2bn multicurrency loan facilities in March 2020, in the midst of the first major wave of the global pandemic. The financing was widely syndicated with over 20 international banks forming the lender group and was the world's first syndicated multicurrency loan agreement to incorporate both the Sterling Overnight Index Average (SONIA) and the Secured Overnight Financing Rate (SOFR) – the emerging standard reference rates intended to replace LIBOR for sterling and US$ loans, respectively. It also incorporated the Euro short-term rate (€STR) as the reference rate for euro swingline loans, which is intended to replace EONIA as the overnight euro rate.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Generally yes, provided there is adequate corporate benefit (which need not be direct financial benefit but can include less tangible factors such as management support) and the company has the legal capacity to give the guarantee (which almost all do).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In general, directors are required to act in good faith and have a duty to promote the success of the company for the benefit of its members as a whole. In normal circumstances, where directors form a view that giving the guarantee promotes the success of the company because of the benefits to the borrower, guarantees for no direct benefit are valid. Downstream guarantees are generally no problem; for upstream or cross-stream guarantees it is necessary for the director to apply more thought to these matters. On the other hand, if the company is likely to become insolvent or is actually insolvent, this duty is displaced with a duty to have regard to the interests of the creditors of the company (taking precedence over the interests of members). If there is no reasonable prospect that the company will avoid going into insolvent liquidation or administration, directors should also be mindful of wrongful trading liability. In certain circumstances, a guarantee may be set aside as a preference or due to the insolvency of the company (see question 8.2).

Commentary in 2017 by the Institute of Chartered Accountants of England and Wales questioned whether a company ought to be able to ascribe no liability, in the company's accounts, to a guarantee given in respect of a parent company even if the directors assess that there is a low likelihood of the parent company failing to pay and the guarantee being called. Although this view is discussed occasionally, particularly if a company is near insolvency, for most transactions this is seen as an academic debate and market practice has not changed.

2.3 Is lack of corporate power an issue?

Lack of corporate power would not necessarily make a guarantee void; however, the capacity of a company to enter into a guarantee should be checked by looking at its memorandum (if any) and articles of association. The company's objects will often include an express power to grant guarantees, but even if this is not expressly stated then the objects may be wide enough to cover granting guarantees if that is ancillary to the business.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Generally no; however, there may be particular requirements in the case of regulated entities. A shareholder resolution is also often provided to mitigate corporate benefit concerns.

A guarantee is required to be in writing, signed by the guarantor.

Standalone guarantees are often executed as a deed to avoid any arguments regarding due consideration.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, although directors should consider the solvency of the company as part of promoting its success and best interests.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No, although it is prudent to check whether non-English exchange control or sanctions considerations will apply to a guarantee given by a non-UK company or which relies on recourse to non-UK assets.

Guarantees (and other obligations) of state entities may benefit from sovereign immunity.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

It is possible to take security over all types of assets of an English company.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Security over all or substantially all of a company's assets may be given by a single document, known as a debenture (not the same as a fixed income share of a company, which confusingly is also known as a debenture).

A debenture usually includes:

(a) a fixed charge over assets which are identifiable and can be controlled by the creditors (e.g. restricted accounts);
(b) a floating charge which is used to capture fluctuating and less identifiable assets (e.g. inventory);

(c) an assignment of receivables and contracts; and
(d) mortgages over real estate and shares.

If the debenture includes a real estate mortgage or a power of attorney, it must be executed as a deed (see question 3.13). In practice, all security documents are almost always executed as deeds.

There is no universal registration of perfection (like UCC filings in the United States), so perfection of security over assets is required depending on the type of asset (see questions 3.3 to 3.7). Consideration should also be given to whether additional formalities or documents should be used when securing assets of an English company which are not based in England or when taking security over particular types of assets, e.g. ships, aircraft, or chattels that are moveable.

Security by real persons is also possible, on largely similar terms.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over land is ideally taken by way of a legal mortgage. A legal mortgage transfers legal title to the creditor and restricts the chargor from taking certain actions while the asset is subject to the mortgage, e.g. disposing of or mortgaging the asset further without consent. A legal mortgage cannot be granted over future acquired assets.

It is also possible to create an equitable mortgage over land where the beneficial title in the land is transferred to the creditor but legal title remains with the chargor. We often see an equitable mortgage where the parties have agreed that a legal mortgage will only come into effect if certain events occur or where the formalities required for a legal mortgage cannot be met. An equitable mortgage suffers from certain disadvantages compared to a legal mortgage but, except in the case of fraud by the chargor, these disadvantages are often accepted.

When taking security over land, consider whether the chargor is required to obtain third-party consents (for example, from the freeholder if security relates to leasehold title). Security should be registered with the Land Registry in most circumstances.

Security over plant, machinery and equipment may be caught by a legal mortgage over the land if those assets are sufficiently attached to the mortgaged land; however, a fixed charge is usually granted over these types of assets. A fixed charge is generally only used for identifiable assets and where a creditor is able to show sufficient control over the asset. There are no specific documentation formalities required for creating a fixed charge, although for moveable assets and other types of asset, it may be advisable to affix some sort of notice to the asset to give third parties notice of the security.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, usually by way of an assignment (subject to such receivables being assignable) but can also be covered by a fixed charge (see question 3.2 above) or a floating charge (see question 3.5 below).

An assignment of receivables can be legal or equitable. A legal assignment must be in writing, signed by the assignor, absolute (unconditional and irrevocable) and notice must be given to the relevant third parties. If any of these conditions are not met then the assignment will be an equitable assignment. The main benefits of a legal assignment are (a) the creditor can sue in its own name (if it is an equitable assignment the creditor would have to join the assignor as a third party to any suit), and (b) the third party (once notice has been served) will only be able to discharge its obligations to, or as directed by, the creditor.

It is common for certain assignments to be equitable assignments until a trigger event occurs and the assignor is then required to give notice to the third party (and the legal assignment is perfected), but this is dependent upon negotiation. Acknowledgment of the notice by the third party is often requested but does not affect the nature or validity of the assignment.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, by a fixed or floating charge.

A fixed charge over a bank account is generally only effective where the account is blocked such that the chargor can only make withdrawals with the creditor's permission. A floating charge allows the chargor to continue to deal with the account in the ordinary course of business until there is a trigger event (usually a default), at which point the creditor may notify the account bank that it controls the account. A trading account would only ever be subject to a floating charge, as the chargor would need constant access to the account and repeatedly seeking lender consent would be impractical.

Whether a charge is fixed or floating will be dependent on the level of control the creditor has over the account. A floating charge ranks below certain other claims in an insolvency, such as a ring-fenced fund for unsecured creditors, preferred creditors (which now includes the tax authorities for certain taxes including VAT) and expenses of the liquidation or administration, which can be significant in large transactions.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Shares in English companies are required to be registered (not bearer) and may be certificated or uncertificated (and/or held in a clearing system).

Security over shares in an English company should be effected by an English law security document.

Shares are usually charged by way of a mortgage or fixed charge. A legal mortgage over certificated shares involves transferring ownership of the shares to the creditor and registering the creditor in the shareholder register. The share certificate in the chargor's name will be cancelled and replaced with one in the creditor's name. A legal mortgage allows the lender to vote the shares, and receive any dividends and any information about the shares until the debt is discharged.

Often an equitable mortgage is granted subject to the creditor being able to create a legal mortgage if certain trigger events occur. This is achieved by delivering share certificates and a signed but undated stock transfer form to the creditor. If the security becomes enforceable the creditor can complete the undated stock transfer form and any formalities required to become legal holder of the shares. Prior to the security being enforceable, all voting rights, dividends and any communication about the shares will remain with the chargor.

Uncertificated shares can be secured by an equitable or legal mortgage. In order to hold uncertificated shares, the creditor will need a securities account with the clearing system (or with a financial institution which has such an account). A legal mortgage will be perfected by an instruction to the clearing system to transfer the shares to the securities account of the creditor.

An equitable mortgage of shares in a clearing system is created by depositing the shares into an escrow account with the clearing system and restricting withdrawals without the creditor's permission.

If a legal mortgage over shares is taken and perfected so that the shares are transferred to the mortgagee, then the mortgagee is likely to become a "person with significant control" (**PSC**) under the PSC regime. The mortgagee will then be subject to legal obligation to provide information about itself to the mortgagor. That information will become public information. Failure to provide this information is a criminal offence. These obligations do not arise under an equitable mortgage (which is the more common approach to share security) so are not usually a concern.

When taking security over companies subject to the PSC regime, mortgagees should ensure that they are protected against the risk of a restrictions notice being issued (under the PSC regime) in respect of the shares. A restrictions notice effectively freezes the interest so the security cannot be enforced, dividends cannot be paid nor voting rights exercised. Protection against this risk requires market standard PSC provisions to be included in the credit or security agreement.

Other considerations include: stock exchange notification requirements; tax implications; and restrictions in the company's constitutional documents (such as liens, pre-emption rights or a right to refuse to register a transfer).

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. Typically, a floating charge is most appropriate given the fluctuating nature of inventory and the inability of a secured creditor to exercise sufficient control for a fixed charge. See question 3.5 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, subject to corporate benefit and solvency considerations similar to those for a guarantee (see questions 2.1 to 2.3 above).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Registration requirements depend on the type of secured asset. The majority of security interests created by an English company must be registered at Companies House within 21 days of its creation. Failure to register within this time means that the security will be void against the liquidator, administrator or any creditor of the company and the money secured by the security becomes immediately payable.

A prescribed form must be completed to register a company's security along with supporting documentation and payment of a fee (£23 paper filing or £15 online filing). This registration is a statutory requirement but is not a universal perfection filing (like UCC in the United States) – it does not remove the need to perfect security over specific assets.

Security over English real estate must be registered at the land registry and security over certain other assets, such as IP, ships and aircraft, needs to be registered at the applicable registries.

Security by real persons over certain types of moveable asset may require registration as a bill of sale.

There are no notarisation requirements for security documents under English law.

See question 6.2 regarding stamp duty.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

No, prescribed forms need to be completed (see question 3.9 above) and minor fees need to be paid.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally, no; however, one should consider requirements for third-party consents in underlying contracts. Additional consents may be required if involving regulated entities or assets.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Generally, no.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Creditors generally expect to receive board and/or shareholder minutes approving the documentation for evidentiary purposes and to ensure corporate benefit issues have been considered.

A legal mortgage over land must be in writing, signed by all parties, incorporate all terms expressly agreed and fulfil the requirements of a deed.

A deed must be in writing, clear from its face that it is a deed, validly executed as a deed and must be delivered.

Security agreements usually contain a power of attorney and therefore will need to be executed as a deed.

Other guidelines should be considered, such as law society practice notes and recent case law which states that each party must approve and intend for their signature to be attached to a final form document. Exchanging pre-signed signature pages is not sufficient to execute certain documents effectively.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

A private company can provide financial assistance (including guarantees and security) for the acquisition of its own shares.

Subject to limited exceptions, a public company is prohibited from giving financial assistance for the acquisition of its own shares.

(b) Shares of any company which directly or indirectly owns shares in the company
Private companies can provide financial assistance for the acquisition of shares in a private holding company but not a public holding company.
Public companies are prohibited from providing financial assistance to both public and private holding companies subject to limited exceptions.

(c) Shares in a sister subsidiary
There is no prohibition on financial assistance provided for the purchase of shares in a sister subsidiary.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes, this is usually governed by the agency provisions in the loan documentation and intercreditor or security agreement. The intercreditor agreement will govern how proceeds from security enforcement will be applied.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Agency and trust relationships are well established in England.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Syndicated loans are generally structured so that they are transferrable from one lender to another by using a prescribed form of transfer certificate subject to any restrictions in the loan documentation. A transfer of the loan will also transfer the benefit of any English security or guarantee.

If a loan has not been structured in this way, then (assuming no contractual prohibitions to the contrary) it is possible to assign the benefit of the loan and guarantee to Lender B by giving notice to the borrower and guarantor. Care should be taken if the loan is a revolving credit or not fully drawn, as the obligation to lend cannot be transferred by assignment (so Lender A would still be required to make further advances) and any future drawings may not benefit from the guarantee.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Yes, but subject to several exceptions, one or more of which generally apply in most transactions.

The starting principle is that a company paying "yearly interest" that arises in the UK is required to withhold income tax from that interest at a rate of (currently) 20%. Interest will be "yearly interest" for these purposes if, in broad terms, the debt is part of a scheme or arrangement of borrowing intended to be capable of being outstanding for a year or more.

There are several exceptions. In the context of a commercial bank loan, the most important exception is that for interest payable on an advance from a domestic "bank" or a domestic branch of a foreign "bank", where the person beneficially entitled to the interest is within the charge to UK corporation tax in respect of that interest, or would have been within the charge to UK corporation tax in respect of the interest but for the exemption from UK corporation tax for foreign branches of UK companies.

Other possible exemptions include: interest paid by a bank in the ordinary course of the bank's business; interest paid to a company within the charge to UK corporation tax; and interest payable without deduction under a direction to pay gross pursuant to a double tax treaty.

UK law is not clear on the treatment of payments made under a guarantee. They could be characterised as being of the same nature as the underlying obligation (i.e. interest or principal), or as a separate obligation. This characterisation will determine the UK withholding tax treatment of payment and which exemptions may be available.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no preferential tax incentives for foreign lenders lending into the UK.

Note that UK stamp duty could be payable on the transfer or assignment of certain loans (whether the lender is foreign or domestic). In addition, if the loan is a "chargeable security", UK stamp duty reserve tax (**SDRT**) could be chargeable in respect of an agreement to transfer the loan.

An exemption from UK stamp duty and SDRT applies to loans that are "exempt loan capital". A typical bank loan is likely to be "loan capital". However, if the loan has certain equity-like characteristics (e.g. convertibility, results-dependency, excessive rate of interest), it will not be "exempt". It is rare for bank loans to carry such rights, although there may be concerns where loans carry a margin ratchet or are limited recourse. Where a loan is not exempt loan capital, other exemptions from stamp duty and SDRT may be available.

The grant of security over assets should not be subject to UK stamp duties or taxes. There may be a liability to UK stamp duties or taxes on enforcement of security over shares or securities of a UK company or UK real estate in certain cases.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

By themselves, these factors should not bring a non-UK lender into the charge to UK tax (although, as discussed at question 6.1 above, a foreign lender may be subject to UK withholding tax).

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Generally, no. See question 3.9 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Results-dependent interest will be characterised as a non-deductible distribution of the borrower for UK tax purposes. There is an exemption from this rule where the recipient of the interest is within the charge to UK corporation tax. Therefore, a borrower might be disadvantaged in such circumstances where a lender is outside the UK tax net. There is, however, an exemption for certain margin ratchets which does not depend on the location of the lender. In certain circumstances, UK anti-hybrid legislation may be applicable to cross-border financing arrangements, very broadly, where the arrangements are subject to different tax treatments in the relevant jurisdiction which results in a tax benefit.

Otherwise, the location of an unconnected lender should not concern the borrower.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Generally, yes. The English courts will generally apply a foreign law as the governing law of a contract if it is expressly chosen by the parties, subject to the following: (i) where all elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of law will not prejudice the application of non-derogable laws of that other country; (ii) where all elements relevant to the situation at the time of the choice are located in the UK and/or any of the EU Member States, the choice of a non-EU Member State law will not prejudice the application of non-derogable provisions of retained EU law (as defined in the European Union (Withdrawal) Act 2018); (iii) the chosen law will not restrict the application of overriding mandatory provisions of English law; (iv) effect may be given to overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, insofar as those overriding mandatory provisions render the performance of the contract unlawful; (v) the English courts may refuse to apply a provision of the chosen law if such application is manifestly incompatible with English public policy; (vi) in relation to the manner of performance and the steps to be taken in the event of defective performance, regard will be given to the law of the country in which performance takes place; and (vii) the chosen law may not be applied to determine certain questions in relation to the existence and validity of a contract.

The situation may differ for (a) consumer contracts, and (b) certain specialist situations where the above rules are inapplicable (such as where a contract contravenes exchange controls of an IMF member state), but generally these are not of concern to lending transactions. Given that the circumstances in which the English courts might apply a different law are narrow, the basic position is that the English court will generally respect the chosen law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Generally, yes. A foreign judgment (for these purposes, a judgment given in the New York courts) would generally be treated as constituting a cause of action against the judgment debtor and could be sued upon summarily in the English courts. The English courts should enter judgment in such proceedings, without re-examination of the merits of the original judgment, provided that: (i) the New York court was of competent jurisdiction and the foreign judgment is final and conclusive; (ii) the foreign judgment is not for multiple damages or on a claim for contribution in respect of multiple damages; (iii) the foreign judgment is for a fixed sum of money and not payable in respect of a tax, fine or penalty; (iv) the foreign judgment was not given in proceedings brought in breach of a dispute resolution agreement (unless the proceedings were brought with the agreement of judgment debtor or the judgment debtor counterclaimed in the proceedings or otherwise submitted to the jurisdiction); (v) the foreign judgment was not obtained by fraud, or in proceedings contrary (a) to natural justice, (b) to the Human Rights Act 1998, (c) to the principles of the European Convention on Human Rights, or (d) to English public policy; (vi) enforcement proceedings are instituted within six years after the date of the judgment; (vii) the foreign judgment is not inconsistent with an earlier judgment in proceedings between the same parties or their privies; and (viii) the foreign judgment is not contrary to the Protection of Trading Interests Act 1980 or any powers exercised under the 1980 Act.

There is doubt as to the enforceability in England and Wales of U.S. judgments in respect of civil judgments predicated purely on U.S. securities laws.

Different considerations may apply if the judgment debtor is a state or sovereign entity.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The answer is context-specific and dependent upon the court diary.

If the enforcement of an English law-governed contract in England is uncontested and there is no dispute as to jurisdiction, a judgment in default could be obtained in one to two months. If the company files a defence but the foreign lender is able to obtain summary judgment, this could take two to three months. If the matter is heavily contested and there is a material dispute about the facts, then it could take much longer. If the governing law of the contract is not English law, then the proceedings may take longer since the court will need to hear expert evidence on that foreign governing law. In terms of enforcing a judgment,

once given, against assets, the time taken will depend upon which assets and what method of enforcement is chosen.

For enforcement of a foreign judgment against assets, once an English judgment as described in the answer to question 7.2 has been obtained, the timing would be no different.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Generally no, but regulatory consents may be required if the company is a regulated entity or the assets are regulated.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No, foreign lenders are essentially treated the same as domestic lenders. It may, however, be more likely that a court would make an order for security for costs against foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

In liquidation, the aim is to realise the unsecured assets of the company for the benefit of creditors as a whole (save for secured creditors, who have recourse to the secured assets). Security rights against the company remain enforceable. In a compulsory liquidation, there is a limited moratorium meaning that no action or proceedings can be commenced or proceeded with against the company or its property without court permission. In the case of a creditors' voluntary liquidation, the liquidator may apply for a stay of such proceedings to ensure equal distribution of the assets.

In administration, an interim statutory moratorium on creditor action comes into effect on the presentation of an administration application in court or the filing with the court of a notice of intention to appoint an administrator. This prevents, among other things, the enforcement of security and the commencement of legal proceedings without the permission of the court and a permanent moratorium will come into effect upon the appointment of an administrator (the interim moratorium falling away if the appointment is not made) which cannot be lifted without with consent of the court or the administrator.

A company (an English company or an overseas company with "sufficient connection" to the UK) can also apply for a standalone moratorium to prevent creditors taking certain action against the company for a specified period, during which time the company can explore options for its rescue or restructuring. This standalone moratorium substantially mirrors the moratorium available in an administration of a company, except in relation to the crystallisation of floating charges (unlike an administration moratorium, entry into the standalone moratorium prevents the crystallisation of a floating charge or any imposition of a restriction on disposal of a floating charge asset). The court may give creditors permission to enforce over security and commence legal proceedings except in relation to pre-moratorium debts for which the company has a payment holiday. The standalone moratorium will be for an initial period of 20 business days (beginning with the business day after it comes into force) with the possibility of extension by a further 20 business days by filing certain documents with the court (at any time after the 15th business day of the initial period). This one-time extension can be done by the directors without the consent of the creditors. In addition to the one-time extension route, there are a number of other possibilities for extension. The moratorium can only be extended if, at each extension, the directors confirm that the company has made all the payments it was supposed to make during the moratorium and the monitor confirms that the moratorium is likely to result in the rescue of the company as a going concern.

Subject to certain conditions, the enforcement of financial collateral security (which is, broadly, security over cash, shares, tradeable bonds and certain loans that meet other specified criteria) is exempt from the security enforcement moratorium.

Restructuring plans and/or schemes of arrangement do not impose a moratorium on creditor action but may cram down dissenting secured creditors who will be bound by the restructuring plan and/or scheme if approved by the requisite statutory majorities.

Special insolvency measures apply to credit institutions and investment firms under the Banking Act 2009, pursuant to which the resolution authorities have wide powers to impose a variety of stays.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The award of an English-seated arbitration tribunal may be enforced, with the permission of the English court, in the same manner as a judgment or order of the court to the same effect without any re-examination of the merits. This is subject to the fact that a party may be able to challenge the award if the tribunal lacked substantive jurisdiction, or on grounds of a serious procedural irregularity, or may be able to bring an appeal on a question of English law (the latter may be excluded by the parties in their agreement to arbitrate).

The grounds for refusing to recognise or enforce an award of a tribunal seated in a foreign jurisdiction that has ratified the New York Convention are limited. They are: (a) that a party to the arbitration agreement was (under the law applicable to it) under some incapacity; (b) that the arbitration agreement was not valid under the law to which the parties subjected it or, failing any indication thereon, under the law of the country where the award was made; (c) that the party was not given proper notice of the appointment of the arbitrator or the arbitration proceedings or was otherwise unable to present its case; (d) that the award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration or contains decisions on matters beyond the scope of the submission to arbitration; (e) that the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties or, failing such agreement, with the law of the country in which the arbitration took place; and (f) that the award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, it was made. Recognition or enforcement may also be refused if the award is in respect of a matter that is not capable of settlement by arbitration or if it would be contrary to public policy to recognise or enforce the award.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Entry into an administration will restrict a creditor's ability to enforce its security rights including, for example, by appointing a receiver (see question 7.6 above).

However, an administrator cannot be appointed if, during the interim moratorium, a secured creditor appoints an administrative receiver before the appointment of the administrator becomes effective. In this circumstance, the interim moratorium on enforcement of security would terminate and the permanent moratorium would not come into effect. This "trumping" of appointments only applies where the receiver appointed is an "administrative" receiver. Where a "non-administrative" receiver is appointed, an administrator can still be appointed and the administrator can require the receiver to vacate office even though the receivership enforcement process has commenced, although there are certain protections for secured creditors.

The ability to appoint an administrative receiver is only available in limited circumstances. For this reason, a secured creditor who is a "qualifying floating charge holder" (a holder of security, including a floating charge over the whole or substantially the whole of the company's assets) may instead appoint an administrator out of court as a means of enforcing its security. Unlike a receiver, an administrator is required to act in the interests of all creditors.

Entry into a standalone moratorium will also restrict a creditor's ability to enforce its security rights (see question 7.6 above) including, for example, by appointing a receiver or an administrator (an administrator may still be appointed by the directors of the company). In practice, this restriction is unlikely to materially affect the position of secured creditors under financing arrangements. This is because, typically, the company's entry into a standalone moratorium will constitute an event of default in the underlying loan agreement and thereby allow the lender to accelerate the debt. If the company is unable to pay the accelerated debt, the monitor will have to end the moratorium (unless the lender agrees to an extension) and the lender can enforce over its security once the moratorium has ended.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Yes. Liquidators and administrators are granted wide anti-avoidance powers to challenge certain types of transactions entered into by a company before insolvency. Clawback could be available in relation to certain transactions, such as transactions at an undervalue, preferences or wholly or partially invalid floating charges.

Certain conditions must be met for clawback to be available, including:

- the company must be either in liquidation or administration;
- the company must have been unable to pay its debts when the transaction was entered into or as a result of entering into the transaction;
- an unfair advantage was gained by the party contracting with the company, or there is an absence of adequate consideration flowing to the company, as a result of the transaction; and
- the transaction was entered into during the relevant look-back period, which generally ranges from six months to two years depending on the nature of the transaction.

Certain claims are treated as preferential and hence the order of priority in which a company's assets will be distributed is broadly: (i) fixed-charge holders' claims out of the fixed charge assets (if the assets are insufficient to meet these claims then the secured creditor will have a claim as an unsecured creditor for the surplus); (ii) insolvency expenses; (iii) preferential claims (primarily employee and certain pension contribution claims, Financial Services Compensation Scheme claims (where relevant), and payments to HMRC for taxes that a company collects on HMRC's behalf including VAT, PAYE and employee national insurance contributions); (iv) prescribed part fund (paid *pro rata* to unsecured claimants out of floating charge assets ahead of floating charge creditors – currently subject to a cap of £800,000 per company); (v) floating charge claims; (vi) unsecured claims (customers, contractors, suppliers and secured creditors whose security is insufficient; in the context of financial institutions, unsecured claims are divided into ordinary non-preferential debts, secondary non-preferential debts and tertiary non-preferential debt); and (vii) shareholders (if there are any remaining assets).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The starting position is that the corporate insolvency regimes under the Insolvency Act 1986 apply to companies registered in the United Kingdom (schemes of arrangement and compulsory liquidation proceedings can also apply to companies with a "sufficient connection" to the UK).

Modified versions of the Insolvency Act regimes also apply to certain types of debtors/businesses, such as partnerships, which are dealt with by the Insolvent Partnerships Order 1994.

Entities excluded from applying for the standalone moratorium include banks and parties to a capital market arrangement involving debt of at least £10 million.

Special or modified insolvency regimes apply to certain regulated entities such as certain credit institutions, insurance companies, utility companies and investment firms.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The five main (out-of-court) remedies generally available to a creditor to enforce its security are:

1. going into possession;
2. exercising the power of sale;
3. appointment of a receiver;
4. appointment of an administrator; and
5. appropriation of financial collateral.

Foreclosure is also an enforcement process but requires a court order. Appropriation of an asset does not require a court order but can only be used to enforce financial collateral and is subject to certain conditions.

The preferred method for enforcing security is usually the appointment of a receiver or administrator (in circumstances where any receiver would be an administrative receiver and such an appointment would be prohibited).

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The English courts will usually decline jurisdiction if the parties have agreed that a foreign court is to have exclusive jurisdiction. However, the English courts may assume jurisdiction in special cases, for example: (i) if they have jurisdiction under any international convention or as provided for under the Civil Jurisdiction and Judgments Act 1982; (ii) if the defendant has taken steps in the proceedings in the English courts (or otherwise waived its right to rely on the jurisdiction clause); or (iii) if the court considers that it is the appropriate forum to hear the dispute. This principle is rarely applied where exclusive jurisdiction has been conferred on a foreign court.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

The English courts will normally give effect to a clause in an agreement that provides for (i) the submission by a foreign state to what the courts describe as their "adjudicative jurisdiction" (i.e. the courts' power to adjudicate upon claims against foreign states, which includes recognising a foreign judgment or arbitral award), and (ii) the consent in writing of a foreign state to: (a) relief against the foreign state by way of injunction or order for specific performance or for the recovery of land or other property; and (b) the property of the foreign state being subject to any process for the enforcement of a judgment or arbitration award or, in an action *in rem*, for its arrest, detention or sale, provided, in the case of both (i) and (ii) that the agreement is sufficiently clear and the agreement is within the scope of and is permitted by the State Immunity Act 1978.

Central banks are afforded greater protection than foreign states under the 1978 Act. Different considerations apply to the immunity of international organisations, as well as to diplomatic or consular immunity.

The common law has a concept of "non-justiciability" or "act of state doctrine", which means that certain matters are not capable of being adjudicated by the English courts.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are generally no eligibility requirements, although certain types of lending are regulated in England (e.g. consumer credit).

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

The prevalence of virtual and remote working in 2020 has led to a significant shift towards, where suitable, executing documents by way of electronic signature. Whilst e-signing was in any case becoming increasingly popular due to its flexibility and efficiency, COVID-19 affirmed its use as the norm in transactions. Documents governed by English law can generally be validly executed by way of e-signature, which can include (among others) using a cloud-based platform (such as DocuSign) to insert an e-signature, typing a name into the signature block or using an electronic stylus on a tablet or mobile.

Prior to the pandemic, certain public registries generally required documents to be filed in "wet-ink" for the purposes of registration. In response to the pandemic, some registries have announced that they will, until further notice, accept certain documents that have been executed by way of e-signature. In terms of commonly encountered registries on secured financing transactions:

- Companies House introduced an emergency filing service to allow for submission of certain forms that had not previously been accepted electronically; and
- HMRC generally required wet-ink versions of stock transfer forms where stamp duty was payable to be submitted, but now insist that these instruments are not submitted by post and are instead provided by email (and that they will accept e-signatures whilst COVID-19 restrictions are in place).

It should be noted that not all documents are, by default, suitable for e-signing and particular consideration should be given:

- if the agreement is required to be registered, whether the relevant registry accepts e-signing;
- if the agreement is required to be notarised and/or apostilled for use abroad, whether e-signatures are compatible;
- whether execution of the document requires a witness and, if so, whether that is practicable with the proposed e-signing solution; and
- whether any parties are subject to corporate restrictions on their ability to e-sign or subject to restrictive internal information security policies regarding the use of cloud-based e-signing platforms.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

English law-governed banking documents that are being entered into by an entity which is in-scope for the purpose of Article 55 of the European Union's Bank Recovery and Resolution Directive (2014/59/EU) will need to include a bail-in recognition provision under that regime. This requires a wide range of non-EU law-governed contracts entered into by certain EU financial institutions, investment firms and their related entities to include wording by which the counterparty recognises that the in-scope entity's liabilities may be subject to bail-in by relevant EU authorities (broadly, the counterparty's claims may be written down or converted to equity).

Potentially, there may be a positive obligation on EEA firms to remediate all English law-governed banking documents entered into from 1 January 2016 – this will be a matter for local law and/or regulation. From 1 January 2021, English lawyers cannot advise on this requirement because it is EU law.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

2020 was a year marked by the implementation of governmental schemes aimed at supporting the economy in facing the COVID-19 crisis, including a State-guaranteed loans scheme, measures taken by the European Central Bank to facilitate the refinancing of financial institutions, and the relaxation of certain regulatory constraints. As many countries have supported (and are still supporting) the economy by implementing various measures, the lending market remained active in 2020.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Large corporates took advantage of the State-guaranteed loans scheme made available in 2020 and sought to benefit from such loans. Leveraged buyout financing transactions have been numerous in recent years, from small-cap to large-cap transactions. More and more alternative lenders are also investing in the French market.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Subject to certain limitations and conditions related to corporate interest and to the prohibition of financial assistance, a company may guarantee borrowings of other members of its group – please see the answers under section 2 (*Guarantees*) and section 4 (*Financial Assistance*) below for details.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

It is a principle of French law that guarantees and security interests granted by a French company must comply with its corporate purpose and must be granted in its corporate interest. It is the responsibility of the French company's management to make a business judgment that, under the circumstances of the relevant transaction, the guarantee or security interest is within the interest of the company. If no benefit (or if only too small a benefit) to the guaranteeing/securing company can be shown, the guarantee/security may be considered as not being in the corporate interest of the company. In such a case, the managers/directors of the company may face criminal liability for misuse of corporate assets (*abus de biens sociaux* in the case of *sociétés anonymes*, *sociétés par actions simplifiées*, *sociétés à responsabilité limitée* and *sociétés en commandite par actions*) and civil liability for mismanagement. In addition, some courts have declared void guarantees/security interests that were contrary to a company's corporate interest on the grounds that such guarantees/security interests would jeopardise its existence.

In the context of group companies, the corporate benefit can be considered in the context of the group and, according to case law as interpreted by most French practitioners, guaranteeing/securing a group member may be considered as complying with the company's corporate interest if the following conditions are satisfied: (a) the companies involved in the transaction belong to the same group and share a common genuine group strategy; (b) the granting of the security/guarantee is designed to satisfy a common economic, social or financial interest to all the members of the group; and (c) there is some consideration (not necessarily monetary) involved for the company granting the guarantee/security and the transaction does not exceed the financial capacity of the grantor. Those conditions must be satisfied whether the guarantee/security is granted to secure a subsidiary, a sister company (cross-guarantee) or a parent company (upstream guarantee). It is, however, generally considered that it is in a holding company's corporate interest to guarantee/secure the obligations of its subsidiary.

2.3 Is lack of corporate power an issue?

Provided that the guarantee/security interest is not prohibited by law and that it falls into the corporate purpose (*objet social*) of the company (and save for the cases where the prior authorisation of the shareholders or of the board of directors or supervisory board is required – please see question 2.4 below), the legal representative of a company is deemed to have the authority to grant guarantees and security interests on behalf of the company. If a guarantee agreement has been entered into by a person who is not the legal representative of the company (or who does not act under a valid power of attorney conferred by the legal representative granting such person authority to enter into the guarantee agreement), such guarantee agreement may not be enforceable as against the company unless the party to the guarantee agreement legitimately believed in the reality of the powers of such person. In such circumstances, such contracting party may

claim that the guarantee agreement is void. The company may also ratify the guarantee agreement entered into by the signatory who did not have authority, in which case the company may no longer oppose the voidability or unenforceability of the guarantee agreement.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Except for companies that, in issuing guarantees, carry out banking transactions and which must therefore obtain a banking licence, no governmental consents or filings are required. Shareholder approval is not required by law (except for *sociétés civiles* offering securities to the public) but the by-laws of a company may provide that a shareholder approval (or other corporate approval) is required for the issue of a guarantee. In respect of *sociétés anonymes*, the issue of guarantees is subject to the authorisation of the board of directors or of the supervisory board.

If the guarantee is granted by an individual (who is not subject to restrictions on his/her legal capacity to act) or by a non-commercial company, the signature of the relevant signatory must be preceded by a handwritten statement specifying the maximum guaranteed amount and the duration of the guarantee, unless the guarantee agreement is entered into under the form of a notarial deed. If the guarantee is granted by an individual, the consent of his/her spouse may be required depending on the matrimonial regime of his/her marriage.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Guarantees must not be disproportionate to the secured financing. In respect of guarantees granted by individuals, such guarantees must be proportionate to such individual's income and assets.

Please also see the answer to question 2.2 above as to the limitations related to corporate interest.

Guarantees granted by an insolvent company may be held null and void by a French court – please see the answer to question 8.2 below.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There is currently no exchange control or similar obstacles to enforcement of a guarantee in France.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Collateral can be granted over tangible or intangible assets (such as shares, financial securities, cash, receivables, bank accounts, ongoing business, intellectual property rights, real property, machinery and equipment, inventory and other tangible assets). The nature of the collateral will often determine the type of security interests to be taken, such as: mortgage over real property; lender's lien over real property to secure the financing of the purchase price of such real property; pledge over movable assets; assignment of rights by way of security in certain circumstances; or trust (*fiducie*).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

As the nature of the underlying asset will often determine the type of security, a security agreement specific to such asset must be entered into (e.g., receivables pledge agreement, share pledge agreement). However, some security agreements specific to a particular type of asset may include several assets: a pledge over ongoing business (including all the elements comprising an ongoing business such as goodwill, lease rights and commercial name) may also extend to intellectual property rights and equipment and machinery. One single deed or act may include several types of security interest, but it will provide for a taking of security per the nature of the asset as if it was an aggregation of several security agreements (as is the case for notarial deeds providing for loans, which will often include in the same instrument the security attached to the relevant loan).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral security can be taken over real property under (a) a mortgage (*hypothèque*), (b) a lender's lien (*privilège de prêteur de deniers*) to secure the loan allocated to the payment of the purchase price of the real property, or (c) a pledge (*gage immobilier*). Security over real property may be created only under a notarial deed, which will be registered with the land registry.

Collateral security can be granted by a person acting in the course of his/her professional activities over machinery and equipment under a pledge, but only to the benefit of the vendor of such machinery and equipment or to the lender that has advanced the funds allocated to the purchase of such machinery and equipment. The pledge must be granted within two months of the delivery of the machinery and equipment, and must be registered with the relevant trade and companies registry of the Commercial Court within 15 days of the execution of the pledge agreement for validity purposes. When the pledge is to the benefit of a lender, it must be granted under the relevant loan agreement, which must expressly provide that the purpose of the loan is to finance the machinery and equipment.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Collateral security can be taken over receivables under (a) a pledge, (b) an assignment by way of security (*cession par voie de bordereau Dailly*), or (c) a trust (*fiducie*). The simple assumption of rights mechanism (*délégation simple*) may also achieve a result similar to that of security over receivables, in that it provides that a delegating obligor (*délégant*) obtains from a delegated party (*délégué*) that it agrees to be obliged towards the beneficiary who accepts to have an additional obligor.

A pledge over receivables may be granted under a private deed and must be notified to the pledged debtor for enforceability purposes. As from the receipt of the notification, the pledged debtor must make payment directly to the beneficiary of the pledge unless agreed to the contrary in the pledge agreement.

An assignment by way of security (*cession par voie de bordereau Dailly*) may only be granted by a borrower that is a legal entity or an individual acting in the course of its professional activity

(i.e., it cannot be granted by a guarantor nor any other security grantor) to the benefit of (i) a French licensed credit institution (*établissement de credit*), (ii) a French licensed financial company (*sociéte de financement*), (iii) a foreign financing institution "passported" to carry out banking activities in France under the 2013/36/EU Directive, and (iv) the following French alternative investment vehicles: professional specialised investment funds (*fonds professionnels spécialisés* – FPS); professional private equity investment funds (*fonds professionnels de capital investissement* – FPCI); French limited partnerships (*sociétés de libre partenariat* – SLP); securitisation vehicles (*organismes de titrisation* – OT); and specialised financing vehicles (*organismes de financement spécialisés* – OFS) and only to secure funds advanced by such vehicles. The assignment by way of security is effected under a deed (*bordereau*) that must contain specific mandatory provisions for validity purposes, and which must be delivered to the assignee. The assignment takes effect from the date affixed on the deed by the assignee. The assignee may notify the assignment to the assigned debtor, upon which the assigned debtor must make payment directly to the assignee.

A trust (*fiducie*) over receivables may also be granted as security under a trust agreement, which must contain certain mandatory provisions and must be registered within one month of its signing date for validity purposes. The trust (*fiducie*) must be notified to the assigned debtor for enforceability purposes.

A simple assumption of rights mechanism (*délégation simple*) will most often be used in relation to vendors' warranties and insurance indemnities. A delegation agreement will have to be entered into by the delegating obligor (*délégant*), the beneficiary (*délégataire*) and the delegated obligor (*délégué*). No notification to the delegated obligor is required as it is a party to the delegation agreement.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Collateral security can be taken over the balance of a bank account under a pledge. The bank account holder must be notified of the pledge for enforceability purposes.

Security can also be created over cash under a transfer of ownership of such cash to the benefit of the secured creditor who may dispose of such cash, provided that such cash be returned to the grantor upon discharge of the secured obligations.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Shares issued by a company incorporated in France are either under the form of securities registered in a shareholder's account (*compte d'actionnaire*) if issued by a joint stock company (*société anonyme*, *société par actions simplifiée*, *société européenne*) or under the form of shares (*parts sociales*) if issued by other types of companies such as a *société civile*, *société à responsabilité limitée* or *société en nom collectif*. In both cases, shares are not in certificated but dematerialised form.

Collateral security is taken over securities under a securities account pledge, which encompasses the cash proceeds attached to such securities. However, if the securities account pledge is opened in the books of the issuer that is not a person authorised to receive funds from the public, the cash proceeds are credited to a special bank account that is deemed to be part of the pledged account. The security extends to any additional securities and additional cash proceeds that are credited to the pledged accounts. The pledge is created under a pledge statement (*déclaration de nantissement*) signed by the pledgor and which must contain certain mandatory provisions for validity purposes. The pledge is registered in the share transfer registry (*registre de mouvement de titres*) and in the pledged securities account. The securities account holder and the special bank account holder are customarily required to sign and deliver to the secured creditor certificates acknowledging the existence of the pledge and certifying the number of pledged securities and the amount standing to the credit of the pledged special bank account, respectively.

Collateral security is taken over shares under a share pledge, which only applies to the initial shares and therefore does not extend automatically to additional shares nor to the attached cash proceeds as opposed to a securities account pledge. The pledge is created under a pledge agreement, which is required to be registered with the registry of the relevant Commercial Court. Other perfection formalities are required depending on the type of company whose shares are pledged.

Considering (a) the existence of mandatory provisions in respect of a pledge statement, and (b) the perfection formalities in respect of share pledges, there is no certainty that a New York or English law-governed pledge over shares issued by a French company would be recognised as valid and enforceable in France.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security can be taken over inventory under two alternative procedures at the parties' option, both of which may be enforced by contractual enforcement (*pacte commissoire*) if so provided under the pledge agreement.

The original procedure provides for a pledge governed by the provisions of the Commercial Code, which can be granted by a borrower only (and not by a guarantor or a security grantor) to the benefit of a licensed credit institution or financing company (or "passported" to carry out banking activities in France in accordance with the 2013/36/EU Directive) that has loaned funds for the exercise of the borrower's professional activity. The pledge agreement must contain mandatory provisions for validity purposes. The pledge is enforceable as against third parties by the dispossession of inventory or by its registration with the registry of the relevant Commercial Court.

The second procedure provides for a pledge governed by the provisions of the Civil Code, which is not subject to the restrictions applicable in respect of the capacity of the grantor and the secured creditor under the pledge governed by the Commercial Code. The pledge over inventory governed by the Civil Code must be registered with the registry of the relevant Commercial Court for enforceability purposes as against third parties.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Subject to the corporate purpose, corporate benefit and financial assistance limitations, a company may grant a security interest in order to secure its obligations as a borrower under a credit facility or as a guarantor of the obligations of other borrowers and/or guarantors under a credit facility. There are, however, additional limitations in respect of specific security interests, which relate to the capacity of the company (i.e. the company may grant security only to secure its own obligations as a borrower) and

to the nature of the secured liabilities: (a) a lender's lien over a real property (*privilège de prêteur de deniers*) may only be granted by a borrower as security for the repayment of the loan allocated to the financing of the purchase price of the real property (see the answer to question 3.3); (b) a receivables assignment by way of security (*cession Dailly*) may only be granted by a borrower as security for the repayment of a facility granted by certain categories of lenders (see the answer to question 3.4); (c) a pledge over inventory governed by the provisions of the Commercial Code may only be granted by a borrower as security for the repayment of a loan granted by a licensed credit institution or financing company (see the answer to question 3.7); and (d) a pledge over machinery and equipment can only be granted by a borrower as security for the repayment of a loan allocated to the financing of such machinery and equipment (see the answer to question 3.3).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Security over real property must be granted under a notarial deed, and triggers costs and fees based on the secured amount. Therefore, security over real property may be costly. In respect of a mortgage, the notarial costs and fees include (a) a land registry fee (*taxe de publicité foncière*) of 0.715%, (b) a land registrar's fee (*contribution de sécurité immobilière*) of 0.05%, (c) notary fees of 0.439% (for secured amounts exceeding EUR 60,000, it being noted that discounts may be obtained under certain conditions), and (d) a fixed registration fee of EUR 125. In respect of a lender's lien, the amount of costs and fees will be lower as the land registry fee (*taxe de publicité foncière*) is not applicable. The aforementioned rates are those applicable as of 1 January 2021.

Security over non-real estate assets may be entered into under private deed and are not required to be notarised. However, where some security interests are required to be registered either for validity purposes or for enforceability purposes, they trigger (a) when required to be registered with the tax authorities, a fixed fee of EUR 125 (per security agreement to be registered), and (b) when required to be registered with the registry of the Commercial Court, a fixed fee (per pledge to be registered) whose amount depends on the type of pledged asset, the secured amount and the relevant registry. As an example, the registration of a pledge over shares in a civil company (*société civile*) with the registry of the Paris Commercial Court amounts to *circa* EUR 140 (in respect of a secured amount over EUR 41,600). When a pledge is notified by a process server (such as in the case of a pledge over shares in a civil company (*société civile*) granted under private deed), it triggers a fixed fee whose amount depends on the type of pledge (*circa* EUR 23 with respect to the notification of a share pledge to the civil company (*société civile*) whose shares are pledged). In respect of intellectual property rights registered with the INPI (*Institut National de la Propriété Intellectuelle*), the registration of pledges over such rights with the INPI triggers a fee of EUR 27 per intellectual property right for one to 10 rights (for more than 10 rights, the fee is forfeited and equal to EUR 270) under the ordinary procedure. If a request is made for an accelerated procedure for the registration of the pledges, an additional EUR 52 fee per intellectual property right is due, with no maximum limit.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Filing, notification or registration requirements in relation to security do not involve a significant amount of time or expense, except, however, in respect of (a) security over real estate assets whose cost may be significant (see the answer to question 3.9) and whose registration on the land registry depend upon the relevant land registry office, and (b) security over intellectual property rights, which may take two to four months under the ordinary procedure and which may be costly depending on the number of intellectual property rights to be pledged.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory consent is required with respect to the creation of security except for the prior consultation of the works council of a company (if a works council exists in such company) when the granting of the relevant security involves any question on the organisation, management or general conduct of the company, in particular regarding any modifications of its economic or legal organisation. Although the opinion of the works council is not binding, its prior consultation is mandatory and may take 15 days to several months.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no special priority or other concerns.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Security over real estate assets is taken under a notarial deed (see the answer to question 3.9 above). If a foreign entity is a party to the notarial deed, the notary may require the provision of a legal opinion as to the capacity of such foreign entity.

In respect of a guarantee granted by an individual under private deed, the signature of the relevant signatory must be preceded by a handwritten statement specifying the maximum guaranteed amount and the duration of the guarantee (see the answer to question 2.4 above).

In respect of a receivables assignment by way of security (*cession Dailly*), the assignment is effected by the actual delivery of an original of the assignment deed (*bordereau Dailly*) to the assignee. In respect of a pledge over securities, the pledge is created by the execution of the pledge statement (*déclaration de nantissement*) and not by the mere execution of the share pledge agreement.

Under French law, agreements may not be executed by counterparts.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Stock companies incorporated under the form of a *société anonyme* (stock company), a *société par actions simplifiée* (simplified stock company) or a *société européenne* (European company) may not grant any loan, guarantee or security

interest with a view to the acquisition or subscription by a third party of its own shares. The infringement of this prohibition constitutes a criminal offence that may lead to a fine of EUR 150,000 imposed on the chairman, directors or chief executive officer of the company. The loan, guarantee or security granted in violation of such prohibition is null and void.

(b) Shares of any company which directly or indirectly owns shares in the company
The prohibition of financial assistance would apply similarly.

(c) Shares in a sister subsidiary
There would not be any prohibition on the grounds of financial assistance, but the granting of a guarantee or security would remain subject to the corporate benefit principle described above.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The agent role in French credit documentation is most frequently based on a power of attorney granted by lenders. However, a special security agent regime was introduced in the Civil Code in 2007 and amended in 2017. Under such special regime, any security or guarantee may be taken, managed, filed and enforced by the security agent acting in its own name on behalf of the creditors of the secured obligations, and such security agent may also file any claim in any bankruptcy proceeding.

Although France has signed the 1 July 1985 Hague Convention on the Law Applicable to Trusts and on their Recognition, it has not ratified such convention. However, since 2011, French courts have recognised (a) the capacity of a foreign law trustee to file a claim in a French bankruptcy proceeding (the rationale being that it is for the relevant law giving rise to the secured obligations to determine the capacity as creditor of the trustee), and (b) the absence of violation of French international public policy of the parallel debt mechanism, subject, however, to the absence of any risk of double payment for the debtor. However, there is no further case law on the enforcement of loan documentation and collateral security by a trustee.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

See the answer to question 5.1 above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

A loan transfer may be effected by way of (a) assignment of rights (*cession de créances*), (b) novation, (c) transfer of agreement (*cession de contrat*), or (d) transfer of debt (*cession de dette*), in each case in writing.

The consent of the borrower to the loan transfer is required if such loan transfer is made under a transfer of agreement (*cession de contrat*), transfer of debt (*cession de dette*) or novation. The express consent of the borrower is also required to discharge Lender A from its obligations under the loan agreement in respect of any loan transfer made by way of a transfer of agreement (*cession de contrat*) or transfer of debt (*cession de dette*). If the loan to be transferred by way of transfer of agreement (*cession de contrat*), transfer of debt (*cession de dette*) or novation is secured by a guarantee or any security interests, the consent of the guarantor and of the third-party security provider is required in order for Lender B to benefit from such guarantee and security interests. Those consents from the borrower or from the guarantor or third-party security provider may be granted in advance in the loan agreement or in the relevant guarantee or security agreement.

Although the consent of the borrower is not required for a loan transfer by way of assignment of rights (*cession de créances*), such assignment must be notified to the assigned borrower. Since a 2016 reform, such notification is no longer required to be carried out by a process server (*signification par huissier*) and a simple notification will be sufficient. The notification of the borrower is also required if the loan transfer is made under a transfer of agreement (*cession de contrat*) or a transfer of debt (*cession de dette*), or the borrower must be a party to the contract providing for the transfer of agreement (*cession de contrat*) or the transfer of debt (*cession de dette*).

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) Interest payable on loans made to domestic or foreign lenders

Domestic lenders – Interest payments made to French tax resident companies are not subject to any withholding tax. Interest payments made to French tax resident individuals are subject to personal income tax under a flat tax at a rate of 12.8%, unless such individuals have opted for the progressive tax schedule for all their investment income. The paying party will withhold a compulsory tax advance at a rate of 12.8%, which will be set off with the final income tax charge due from the individual lender (12.8% flat tax or progressive tax schedule). In addition to the income tax, social contributions are payable by the relevant individual at the rate of 17.2%.

Foreign lenders – Interest payments made to foreign companies do not give rise to any French withholding tax on the sole basis of the nationality of the companies.

Non-Cooperative State or Territory – Interest payments made to an account located in a Non-Cooperative State or Territory give rise to a 75% withholding tax notwithstanding the tax residency of the lender, unless the French debtor demonstrates that such payments correspond to actual economic transactions that do not have the purpose or effect of allowing their location in a Non-Cooperative State or Territory. If the lender is tax resident in a country that has entered into a double tax treaty with France, the provisions of that treaty (if available) may provide for the reduction of the rate of such withholding tax. The latest list of Non-Cooperative States or Territories (as of 6 January 2020) comprises the following jurisdictions: Anguilla; Bahamas; British Virgin Islands; Fiji; Guam; Oman; Panama; Samoa; Seychelles; Trinidad and Tobago; U.S. Samoa; U.S. Virgin Islands; and Vanuatu.

(b) Proceeds of a claim under a guarantee or the proceeds of enforcing security

Proceeds of a claim resulting from the enforcement of a guarantee or security are not subject to withholding tax in France (irrespective of the tax residence of the beneficiary). However:

- when the proceeds resulting from the enforcement of a security are allocated to the payment of interest accrued under a loan agreement, the rules indicated in the answer to question 6.1 (a) above are applicable;
- when the security provider is not a French tax resident, the security enforcement proceeds may be subject to capital gains withholding (to the extent any capital gain is realised upon the sale of the asset over which security is taken) at rates varying based on the nature of the relevant asset; when the security provider is tax resident in a country that has entered into a double tax treaty with France, the provisions of such treaty may provide for the avoidance (or the reduction of the cost) of the withholding; and
- when the proceeds received under a guarantee claim correspond to payment of interest accrued under a loan agreement, it cannot be excluded that such guarantee payments would be viewed (at least in part) as interest payments and, consequently, be subject to French interest withholding under the rules indicated in the answer to question 6.1 (a), and no firm position of the French tax authorities, nor relevant case law, has been established in this respect.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There is no more favourable or less favourable regime for foreign lenders to the extent that payments are not made to an account opened in a Non-Cooperative State or Territory. Applicable taxes are due regardless of the nationality of the lender (see the answer to question 3.9 regarding fees due in relation to registration with the tax authorities).

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No, it will not.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Translation costs may be incurred when security agreements drafted in the English language need to be translated into French prior to their filing with the registrar of the Commercial Court or when the foreign lender is a party to a notarial deed and represented by a signatory who does not understand French (the notary is required to ensure that the relevant signatory understands the provisions of the notarial deed, which is drafted in French). Applicable fees are due regardless of the nationality of the lender (see the answer to question 3.9 regarding fees due in relation to registration with the tax authorities and the answer to question 3.13 regarding costs relating to legal opinions to be provided to the notary).

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are no adverse consequences on the sole basis of lenders being foreign lenders. Thin capitalisation principles apply regardless of the nationality of the lenders.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

French law recognises the principle of free choice of law applicable to an international contract. The choice of foreign law to govern the international contract will be upheld by French courts to the extent that (a) the provisions of the relevant foreign law are not considered by French courts to be contrary to French public policy doctrine as applied in private international matters (*ordre public international français*) or French overriding mandatory provisions (*lois de police*) (i.e., provisions regarded as crucial by France for safeguarding its public interests to such an extent that they are applicable to any situation falling within their scope, irrespective of the applicable law), and (b) the choice is found not to be contrary to the mandatory provisions of the laws of any other jurisdiction having a close connection with the relevant transaction (in which case, the laws of such jurisdiction may be applied by French courts irrespective of the foreign law chosen by the parties to govern the contract).

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A final, binding and enforceable judgment for the award of a fixed and definite sum of money obtained after service of process in the required form rendered by a court of competent jurisdiction in England (in respect of an action initiated on or after 1 January 2021) or in the State of New York would be capable of recognition and enforcement in France without review of the substantive matters, through an action for exequatur before the competent French court (subject to appeal against the exequatur order itself, again without a review of the substantive matters adjudicated by the foreign judgment), provided that (a) such French court is provided with the original and a translation into French (by a sworn translator) of each document concerned and the foreign judgment, (b) there is no prior judgment rendered in France in a dispute over the same cause of action between the same parties, (c) its recognition or enforcement in France would not be inconsistent with a judgment rendered in France in a dispute between the same parties, and (d) the foreign judgment was issued by a court having jurisdiction over the matter, contains nothing contrary to French public international policy (whether substantive or procedural) and is not tainted with fraud.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would

it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Any enforcement against the assets of the company in France will be governed by substantive and procedural French law and will fall within the jurisdiction of French courts.

After sending the company a formal letter of notice that has remained without effect, the lender may summon the company under a summary proceeding known as *référé provision* before the president of the relevant Commercial Court so as to obtain an order (*ordonnance de référé*) enforceable by operation of law. Such order may be issued provided that the amounts due and payable are not challengeable on serious grounds. The average timeframe to obtain such enforceable order would be three months from the issue of the summons to the company. However, a stay of enforcement can be ordered by the *Premier Président de la Cour d'appel* if the defence raised by the company is deemed serious and if the provisional enforcement is likely to result in clearly excessive consequences. Enforceable orders (*ordonnances de référé*) may be appealed within 15 days (plus two additional months if the appellant's residence is located abroad). There may be a further challenge before the *Cour de cassation* (French Supreme Court) and in such case the decision of the *Cour de cassation* may take up to 18 months.

If the president of the relevant Commercial Court finds there are serious grounds for challenges and consequently declines jurisdiction in favour of the court having jurisdiction on the merits of the case, or if the lender files an action through normal proceedings, the judgment on the merits may be obtained within 12 to 18 months, it being specified that since 1 January 2020, provisional enforcement is automatic unless the judge considers that such provisional enforcement is not compatible with the nature of the case.

It is worth noting that since 2018, an international commercial chamber at the Paris Court of Appeal (*chambre commerciale internationale à la cour d'appel de Paris* or CCIP-CA) may examine cases brought before the Paris Commercial Court or the Paris Court of Appeal where such cases have an economic and commercial nature of international reach (including where foreign law provisions are likely to be applicable) or where the interests of international trade are at stake. Documents to be examined by the court may be submitted in the English language and debates may be translated simultaneously during the hearing. A judge may set a mandatory procedural timetable for the parties. The judgment will be drafted in the French language and will have a sworn English translation.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

French law-governed security interests may be enforced upon non-payment of the secured obligation but not upon the mere occurrence of any other event of default. Security may be enforced by way of judicial proceedings (judicial foreclosure or public auction) or, depending on the type of security, by way of contractual enforcement (*pacte commissoire*). Enforcement under judicial proceedings may take some time while contractual enforcement may be swift.

When the security enforcement leads to a transfer of shares or securities, rules requiring regulatory consents applicable in any shares or securities transfer will be applicable: consent from the *Autorité des Marchés Financiers* (French stock exchange regulator) in respect of public companies if the relevant thresholds are met; consent from the French or European competition authorities if the transfer triggers the relevant thresholds; and consent from the French Ministry of Economy and Finance if the transfer constitutes a foreign investment in certain types of sensitive activities.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No specific restrictions apply on the sole basis of lenders being foreigners in filing suit against a company in France or foreclosing on security, save for the restrictions that may be applicable if the foreclosure leads to a transaction considered as a foreign investment that is subject to the control of the French Ministry of Economy and Finance (see the answer to question 7.4 above). However, a foreign petitioner must elect domicile in France in respect of any writ of summons before the Commercial Court.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The opening of bankruptcy proceedings (safeguard proceedings (*sauvegarde*), accelerated safeguard proceedings (*sauvegarde accélérée*), accelerated financial safeguard proceedings (*sauvegarde financière accélérée*), judicial administration proceedings (*redressement judiciaire*) or liquidation proceedings (*liquidation judiciaire*)) leads to the moratorium of enforcement of claims and of security interests (except for *Dailly* assignment of receivables, cash collateral (*gage-espèces*) actually held by, and taken in favour of, the relevant creditor and *fiducie* provided that the use and enjoyment (*usage et jouissance*) of the asset transferred under the *fiducie* was not kept by the grantor). During a conciliation proceeding, a debtor may obtain from the judge against a creditor claiming its rights the rescheduling of debt for up to two years and the suspension of any pending enforcement measures, subject to the conclusion of a conciliation agreement.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

A final arbitral award of a commercial nature requiring the payment of a fixed and definite sum of money, arising from an arbitral proceeding initiated in the required form, would be enforced in France without review of the substantive matters by way of an exequatur order, provided that the French court is furnished with the original and a translation into French (by a sworn translator) of the arbitral award and determines that the arbitral award does not manifestly conflict with French public international policy. In accordance with article 1520 of the French Code of Civil Procedure, the arbitral award may be set aside on one or more of the following grounds: (a) the arbitral tribunal wrongly upheld or declined jurisdiction; (b) the arbitral tribunal was not properly constituted; (c) the arbitral tribunal

ruled without complying with the mandate conferred upon it; (d) due process was violated; or (e) recognition or enforcement of the award is contrary to international public policy.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Please see the answer to question 7.6 above.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

A security interest granted during the clawback period (*période suspecte*) may be declared null and void if (a) it has been granted to secure a previously incurred debt, or (b) it has been granted while the beneficiary of the security had knowledge of the insolvent state (*état de cessation des paiements*) of the grantor. A company is in an insolvent state if it is unable to pay its liabilities as they fall due with its immediately available assets. A court may set back the insolvency date of a company as far as 18 months prior to the opening judgment of the relevant bankruptcy proceeding.

Preferential creditor's rights are recognised for various categories of creditors: employees; the French tax administration; creditors providing new money in the framework of a conciliation proceeding that gave rise to a court-approved conciliation agreement; and creditors benefitting from a mortgage or from a retention right over a pledged asset.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Entities not registered with the register of the Commercial Court or with the trade register (*Répertoire de Métiers*) or that do not have any legal personality, and public law regulated entities (*personnes morales de droit public*), are excluded from bankruptcy proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Most types of security interests may be enforced outside of any court proceeding by way of contractual foreclosure (*pacte commissoire*). However, contractual foreclosure remains subject to any applicable moratorium (see the answer to question 7.6 above).

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Subject to the exclusive jurisdiction attributed to certain courts in relation to certain actions (e.g. disputes relating to real property or to pledges over ongoing business must be examined by the court having jurisdiction at the location of the real property or ongoing business), the submission to a foreign jurisdiction will be upheld in any proceeding before a French court provided that (a) the dispute is international, and (b) the submission to the foreign jurisdiction does not preclude the mandatory exclusive jurisdiction of a French court in relation to certain matters.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Since the entry into effect of the 9 December 2016 law relating to transparency, the fight against corruption and modernisation of economic activity (*Loi Sapin 2*), the French Code of Civil Enforcement Procedure provides that interim or enforcement measures against an asset of a foreign State may be authorised under an order (*ordonnance sur requête*) delivered by a judge only if one of the following conditions are satisfied:

- the relevant foreign State has expressly consented to such measure;
- the relevant foreign State has reserved or assigned such asset to the satisfaction of the request in respect of which the proceeding is initiated; or
- when a judgment or arbitral award has been issued against the relevant foreign State and the relevant asset is employed or allocated for the use of the foreign State other than for the purposes of non-commercial public service and there is a relationship with the foreign State entity against which the proceeding is initiated.

An interim or enforcement measure may be taken on assets used or intended to be used in the exercise of diplomatic missions of foreign States only if the relevant foreign State has granted an express and special waiver.

It should be noted that under case law developed immediately prior to the Loi Sapin 2, a waiver of sovereign immunity from execution had to be separately expressed and would be enforceable provided that it was (a) express (i.e. it is granted without ambiguity), and (b) special (i.e. it specifically identifies the assets (or categories of assets) in respect of which the waiver is granted).

The Loi Sapin 2 also provides that no interim or enforcement measure against an asset of a foreign State in respect of debt obligations, instruments or rights having the characteristics of a debt instrument may be authorised by a judge if:

- the foreign State was a beneficiary of aid from the development assistance committee of the OECD at the time it issued the debt document;
- the holder of the debt obligation acquired it at the time the relevant foreign State was in default under that debt obligation or had proposed an amendment of the terms of such debt obligation; and
- the default status under the debt obligation is less than 48 months (or 72 months if the holder of the debt obligation demonstrates grossly abusive behaviour) at the time the holder of the debt obligation seeks an order to obtain the authorisation to take an enforcement measure or an interim measure.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that

is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Credit transactions in France are subject to the banking monopoly rules. Therefore, a lender granting a loan to any person in France on a regular basis must be duly licensed as a credit institution (*établissement de crédit*) or as a financing company (*société de financement*) by the *Autorité de Contrôle Prudentiel et de Résolution* (ACPR), or be passported under the 2013/36/EU Directive. Violation of the banking monopoly rules may lead to criminal liability.

However, the banking monopoly has been relaxed recently and exceptions to such monopoly include, among others, the following:

- Alternative investment vehicles: professional specialised investment funds (*fond professionnels spécialisés* – FPS), professional private equity investment funds (*fonds professionnels de capital investissement* – FPCI), free limited partnerships (*société de libre partenariat* – SLP), securitisation vehicles (*organismes de titrisation* – OT) and specialised financing vehicles (*organismes de financement spécialisés* – OFS) may, under certain conditions, advance loans to a French borrower.
- Foreign entities: entities and institutions governed by the laws of a foreign jurisdiction whose purpose or activity is similar to those of French credit institutions, financing companies or securitisation vehicles, may acquire non-mature receivables arising under credit transactions entered into by credit institutions, financing companies or alternative investment vehicles, except for receivables against individuals acting for non-professional purposes.

Payment services constitute a regulated activity. Therefore, if an agent provides such services under a syndicated facility, then such agent is required to obtain a licence from the ACPR to carry out such payment services activity.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

Many transactions that closed in 2020 and 2021 used an electronic signature, which is authorised under the French Civil Code provided such electronic signature uses a reliable identification process that guarantees its link to the document to which it relates. Documents signed electronically must permit the identification of the signatory and must be established and kept under conditions that allow the maintenance of their integrity. Since electronic signatures are time-stamped, signatories must be more focused on signature timeline, especially in transactions where the sequence of the closing steps is important. The French market seems to have rapidly adopted the electronic signature, so it may soon become a well-established practice.

Since November 2020, notaries are allowed to establish an electronic power of attorney via videoconference, thus enabling a party who cannot attend the signing meeting of a notarial deed in person to grant a power of attorney to an authorised signatory.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

French borrowers must be informed, no later than upon the subscription of the loan, of the effective global rate (TEG) applicable to such loan, failing which the legal interest rate will be applicable. Interest accruing under French law documents may be compounded only if they have accrued for at least one year.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The negative interest on the deposit facility continued to have an adverse effect on the net interest income of financial institutions. At the same time, the general trend of financial institutions tightening their credit standards has continued. This development became even more visible due to the impact of COVID-19.

While certain industries such as online business, DIY and furniture benefitted from the COVID-19 crisis, most industries are suffering. This is not limited to general retail business, airlines or the tourism industry. The mechanical engineering industry and numerous others have had to fight against the impact of COVID-19, which has aggravated the uncertainties resulting from trade wars, sanctions, Brexit and global political instability.

These developments are mirrored in bank lending, which has faced higher demands for loans to enterprises in an unpredictable environment.

Following the outbreak of the pandemic, many borrowers faced difficulties in complying with financial covenants under existing loan agreements due to a decline in sales, while expenses continued to accrue. In general, lenders were prepared to grant reasonable waivers or even to accept standstill agreements in order to enable borrowers to continue their business on the basis of existing financing arrangements.

By the Act on the Temporary Suspension of the Obligation to file for Insolvency and Limitation of Directors' and Officers' Liability in the Event of Insolvency caused by the COVID-19 Pandemic (*COVID-19 Insolvency Suspension Act* – "**COVInsAG**") dated 27 March 2020, as amended, the granting of new loans to companies in a crisis has been subject to certain privileges in terms of insolvency law. Besides a limitation of liability for managing directors and of clawback risks, the law provides for a limitation of tort liability for lenders granting loans to companies in a crisis, which could otherwise be regarded as a contribution to a delayed filing for insolvency (which is a criminal offence under German law). The COVInsAG initially was set to suspend the obligation to file for insolvency only until 30 September 2020. In light of the ongoing effects of the COVID-19 pandemic and the associated uncertainties for companies in terms of their business forecasts, the German government approved two amendments partly extending the suspension of the obligation to file for insolvency until 31 January 2021.

In addition to the measures set out above, various forms of state aid were established within the (European) "Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak". For further details in this regard, please see our answer to question 11.2 below.

Despite the distortions caused by the COVID-19 pandemic, sustainable finance continues to play an increasingly important role in the German finance sector. As part of the Green Deal, the European Commission presented on 14 January 2020 the European Green Deal Investment Plan ("**EGDIP**"), which aims to mobilise at least EUR 1tn of sustainable investments over the next decade. It aims at establishing a framework to facilitate public and private investments needed for the transition to a climate-neutral, green, competitive and inclusive economy.

Furthermore, a greater degree of standardisation as regards the definition of green or sustainable finance is strongly supported by the German government, and hence has a long-term impact on finance, including without limitation on the availability of export credit agency ("**ECA**") cover.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

A significant acquisition finance transaction currently in the pipeline is the acquisition by Deutsche Börse AG of 80% of the shares in the US-company Institutional Shareholder Services ("**ISS**"). Deutsche Börse plans to finance the acquisition with around EUR 1bn of debt and the remainder with cash. The transaction is expected to close in the first half of 2021.

Another significant financing transaction was the financing of Traton SE's acquisition of US truck producer Navistar. The purchase price in the amount of EUR 3.7bn will be financed under a syndicated credit facility involving 21 banks as lenders under the lead of Bank of America, Crédit Agricole, CIB, Mizuho Bank and Skandinaviska Enskilda.

In the area of project finance, one outstanding transaction was the financing of the construction of a state-of-the-art ammonia plant in Topolobampo in northwest Mexico. A syndicate of

lenders led by KfW IPEX-Bank is contributing USD 860m in debt capital. The ammonia plant will have a capacity of 770,000 tonnes per year.

DZ BANK AG provided export finance facilities for a large number of wind parks in Turkey and other jurisdictions, which are covered by export guarantees issued by the German government, acting through its mandatary Euler Hermes.

Noteworthy is Bosch's placement of a *Schuldscheindarlehen* in the amount of EUR 2bn, including tranches with fixed as well as floating interest rates. This transaction is one of the three largest *Schuldschein* placements in the history of the German *Schuldschein* market and the largest *Schuldschein* placement in the history of Bosch.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

It is common in credit agreements under German law that a company guarantees borrowing of other members of its corporate group. Downstream guarantees, in general, do not cause specific problems. In case of upstream and cross-stream guarantees granted by a limited liability company ("**GmbH**") or a stock corporation ("**AG**") or *societas europaea* ("**SE**"), capital maintenance rules applicable to the respective guarantor must be observed. The same applies for corporate structures where corporations of the relevant types ultimately assume the liability for the relevant guarantee, e.g. in case of a German law GmbH & Co KG (a limited partnership where a limited liability company is the general partner).

These rules do not only apply to guarantees, but also to other forms of security, including sureties (*Bürgschaften*).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

With regard to enforceability of guarantees and other forms of security, including sureties (*Bürgschaften*), certain restrictions have to be observed in order to avoid possible personal liability of the managers of the respective company which has granted security. Details depend on the legal form of the relevant company.

GmbHs: It used to be standard market practice in Germany to include enforcement limitation language in the documentation for upstream and cross-stream guarantees that limits any enforcement action by a secured borrower into the assets of the limited liability company. Such limitation language is included in the relevant guarantee documentation to protect the managing directors of the company against personal liability which could otherwise be triggered in case an enforcement action would result in the share capital of the company falling below the statutory minimum share capital.

For a long time, there was a dispute in German legal literature over which point in time should be relevant for assessing whether or not a shortfall of the statutory minimum share capital would occur: the point in time when the guarantee is granted or the point in time when it comes to realisation of the guarantee by way of enforcement. According to recent court decisions of the German Federal Supreme Court (*Bundesgerichtshof* – "**BGH**"), no liability of the managing director shall be triggered if the manager, after due and diligent assessment of the financial situation of the company, comes to the conclusion that, at the point in time of granting collateral, it can be assumed that the principal debtor will be in a position to repay its borrowing so that the collateral will not have to be realised and no shortfall of the statutory minimum share capital will occur. Although the relevant court decisions do not directly relate to guarantees, this has triggered discussions in the German market regarding the justification and future role of limitation language, and possible adjustments of the existing practice to these new court decisions. It is therefore recommended to seek legal advice to properly address the resulting changes to the legal framework.

GmbH & Co. KG: The explanations above are also true for the general partner of a limited partnership which would ultimately assume the liability for any security granted by the limited partnership.

AG: The capital maintenance rules to be observed in case of an AG are even stricter. In principle, any payments and the granting of any advantages by the company to its shareholders are prohibited (except for the distribution of dividends on the basis of a resolution of the general meeting of the shareholders). There are only limited exceptions to this rule, e.g. in case of an existing control and profit transfer agreement or in case the company granting the security has a valid compensation claim against its shareholders.

***Societas Europaea* (SE)**: Pursuant to Art. 5 of Council Regulation (EC) no. 2157/2001 of 8 October 2001 on the Statute for a European company (SE), the capital of an SE, its maintenance and changes thereto, together with its shares, bonds and other similar securities shall be governed by the provisions which would apply to a public limited liability company with a registered office in the Member State in which the SE is registered. Hence, the rules for German stock corporations apply accordingly to SEs registered in Germany.

2.3 Is lack of corporate power an issue?

Lack of corporate power is generally not an issue. German law does not recognise the concept of "*ultra vires*" for companies (save for certain specific exceptions). Limitations to the managing director's power to represent the company (e.g. based on articles of association or internal rules of procedure for the management) do, in principle, have no effect in relation to third parties. An exception applies if it is obvious for the third party that the managing director has exceeded its authority to represent the corporation (*Evidenz*) or if the managing director and the relevant third party have cooperated in a collusive way to the detriment of the company (*Kollusion*). A further exception applies, at least according to German jurisdiction and legal scholars, to certain legal entities under public law, which shall not be in a position to validly enter into legal transactions that go beyond their statutory field of activity.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

A guarantor qualifies as a credit institution and hence requires a licence from the German Federal Financial Supervisory Authority ("**BaFin**") if it issues guarantees in a commercial manner or in a way which requires a commercial business organisation (§ 31 in conjunction with § 1 para. 1 no. 8 of the Banking Supervisory Act – *Kreditwesengesetz*, "**KWG**"). A guarantor shall, however, not qualify as a credit institution if it conducts the relevant transactions only with its parent company, subsidiaries or sister companies (§ 2 para. 1 no. 7 of the KWG). However, the construction of this so-called group privilege is now much stricter than in former years.

Guarantees issued by private companies are not subject to individual government consent requirements. Exceptions may apply to public entities acting as guarantors, in addition to state aid rules applicable to public and publicly owned entities.

While there is no statutory requirement for a shareholders' resolution or resolution of the supervisory board or other corporate bodies in case of the assumption of guarantees, the articles of association of the respective corporation may require such consent.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, except for the limitations imposed by the capital maintenance rules under German law (*cf.* above under questions 2.1 and 2.2).

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Under German law, there are generally no exchange controls that would restrict the enforcement of a guarantee.

This is without prejudice to restrictions resulting from existing German or European sanctions legislation, which also affects guarantees.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Under German law, in principle, all transferable assets are eligible as collateral. Common types of classic security are pledges and transfers and assignments for security purposes in case of movable assets, and mortgages and land charges in case of real property. In addition thereto, there exist certain special types of security rights such as mortgages for aircraft and vessels and other less common types of security, in addition to quasi-security arrangements.

Shares and bank accounts are commonly pledged. Financial institutions usually insist on the use of their own templates for the pledge of accounts held with them. Receivables, claims and intellectual property rights may be assigned as security and the ownership in fixed assets (such as movable property and equipment) is frequently transferred as security. Real property may be encumbered by a mortgage or land charge.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Security over different kinds of assets could be created in the same agreement. However, particularities would need to be observed with respect to each asset class and with respect to each type of security. Furthermore, security over real property requires notarial form, for which reason it would be inefficient to combine this in the same document.

It is more common under German law to create collateral in a separate agreement for each type of security, and furthermore the parties may wish to enter into different documents if third parties are involved.

German law does not recognise the concept of floating charges.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Real property can be encumbered by a land charge (including rent charges) or a mortgage. Land charges are more common because – unlike mortgages – they are independent in their existence from the underlying claim that is secured by them. While a mortgage can only be transferred together with the underlying receivable, a land charge can be created and transferred without the receivable secured by it. Both mortgages and land charges need to be established in notarised form and registered in the land register to become valid and binding. A land charge can be created without certificate (*Buchgrundschuld*) or as a certified land charge (*Briefgrundschuld*) in which case the handover of the certificate to the beneficiary of the land charge is necessary. A land charge or mortgage also covers appurtenances (*Zubehör*), but attention should be paid to the distinction between immovable and movable assets, e.g. in case of temporary structures.

Ownership of plants, machinery and equipment which are not an essential part of the property can be transferred as security by a simple transfer agreement. Here, special attention should be paid to possible conflicts of different security rights (e.g. conflicts with reservation of title arrangements).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. The common way of creating security over receivables and claims of the debtor is a security assignment which is usually executed in simple written form. The obligor generally does not need to be notified to create a valid assignment, and, according to market practice, many assignments remain undisclosed. However, a notification is required for perfection purposes. Since the obligor may still validly fulfil its obligation by payment to the former creditor (unless the obligor has knowledge of the assignment to the new creditor), it may be advisable to notify the obligor of the assignment in order to mitigate such risk. The relevant receivables to be assigned must be identifiable without doubt, a requirement that requires particular attention in case of future receivables.

Attention should be paid to contractual consent requirements which may apply on the assignment of individual receivables.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

The common form to create security over a bank account and cash deposited therein is an account pledge which is generally entered into in simple written form. Most financial institutions insist on the use of their own templates for pledges of accounts held with them. The pledge needs to be notified to the account-holding bank as the obligor. Such notification is a validity requirement.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

With regard to shares in companies, a pledge is the most common form of security. A pledge over shares in a German limited

liability company (GmbH) requires notarisation. It is generally not necessary to notify the pledge to the GmbH. However, the articles of association of the GmbH may require the prior consent of the company or its shareholders for a share pledge to become effective. The creation of the pledge is governed by the law governing the company, i.e. in case of a German GmbH by German law. It is not possible to agree on foreign law as the applicable law for the creation of the pledge.

A pledge over shares in a stock corporation may be completed without observing specific formalities. However, any share certificates issued for the relevant shares need to be transferred to the pledgee. Generally, the shares are certificated in one global certificate (*Globalurkunde*), which is deposited with a clearing system. In such case, the (indirect) possession of (parts of) the certificate needs to be transferred, which can be achieved by transferring the respective claim for handover. The creation of the pledge is governed by the law in which the share certificates are situated (*lex rei sitae*), i.e. in case of a German stock corporation the shares of which are deposited in Germany by German law. It is not possible to agree on foreign law as the applicable law for the necessary transfer of ownership in the share certificate. In case of registered shares (*Namensaktie*), the transfer/pledge is regularly evidenced on the certificate by way of endorsement (*Indossament*).

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security transfers are generally used in order to create security over inventory or movable property. A security transfer agreement is generally executed in simple written form. A practical challenge is the precise and identifiable description of the assets, in particular with regard to inventory. In such case, the agreement will frequently be either all-inclusive, refer to a certain area on the business premises and state that title to all assets located therein will be transferred, or list individual inventory in an explicit way.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, a company can grant security to secure its own obligations as a borrower under a credit facility as well as its obligations as a guarantor for obligations of other borrowers/guarantors. For limitations, please see questions 2.1 and 2.2.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Where notarisation is required in order to create security (e.g. pledge of shares in a limited liability company (GmbH) or creation of a land charge or mortgage), notary fees are incurred. The amount of the notary fees depends on the value of the encumbered assets and is calculated according to a statutory fee schedule. In addition, registration fees of the land register will be triggered for the registration of a land charge or mortgage. There is no stamp duty in Germany.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Land charges and mortgages need to be registered in a public register. The land register at the local court of the district where the encumbered real estate is located will be competent for the registration. Depending on the land register in charge and the complexity of the legal questions to be assessed, the registration procedure might take anything from one or two days to several weeks. In case the encumbered real property itself is not yet registered (e.g. in case of the formation of one or more new plots of land as a result of a split, merger or other alteration of existing plots of land), there may be additional time required to effect a necessary land survey, etc.

With regard to expenses, please see the answer to question 3.9.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No general regulatory or similar consents are required with respect to the creation of security.

With regard to licence requirements applicable on a guarantor that qualifies as a financial institution, and with respect to public or publicly owned entities, please see the answer to question 2.4.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are generally no special priority or other concerns with regard to security, if borrowings are granted under a revolving credit facility. Under German law, it is even possible to grant security for future obligations and to extend security interest to future-acquired assets (e.g. a future claim or revolving inventory) as long as they can be identified at the time of the conclusion of the security agreement in a manner that ensures their determinability when acquired.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Regarding notarisation requirements, please see the answers to questions 3.3 and 3.6. Execution under power of attorney is generally possible. However, notarial certificates of representation might be required if the signatories of the power of attorney are not registered in public registers (e.g. in the commercial register). Powers of attorney which shall be used for real estate transactions and for filings with public registers (commercial register, land register) generally need to be executed in notarial form. For notarisations effected in certain foreign countries, the notarial certification must be accompanied by an apostille. Furthermore, restrictions apply to self-dealing or representation of conflicting interests by the same proxy.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the

company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company
For stock corporations, section 71a para. 1 of the German Stock Corporation Act (AktG) contains a strict prohibition to grant a loan or security to third parties in order to enable such third party to acquire shares in the company. This prohibition does not apply in case financial assistance is granted (i) in the course of the regular business of a credit or financial services institution, (ii) on the basis of an existing control and profit and loss transfer agreement, and (iii) in connection with an employee participation programme.
German law does not provide for an explicit prohibition of financial assistance measures for limited liability companies (GmbH). However, the capital maintenance rules applicable to limited liability companies (for details, *cf.* above under questions 2.1 and 2.2) often result in a similar effect.

(b) Shares of any company which directly or indirectly owns shares in the company
For stock corporations, section 71a para. 1 of the German Stock Corporation Act is not directly applicable. However, according to section 71d para. 1 sentence 2 and 4 of the German Stock Corporation Act, the financial assistance rules described above apply accordingly in case a controlled company grants a loan or security to a third party in order to enable such third party to acquire shares in the controlling company.
For limited liability companies, restrictions may result from the capital maintenance rules described above under questions 2.1 and 2.2.

(c) Shares in a sister subsidiary
The financial assistance rules for stock corporates as described above do not directly apply in such a scenario. However, for stock corporations as well as limited liability companies, restrictions may result from the general capital maintenance rules (*cf.* questions 2.1 and 2.2 above).

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

German law generally recognises the role of an agent or trustee (also with regard to the enforcement of security).

Exceptions apply to "accessory" security interest (for details, see the answer to question 5.2).

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

With regard to certain accessory security rights (which are legally inseparable from the secured claim), it is common practice to create, in addition to the underlying secured claim, a parallel debt, i.e. a second claim for the benefit of the security trustee as abstract acknowledgment of debt in the amount of the current or future payment obligations against the finance parties. In order to avoid risks of double payment, the security trustee must not realise its claim under the abstract acknowledgment of debt to the extent the original secured claim has been fulfilled. The parallel debt structure ensures that certain accessory security rights (e.g. pledges, guarantees) are not terminated by operation of law in case of changes to the lenders of a syndicated loan agreement involving the termination of the initial secured claim while creating a new claim with the acquirer. While the validity of parallel debt structures is generally accepted in German legal literature, it has not yet been confirmed by German courts.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The loan and a guarantee, which by nature are non-accessory, can generally each be transferred by simple assignment agreement. In contrast to a guarantee, a surety (*Bürgschaft*) (which is of an accessory nature) will automatically transfer upon assignment of the secured loan.

Also, with regard to possible defences of a guarantor under German law, differentiation has to be made between guarantees and sureties. While the most common form is the independent (non-accessory) guarantee, the guarantor has only very limited defences in this case. Further details depend on the type of guarantee (e.g. guarantees on first demand, standard guarantees, etc.) involved and the underlying terms of the individual guarantee. In particular, in case of an independent guarantee, the existence of the main debt is not a condition for the guarantor's obligation to pay. Often, the guarantor is restricted to the objection of abuse of law by the creditor.

In contrast thereto, a surety (*Bürge*) can principally invoke all defences and objections of the main debtor. The surety can also refuse payment in case the debtor is entitled to challenge the transaction creating its debt and in case the creditor can satisfy its claim by way of set-off against a claim of the debtor. Further, the surety is generally only obliged to pay the creditor if the creditor cannot realise its claim against the debtor. All these defences are subject to a possible waiver by the surety. However, a waiver might be invalid if agreed upon in general terms and conditions because such waiver would contradict the concept of accessoriness and transform the surety into an instrument that is tantamount to an independent, non-accessory guarantee.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

In general, there is no requirement under German tax law to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of an enforcement of security, provided the loan has no profit link feature and is not securitised as a fungible debt instrument.

However, interest payments to a foreign lender may be considered German-sourced income, if the loan is directly or indirectly

secured by German-*situs* real property, comparable rights or ships registered in Germany. In such a case, the foreign lender might be under an obligation to file a tax return (at least, where an applicable double taxation agreement also permits Germany to tax such income from interest payments). In such a case, the German tax authorities have the discretion to require the obligor to withhold tax. The tax rate for corporate taxpayers is 15.825% (i.e. 15.0% corporate tax plus 0.825% solidarity surcharge). Any tax withheld might be credited or refunded upon a tax assessment of the foreign lender.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no German tax incentives or other incentives provided to foreign lenders. No taxes apply with respect to their loans, mortgages or other security documents for the purposes of effectiveness or registration.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No. The income of a foreign lender will not become taxable in Germany solely because of a loan to, or guarantee, and/or generally the granting of security by, a company in Germany.

However, the income of a foreign lender, notwithstanding the foregoing, may become taxable in Germany in case the loan is secured by real estate in Germany, comparable rights or ships registered in Germany (see above at question 6.1). This does, in general, not apply in case of the existence of a double taxation agreement between Germany and the country of residence of the foreign lender.

Furthermore, the income of the foreign lender may become taxable in Germany in cases where such income is attributable to the business property of a permanent establishment (including a permanent representative) of such a lender in Germany.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

The costs for foreign lenders will generally not be different from the costs incurred by a German lender. For such costs, please see the answer to question 3.9.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are generally no such adverse consequences under German law.

However, in cross-border transactions, there may be conflicting sanction rules, and in addition thereto European and German blocking legislation needs to be observed.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

According to article 3 para. 1 of regulation (EC) no. 593/2008 on the law applicable to contractual obligations (Rome I), which is applicable in Germany, a contract shall be governed by the law chosen by the parties. Pursuant to article 2 of this regulation, such rule also applies if the chosen law is not the law of an EU Member State. A specific link to a foreign jurisdiction is generally not required in order for the choice of law to be valid. However, in case the only link to a foreign jurisdiction is the law chosen by the parties, mandatory provisions of the jurisdiction to which the case is linked will apply irrespective of the chosen law. Further, the freedom of choice of law does not apply to certain types of collateral and the underlying agreements. For example, *in rem* security is mandatorily governed by the law of the location of the property (*lex rei sitae*).

Apart from the aforementioned limitations, German courts will recognise foreign law chosen by the parties for the contract and enforce the respective provisions.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The future rules for the mutual recognition and enforcement of judgments between Germany and the United Kingdom are still unclear. While it is likely that this issue will soon be solved by the entry into force of the new 2019 Convention on the Recognition and Enforcement of Foreign Judgments in Civil or Commercial Matters, provided that the United Kingdom declares its accession to this convention, the legal situation after the end of the transition period is not entirely clear.

There are good arguments that for the intermediate period the Convention dated 14 July 1960 between the Federal Republic of Germany and the United Kingdom of Great Britain and Northern Ireland for the Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters should be revived, as this convention is still formally in force. However, there is also an argument that such a revival should not take place, because this bilateral convention was superseded by EU law, in particular by Regulation (EU) no. 1215/2012 on jurisdiction and recognition and enforcement of judgments in civil and commercial matters, for a long time. If this convention cannot be revived, then the recognition of judgments would be governed by the provisions of the German Code of Civil Procedure ("**ZPO**").

With regard to New York courts (as well as courts of non-EU Member States), the recognition of judgments would be governed by the provisions of the ZPO. Such judgments will generally be recognised, subject to limited exceptions, e.g. if the foreign judgment violates the German *ordre public* (*cf.* section 328 ZPO).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a

court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

It is difficult to predict how long it would take for a foreign lender to obtain and enforce a judgment or to enforce a German judgment in Germany since the timing will be influenced by different factors, such as the workload of the court, whether the defendant might introduce even unjustified defences, and the complexity of the case. In case a judgment by default can be obtained, the proceedings may only take a couple of weeks. In case of ordinary court or enforcement proceedings, the duration of the proceedings will depend on the individual circumstances of the case, and in particular on the type of defences brought forward by the defendant.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Pledged security is generally sold in a public auction, which is a formal proceeding and requires prior notification of the owner of the pledged security at least one month before the public auction shall take place. If the asset has a market price, pledged security can be enforced by way of a private sale at the choice of the pledgee. Banks prefer private sales, as they usually lead to better results and are less formalistic.

Land charges and mortgages are enforced by way of a public auction or forced administration in formal proceedings organised and conducted by a special enforcement court. However, the parties may agree on alternative forms of enforcement (e.g., private sale) in order to simplify proceedings and realise better results.

Assigned receivables against third parties are generally realised by collecting them from the debtor, which does not entail specific formalities.

Regulatory consents are generally not required in connection with the enforcement of security except for the providers of debt collection services which need to be registered according to the German Legal Services Act (*Rechtsdienstleistungsgesetz*), which is only possible if certain requirements are met.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

In general, no such restrictions apply to foreign lenders. However, lenders from countries other than EU Member States or Member States of the Hague Convention of 1 March 1954 on Civil Procedure might be obliged to provide collateral for court costs.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

After filing for insolvency, but before opening actual insolvency proceedings, the court may prohibit enforcement measures against the debtor (except for security over real estate).

After the opening of insolvency proceedings, individual enforcement measures are prohibited. However, a secured creditor generally has a right to preferential treatment, which must be asserted against the insolvency administrator. However, certain forms of security can only be enforced by the insolvency administrator (e.g., movables in the possession of the insolvency administrator, receivables).

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

According to section 1061 of the ZPO, the recognition and enforcement of foreign arbitral awards in Germany is governed by the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, dated 10 June 1958. On that basis, foreign arbitral awards will generally be recognised and enforced without re-examination of the merits of the case. Certain exceptions apply, as set out in the New York Convention.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Security granted by a debtor that falls into bankruptcy may be affected by the debtor's insolvency. In insolvency proceedings over the assets of a debtor, secured creditors will be satisfied with priority (*Absonderung*). Unsecured creditors will be satisfied on a *pro rata* basis from the remaining assets once the secured creditors have been satisfied. Shareholders of the debtor rank last in the satisfaction chain. Furthermore, the insolvency administrator may challenge certain transactions of the insolvent debtor which occurred during certain periods prior to the insolvency and which impair the position of other creditors.

Security granted by third parties is generally not affected by an insolvency of the principal debtor.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The insolvency administrator may challenge certain transactions of the insolvent debtor which occurred during certain clawback periods prior to the opening of insolvency proceedings. Relevant clawback periods vary from one month to 10 years prior to the insolvency proceedings and depend on the nature of the relevant legal action (e.g. 10 years in case the action was taken with intent to the detriment of other creditors).

With regard to tax debts, differentiation has to be made as to whether the relevant tax triggering event has occurred prior to the opening of insolvency proceedings (in which case no preferential payment of such debt will be made) or whether such event occurred after the opening of insolvency proceedings, e.g. by an action taken by the insolvency administrator (in which case such debt has to be satisfied with priority from the insolvency estate).

The same applies, in principle, to employee's claims: claims which result from periods prior to the opening of insolvency proceedings will be treated as non-priority insolvency claims, whereas claims which result from the continuation of the employment relationship after the opening of insolvency proceedings will be satisfied with priority. In addition, employees of the insolvent debtor may be entitled to insolvency

payments (*Insolvenzgeld*) to be paid by the Employment Agency on non-satisfied employment claims for a period up to three months prior to the opening of insolvency proceedings.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Under German law, certain public entities (e.g. the federal states, municipalities) are excluded from insolvency proceedings. Furthermore, financial institutions are subject to special rules for insolvency and winding-up proceedings under European law.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

With regard to the collection of receivables, creditors may engage debt collection agencies (*Inkassounternehmen*), which need to be registered under the German Legal Services Act (*cf.* the answer to question 7.4 above). Apart from that, creditors usually rely on court proceedings to seize the assets of a company in an enforcement. Private seizure measures are generally not permitted. Further, agreements entered into prior to an event which entitle a pledgee to enforcement and according to which the pledgee shall automatically become an owner of the pledged asset if his claim is not fulfilled in time, are null and void (*cf.* section 1229 of the German Civil Code ("**BGB**")).

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Within the territory of the European Union, Regulation (EU) no. 1215/2012 on jurisdiction and recognition and enforcement of judgments in civil and commercial matters applies. According to article 25 of Regulation (EU) no. 1215/2012 on jurisdiction and recognition and enforcement of judgments in civil and commercial matters, and subject to the exclusive jurisdictions stipulated in this regulation, a court shall have jurisdiction if the parties contractually agreed on the jurisdiction of such court.

In addition, the Lugano Convention is relevant as far as Iceland, Norway or Switzerland are involved.

In relation to jurisdictions that are not covered by the above regulation and convention, domestic rules shall apply, including, without limitation, section 38 *et seq.* of the ZPO. In principle, German courts will recognise agreements in a submission to a foreign jurisdiction, subject to certain exceptions. This, however, shall not exclude that a German court might nevertheless acquire jurisdiction based on section 39 of the ZPO, based on the appearance of the defendant if the defendant fails to plead lack of jurisdiction.

Certain requirements (e.g. an agreement in writing or evidenced in writing, no exclusive jurisdiction of another court) need to be fulfilled.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

The Federal Republic of Germany, the German federal states and their subdivisions do not enjoy immunity before German courts. However, an enforcement regarding assets, which serve a sovereign purpose, is prohibited. A waiver of such type of sovereign immunity regarding enforcement is possible. To avoid conflicts, such waiver should be made in explicit (written) form.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

The German Banking Act ("**KWG**") provides that the extension of loans in a commercial manner, or to an extent that requires a commercially organised business, requires a banking licence issued by the BaFin or a corresponding licence issued by the responsible authority of another EEA Member State. The requirements are the same for German and foreign lenders if the loans are granted in Germany. No distinction is made between banks and non-banks if the extension of loans is made in the aforementioned manner.

Non-compliance with the licensing requirements is a criminal offence under German law and may, in addition, be sanctioned by fines.

No specific licensing or other eligibility requirements apply to an agent under a syndicated facility. However, in case the agent also acts as a lender under the facility agreement, the aforementioned licensing requirements apply.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

With regard to document execution and delivery requirements and mechanics, there have been no changes to the relevant legal framework due to the COVID-19 pandemic. Even before 2020, however, digital and remote signings have been quite common with regard to finance agreements to the extent that no stricter form requirements apply (e.g. in case of notarisation requirements). Due to travel and contact restrictions since the outbreak of COVID-19, remote signings became even more common than in the past.

For types of agreements that are subject to notarial form (see the answers to questions 3.3 and 3.6), which include mortgages (*Hypotheken*), land charges (*Grundschulden*) and certain share pledges (*Geschäftsanteilsverpfändungen*), the relevant parties may authorise proxies to act on their behalf on the basis of a power of attorney. It is not uncommon to grant such powers of attorney to employees of the relevant notary's office. Having said this,

notaries, in principle, remain under the obligation to continue their services even during the present crisis.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Presently, the most dynamic area of new legal developments in the area of finance is represented by the various forms of state aid within the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak. This state aid takes the form of, *inter alia*, guarantees as well as recapitalisation measures, which may take the form of equity, debt or hybrid forms of finance. The European Commission approved the German plans to set up the German Economic Stabilization Fund (*Wirtschaftsstabilisierungsfonds*) with a budget of up to EUR 500bn. Up to EUR 400bn of this amount is allocated to guarantees and up to EUR 100bn is allocated to recapitalisation measures. Only companies that were not considered to already be in difficulty on 31 December 2019 are eligible for aid under this scheme. Guarantees as well as recapitalisation measures are combined with complex undertakings (including a ban on distributions or dividends or bonus payments to members of executive bodies and managing directors).

Particular legal requirements apply under German law in case of restructurings. In relation to bridge loans (*Überbrückungskredit*) granted to distressed enterprises for a limited period until a restructuring plan is in place, the German Supreme Court decided that the maximum term for such type of loan depends on the individual circumstances of each particular case, hereby overruling contradicting decisions of the Berlin Court of Appeals. While this allows more flexibility in the structuring of bridge loans, the parties still must comply with requirements developed by court precedents and prudent standards to avoid the risk of liability for delaying the filing of insolvency. Similar considerations apply to restructuring loans (*Sanierungskredit*) that serve the purpose of financing the restructuring of a distressed enterprise once a restructuring plan is in place. If a lender is granted significant influence over business decisions of the borrower in a crisis, such lender is at risk to qualify as *de facto* manager of the borrower, which may lead to corresponding liability. As the exact standards as to which level of influence is allowed (or even required for prudent risk management) are not always clear and depend very much on the circumstances of the individual case, lenders are well advised to seek legal advice to avoid corresponding risks. Further, shareholders should be aware that their claims will rank below the claims of other creditors in case of insolvency proceedings.

In Germany, *Schuldschein* loans have a long history. This type of loan continued its success story over the last few years, as it allows much flexibility. Although *Schuldschein* loans are not listed, the amounts range between the lower double- and higher triple-digit millions of Euros, and maturities may be much longer than in the case of syndicated finance. At the same time, this product is available at relatively low costs with simple documentation.

Especially in cross-border transactions, the German sanctions regime must be observed, which includes European sanctions applicable in Germany. This sanctions regime also includes certain German and European blocking rules regarding foreign sanctions. The German blocking rules set out in section 7 of the foreign trade regulation (*Außenwirtschaftsverordnung*) were very much liberalised, with effect from 29 December 2018. Nevertheless, well-drafted loan documentation will address corresponding restrictions for the protection of the finance parties as well as for the protection of the obligors.

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In addition to issues dealing with general finance, bank and bank supervisory law, we advise our clients in all matters concerning finance transactions including the (tax-optimised) structuring of financing and financing instruments, and corresponding capital market products. Our areas of expertise further include advice on work-outs/restructuring.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

On 1 January 2021, the new Greek Law no. 4738/2020 titled "Debt Settlement and Second Chance Provision" (the "New Insolvency Law") came into force, incorporating the provisions of Directive (EU) 2019/1023. The New Insolvency Law replaced the provisions of Law no. 3588/2007, as well as other laws provided for the restructuring of the debts of natural persons, for out-of-court debt settlement procedures, etc. The New Insolvency Law introduced an integrated framework for dealing with early warning mechanisms, preventing restructuring procedures (such as out-of-court settlement procedures and pre-insolvency business recovery processes) as well as for personal and corporate insolvencies.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

During 2020, due to the impact of COVID-19, the vast majority of corporate financing for working capital purposes was made by banks through the Guarantee Fund of the Hellenic Development Bank. We anticipate that this trend will continue during the first half of 2021. In parallel, some of the large groups of companies in Greece raised working capital by the Greek banks under their customary financing terms.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

According to the provisions of Law no. 4548/2018 (the "SA Company Law"), applying to transactions between *société anonyme* companies and their related parties (related-party transactions), in line with Directive (EU) 2017/828, all transactions between companies and their related parties are prohibited as not valid, and no security or guarantee may be granted to any third party for the benefit of said related parties without the previous consent of the company's Board of Directors or the General Assembly of the Shareholders. However, the SA Company Law provides for exceptions to the above-mentioned prohibitions in certain cases, and lays down the procedure for the consent of the Board of Directors or the General Assembly required for the said related-party transaction (for example, parent companies may guarantee the borrowings of one or more 100% subsidiary(ies) and/or any subsidiary(ies) whose shareholder structure does not include any related party). It should be noted that the conditions for the granting of consent for related-party transactions depend on whether the company is listed on a regulated market or not (for example, for listed companies the consent is provided on the basis of a fairness opinion by an independent auditor). Finally, transactions entered into in the ordinary course of business and concluded on normal market terms fall outside the scope of the above restrictions.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

As a general rule, corporate guarantees must serve the corporate purpose of the corporate guarantor. In case such condition is not met, the guarantee may be invalid and directors' liability may arise.

2.3 Is lack of corporate power an issue?

Lack of corporate power may arise only in respect to the service of the corporate purpose of the corporate guarantor.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In case of guarantees between companies which are not subject to exceptions (see question 2.1), according to the SA Company Law, the Board of Directors must decide if such a transaction may take place by giving its consent. Such decision must be recorded in the General Commercial Registry ("G.E.MI."). The consent is effective and the guarantee may be validly granted after the lapse of 10 days following the publication of said consent to G.E.MI. and provided that shareholders representing 1/20 of the paid up share capital of the company have not requested the meeting of the General Assembly to decide whether their consent is granted. The company's Articles of Association may reduce this rate to 1% of the capital. The 10-day period does not apply in cases where all shareholders of the company provide their written consent granting the said guarantee and/or security.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no such limitations.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

In general, no.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Under Greek law, lending obligations are secured by securities *in personam* and/or by securities *in rem*. Securities *in personam* mainly include guarantees, and securities *in rem* include mortgages (or prenotation of mortgages) and pledges over assets, rights and claims. Legislative degree 17.7.1923 on pledges over claims, in favour of credit institutions, provides that such pledge also gives entitlement to assignment for the collection of such claims. It should be noted that, in practice, most term loan facilities to Greek companies (in the form of *sociétés anonymes*) are structured as bond loans, i.e. through the issuance of debt securities subscribed by private placement. This is because the legal framework for bonds provides for cost and tax exemptions (see our answer below under question 3.9).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Asset security by means of a general security agreement is possible. Nevertheless, since each type of asset and each type of security is perfected by different procedures and registration requirements, a separate agreement is commonly used. As far as the procedure is concerned, see our answers below regarding different types of assets and different types of security.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over real property (land) and plant is created by mortgage (by virtue of a notarial mortgage deed) or by mortgage prenotation (by virtue of a county court decision) and perfected by registration in the public books of the competent land registry or cadastre where the land and plant are located. Prenotation of mortgage provides its beneficiary with the pre-emptive right to obtain a mortgage perfected as of the date of registration of the prenotation of mortgage once its claim becomes final. Such security extends to all component parts and accessories of the real estate (i.e. machinery and equipment).

As far as machinery and equipment are concerned, security can be created by a non-possessory pledge agreement by virtue of article 1 of Law no. 2844/2000 and perfected by registration to the public book established by Law no. 2844/2000 and kept by the competent public registry where the borrower has its corporate seat.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables (trade receivables and insurance proceeds) is created by a private agreement and perfected by notification to the debtor of the relevant claims. In banking practice, such security is granted in the form of pledge and assignment of the receivables due to such pledge, by virtue of legislative degree 17.7.1923. Security over business receivables may also be granted under articles 11–15 of Law no. 2844/2000 and perfected by registration to the public book established by Law no. 2844/2000 and kept by the competent public registry where the borrower has its corporate seat (in addition to notification to the debtor).

Security may extend to future receivables, provided that they are specifically defined in the security agreement and fall within the scope of the pledge.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Collateral security over cash deposited in bank accounts is created by a private agreement and perfected by notification to the bank holding such accounts. Standard practice provides for such collateral in cash to be governed by legislative degree 17.7.1923 and/or Law no. 3301/2004 on financial collateral agreements.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Unless otherwise provided by the Articles of Association of a company incorporated under Greek law, collateral security (pledge) over the company's shares is created by a private agreement and perfected by physical delivery of the shares to the pledgee or a third-party custodian.

It should further be noted that, according to the new provisions of the Company Law, Greek companies can no longer issue bearer shares. Bearer shares already issued by Greek companies had to be converted to registered shares by 1 January 2020.

Security over shares listed on the Athens Stock Exchange is created by private agreement and perfected by notification and registration to the Dematerialised Securities System, pursuant to the regulation of the Hellenic Central Securities Depositary.

Security may extend to new shares issued by the company and dividends or other benefits, such as voting rights, but not to preference rights of the shareholders, since such rights do not exist at the time the security agreement is perfected (under Greek law, preference rights of the shareholders are considered as rights of expectation and are created when the General Assembly decides on a share capital increase).

The law governing the pledge over shares issued by Greek companies is subject to the rule of *lex rei sitae*; i.e. the law of the place where the property is situated. Therefore, such security may only be governed by Greek law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over inventory is governed by articles 16–18 of Law no. 2844/2000 (floating charge over inventory) and created by a private agreement. In order for such security to be perfected,

the private agreement must be registered in the public book established by Law no. 2844/2000 and kept by the competent public registry where the borrower has its corporate seat.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A company may grant security to secure its obligations both as a borrower under a credit facility and as a guarantor of the obligations of other borrowers and/or guarantors of obligations. We also refer to our answers in section 2 above regarding intragroup company guarantees.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Mortgages, prenotation of mortgages, non-possessory pledges and floating charges are subject to registration in the public books of the competent land registry and/or cadastre. Registration fees for the land registry amount to 0.775% of the secured amount. Registration fees for the cadastre amount to 0.875% of the secured amount.

In case of mortgages, notarial fees range from 0.2% to 1% of the secured amount. In case of prenotation of mortgages, court fees do not exceed €300.

Under the legal framework for bond loans, registration fees are fixed at €100 per registration, which minimises the costs of securities granted under bonds loans.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The filing, notification and registration process does not usually require a significant amount of time to be completed. However, the time needed may vary depending on the efficiency of the competent authority/registry office in each individual case. As for the expenses, please refer to question 3.9 above.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In principle, no consents are required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No. Revolving credit facilities are secured by the same means and procedure described herein in section 3.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Please refer to our answers above.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company
Under applicable law, that is, pursuant to the relevant provisions of article 51 of the Company Law, a company (other than a credit institution) is prohibited from making down payments, providing guarantees and/or loans to support borrowings incurred to finance the direct or indirect acquisition of its shares by third parties, unless the following conditions are met:
  (1) The aforementioned transactions are carried out under the responsibility of the Board of Directors of the company within the market standards, in particular with respect to the interest received by the company and the guarantees it receives to secure its claims. Proper due diligence must be conducted regarding the solvency of the third party or, in the case of multilateral transactions, of each counterparty.
  (2) The General Assembly of the Shareholders of the company provides its prior consent by an increased quorum and majority. It should be noted that the Board of Directors submits to the General Assembly a written report setting out the reasons which, in light of the company's best interests, justify the said transaction, its terms (including the price at which the third party will acquire the shares) as well as the risks that the contemplated transaction may pose to the liquidity and solvency of the company and the price. Please note that, in case the members of the Board of Directors of the issuing or the parent company are directly or indirectly contracting parties to the respective transactions, an auditor's report must also be submitted to the General Assembly.
  (3) The total financial assistance provided to third parties (or the total secured amount), which shall appear in the balance sheet as a non-distributable reserve, does not result in a reduction of the company's own funds to an amount lower than the aggregate amount of share capital and non-distributable reserves.

(b) Shares of any company which directly or indirectly owns shares in the company
Pursuant to the provisions of the same article 51 of the Company Law, the restrictions mentioned under (a) above also apply to down payments, guarantees and/or loans provided by subsidiaries for the acquisition of the parent company's shares by third parties.

(c) Shares in a sister subsidiary
The Company Law does not include provisions regulating the case in question.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan

documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The role of the agent/trustee is provided by the bond loan legal framework, under which any security granted by the borrower is granted in the name of the bondholders' agent, for the benefit of the bondholders. The bondholders' agent is responsible for enforcing loan documentation and collateral securities and applying the proceeds from the collateral to the claims of all the lenders *pro rata*, unless otherwise agreed.

Furthermore, article 73 § 3 of the Company Law provides that in case a bond loan is governed by foreign law, collateral security and guarantees are granted in the name of the person who, under the law governing the bond loan, may hold securities and guarantees on his/her account on behalf of the bondholders. The registration shall be made in the name of the agent, with an explicit indication that the guarantee is granted to secure debts from a bond loan.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Since Greek law only recognises the notion of a bondholders' agent, an alternative mechanism to achieve such an effect is a contractual agreement between the lenders of a syndicated credit facility (intercreditors' agreement) providing that the collateral security is granted in the name of the security trustee, who is also a joint and several creditor with the other secured lenders. However, lenders are not protected in case of insolvency proceedings of the security agent.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The transfer of a loan from the initial lender to a successor lender or, to be more precise, the transfer of the relevant rights and obligations, is legally permitted in principle, subject to the specific provisions of each individual loan agreement. The procedure of such transfer of rights and obligations is regulated by the relevant provisions of the Greek Civil Code and is considered to be perfected on the condition that the debtor and/or the guarantor is notified of the said transfer.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

The current tax rate for tax withholding on interest from bond loans is 15%. Notably, interest payable on credit facilities concerning either domestic or foreign lenders is not subject to withholding tax. As for foreign lenders in particular, please refer to question 6.2 below.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Interest payments to lenders that are tax-resident outside of Greece and without a permanent establishment in Greece are subject to Greek withholding tax, currently at the rate of 15%, if not otherwise provided for in the tax treaty (if any) between Greece and the jurisdiction of tax-residence of the foreign lender.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No income of a foreign lender becomes taxable in Greece solely because of a loan to or guarantee and/or grant of security from a company in Greece.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

An annual contribution of 0.6% is imposed on the average outstanding monthly balance of each loan granted by a bank to a Greek resident. Loans between banks, loans to the Greek State and loans funded by the European Investment Bank or the European Bank for Reconstruction and Development are exempt from said contribution. As far as guarantees are concerned, there are no additional costs and fees. As for securities, please refer to question 3.9 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

In case some or all of the lenders are organised under the laws of a jurisdiction other than Greece, there are no particular adverse effects for the borrower stemming from this fact.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Under applicable law, that is, pursuant to the provisions of (a) Regulation EC 593/2008 "on the law applicable to contractual obligations (Rome I)" (which replaced the 1980 Rome Convention on the law applicable to contractual obligations, except as regards the territories of the Member States which fall within the territorial scope of that Convention and to which this Regulation does not apply pursuant to article 299 of the Treaty), (b) the 1980 Rome Convention (to the extent that it was not replaced by Regulation EC 593/2008), and (c) the relevant articles of the Greek Civil Code (in the cases where (a) and (b) above do not apply), it can be concluded that, in principle, the

parties to a contract are free to choose the law that shall govern their contract. However, there are certain limitations on this freedom of choice, concerning overriding mandatory provisions (i.e. provisions, the respect for which is regarded as crucial by the Hellenic Republic for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract) as well as the Greek public order. Therefore, it can be concluded that, subject to the aforementioned limitations, Greek courts do recognise and enforce contracts that are subject to foreign governing law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Under applicable law, that is, pursuant to the provisions of (a) the relevant EU Regulations (e.g. Regulation EU 1215/2012 "on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters" and Regulation EC 805/2004 "creating a European Enforcement Order for uncontested claims"), (b) bilateral international conventions, and (c) the relevant articles of the Greek Code of Civil Procedure ("GCCP"), whichever applies in each case, it can be concluded that although in principle Greek courts will recognise and enforce a foreign judgment without re-examination of the case, such recognition and enforcement may be denied if any of the following applies: (a) the foreign judgment is not an enforceable title or *res judicata* according to the law of the foreign country where the judgment was issued; (b) it is issued by a foreign court not having jurisdiction as per Greek law; (c) the defendant was deprived of its rights to a fair trial; (d) the foreign judgment is irreconcilable with an earlier Greek judgment, which is *res judicata* and involves the same cause of action between the same parties; or (e) it violates Greek public order.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Pursuant to the provisions of Law no. 4335/2015, which entered into force on 1 January 2016, as amended by Law no. 4512/2018, and which constituted a significant reform of the GCCP, particularly aiming to accelerate the dispensation of justice, strict timeframes were set regarding the procedural stages from filing a law suit in a Greek court to the issuance of a judgment of first degree (i.e. appealable, that is, not yet *res judicata*), resulting in shortening the aggregate time needed for the completion of the said judicial proceedings. In view of the above, as of now it is estimated that, in case of a law suit filed by a foreign lender in a Greek court and based on a contract governed by the Greek law, it might take on average from 12 to 16 months for a judgment of first degree to be issued, whereas in case of a payment order, this timeframe is reduced to approximately six months. It should be noted that, in the case of contracts governed by foreign law, the aforementioned timeframes are expected to be significantly longer.

As far as the enforcement of a judgment (either Greek or foreign) is concerned, it should be noted that the reform of the GCCP introduced the notion of electronic auctions. As of 21 February 2018, all enforcement auctions are conducted solely via the electronic platform which is managed by the competent Greek Notaries Association. According to the provisions of the GCCP, electronic auctions take place no later than seven months after the day of termination of the asset seizure.

It should also be noted that, in the case of a foreign judgment, the period required for its recognition by the Greek court may prove to be considerable.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Under applicable law, that is, pursuant to the provisions of the relevant articles of the GCCP, the individual stages of the enforcement procedure are described in detail and specific timeframes are set, within which enforcement proceedings shall be effectuated. As a general rule, in order for the enforcement procedure to commence, the creditor-beneficiary of the collateral security (i.e. the mortgagee/pledgee of mortgaged/pledged immovable/movable assets) must obtain an enforceable title (i.e. mainly non-appealable judgments, arbitral awards, payment orders, notarial deeds, etc.). Subsequently, as far as pecuniary claims are concerned, the enforcement procedure involves the following main stages: (a) the attachment of the debtor's assets; (b) the intervention of other creditors; (c) the liquidation of the attached assets through public electronic auction; and (d) the distribution of proceeds.

In particular, regarding the liquidation process, it is noted that liquidation is effected by electronic auction, which is administered by a notary public who is certified to conduct electronic auctions (we also refer to our answer to question 7.3 above). As to the distribution of proceeds from the public electronic auction of a specific asset, it is noted that, in principle, the proceeds are distributed to all the creditors who participated in the liquidation process. In cases where the electronic auction proceeds, after deducting the costs and expenses of the enforcement proceedings, are less than the total claims of the creditors who participated in the respective proceedings, then they are proportionally distributed. However, certain categories of creditors have priority over the proportional distribution as follows: (a) claims provided with a general privilege (i.e. claims of the State and of other public entities, claims for wages and personal maintenance, etc.) have a minimum priority of 25% of the total proceeds; (b) claims provided with a special privilege, that is, secured claims (i.e. collateral security on the specific asset on which enforcement takes place) as well as claims regarding the maintenance of the property and the production and harvest of its fruits, have a minimum priority of 65% of the total proceeds; and (c) unsecured claims have a minimum priority of 10% of the total proceeds.

It should be noted that Legislative Decree 17.7.1923 introduces an exception to the aforementioned rule, according to which the liquidation of the attached assets is effectuated through public electronic auction. More specifically, the legal effect of a pledge of claims under the provisions of Legislative Decree 17.7.1923 is that the pledgee-credit institution arguably acquires full ownership of the claim and is entitled to liquidate the claim, with the obligation to return to the pledgor-debtor any amount exceeding the secured claim.

Another exception to the above rule is introduced by Law no. 3301/2004 on financial collateral agreements, under which provisions the satisfaction of the pledgee-creditor is effectuated through sale, set off or application of the financial instruments and/or cash in discharge of the relevant obligations.

No regulatory consents are required.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No restrictions apply. However, it has been argued that foreign lenders do not enjoy the benefits of Legislative Decree 17.7.1923.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Pursuant to the provisions of the New Insolvency Law (see above under question 1.1), in case a company is declared insolvent, a suspension of all individual enforcement actions against the company is imposed on all unsecured creditors and/or all priority creditors (i.e. creditors whose claims have a general privilege for satisfaction from the whole of the debtor's estate, such as the State or the Social Security Authorities). The above suspension of the individual enforcement actions does not apply to the secured creditors (i.e. creditors whose claims are secured by special privilege or real security on a specific asset of the debtor's estate), for a period of nine months after the declaration of insolvency. The claims of the secured creditors are satisfied by the liquidation of the asset secured by a special privilege or real security in favour of them. In case the amount collected by the liquidation of the secured asset is not sufficient for the full repayment of the claim of the secured creditor, the latter may satisfy the remaining amount of its claim by the whole bankruptcy estate. The suspension of the individual enforcement actions also applies to the secured creditors: (i) after the lapse of the nine-month period; or (ii) if the insolvency judgment provides for the sale of the assets of the operational business of the insolvent company, either in whole or in part in case of an integrated operational unit ("going concern liquidation") and the asset secured in favour of the secured creditor is part of the operational business to be sold.

In addition to the above, interim measures may by ordered by the competent court after the filing of an application for a debtor to be declared insolvent in order to prevent a reduction of the bankruptcy estate value and any material adverse effect that may jeopardise the interests of the creditors. The above interim measures do not apply to the secured creditors and do not affect the rights of a creditor under a financial collateral arrangement (Law no. 3301/2004) or the rights of the assignee under an assignment security agreement. Finally, the interim measures ordered by the court are automatically ceased on the date the court decision for the declaration of insolvency is published.

As far as pre-insolvency proceedings are concerned, under the relevant provisions of the New Insolvency Law, which provide for the conclusion of a restructuring agreement between the debtor and a certain percentage of its creditors (i.e. at least 50% of the debtors' total secured liabilities, as well as creditors representing at least 50% of the debtors' other liabilities) (hereinafter referred to as the "Rehabilitation Agreement") and the subsequent ratification from the Court of such agreement, from the filing of the Rehabilitation Agreement for ratification until the issuance of the decision of the Court, all individual and collective enforcement action is automatically suspended. This moratorium may not normally exceed four months. It should also be noted that the Rehabilitation Agreement may include more specific provisions concerning such moratorium. However, it should be mentioned that the above-mentioned moratorium does not affect the rights of the secured creditor under a financial collateral arrangement based on the provisions of Law no. 3301/2004.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Under applicable law, that is, pursuant to the provisions of (a) the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and (b) the relevant articles of the GCCP, whichever applies in each case, it can be concluded that, in principle, Greek courts will recognise and enforce an arbitral award without re-examination of the case, subject to certain limitations, including, e.g., that the award has become binding on the parties, that it does not violate Greek public order, that the party against whom the award is invoked was able to present his case before the appointed arbitral authority, etc.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

As mentioned above under question 7.6, pursuant to the relevant provisions of the New Insolvency Law, in the case of declaration of bankruptcy, the secured creditors (i.e. creditors whose claims are secured by special privilege or real security on a specific asset of the debtor's bankruptcy estate) may pursue their satisfaction by the liquidation of the specific secured asset and by the whole bankruptcy estate in case the special privilege or real security proves to be insufficient for their complete satisfaction.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Moreover, please note that the New Insolvency Law provides that all the transactions carried out by the debtor during the so-called "suspect period" (i.e. the period beginning from the date that the bankrupt debtor discontinued its payments until the declaration of bankruptcy) are subject to clawback upon request of the bankruptcy administrator or a creditor, and thus rescinded and made null and void. In addition, the New Greek Insolvency Law provides that certain types of transactions, that is (a) donations or other transactions in which the consideration received by the bankrupt person or entity from its counterparty are disproportionately small in relation to its own obligations, (b) payments of non-outstanding debt, (c) non-cash payments of outstanding debts, or (d) establishment of *in rem* securities (including the prenotation of mortgage) or provision of guarantees, for pre-existing obligations, if carried out during a period of six months preceding the "suspect period", are subject to clawback, upon request of the bankruptcy administrator or a creditor.

Please note that the legal consequences of the clawback are that transactions in question are null and void and are rescinded. Further, transactions involving the bankrupt debtor and entered into during a period of five years preceding the declaration

of bankruptcy are subject to clawback if the bankrupt person has acted intentionally to damage its creditors or discriminate against some of them and the counterparty was aware of the bankrupt person's intention. It should also be noted that security agreements established by virtue of the provisions of Law no. 3301/2004 on financial collateral agreements are, in principle, not subject to the clawback provisions of the above-mentioned law and generally remain unaffected by the bankruptcy proceedings. The same holds true for security agreements which were carried out pursuant to the provisions of the Rehabilitation Agreement, which is mentioned above under question 7.6. As far as the procedure regarding the liquidation of the bankrupt debtor's estate is concerned, it should be noted that the liquidation proceeds in the context of the bankruptcy proceedings are distributed in accordance with the relevant provisions of the GCCP, which regulate the liquidation process in the context of the enforcement proceedings in general, and also the same system of privileges applies (for a detailed analysis regarding the distribution of proceeds under the provisions of GCCP, please refer to question 7.4).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Under the relevant provisions of the New Insolvency Law, every person regardless of whether they have a commercial status, as well as legal persons pursuing an economic purpose, are subject to bankruptcy proceedings. Legal entities governed by public law, public authorities in general as well as local authorities are not subject to bankruptcy proceedings and cannot be declared bankrupt.

Please also note that there are separate laws providing and regulating a special liquidation process for certain categories of legal entities, that is: (a) Law no. 4261/2014 regarding credit institutions; (b) Law no. 4514/2018 regarding investment firms; and (c) Law no. 4364/2016 regarding insurance undertakings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Please refer to question 7.4 above, where it is noted that, through the processes provided for by Legislative Decree 17.7.1923, as well as by Law no. 3301/2004, the secured creditor/pledgee may satisfy the secured claims without having to necessarily resort to court proceedings and subsequently to the liquidation of the debtor's assets through public electronic auction.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, a party's submission to a foreign jurisdiction is legally binding and enforceable under Greek law.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Where no prevailing mandatory provisions apply, by virtue of which the right to sovereign immunity is under all circumstances and without exception awarded and/or recognised, a party's waiver of sovereign immunity is, in principle, legally binding and enforceable under Greek law.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

The main type of lenders to companies under Greek law are credit institutions, which are regulated by the provisions of Law no. 4261/2014 and are authorised and supervised by the Bank of Greece. There also exist venture capital companies under the provisions of article 5 of Law no. 2367/1995, which have as one of their objects the investment in bonds issued by Greek companies, as well as other licensed companies (e.g. investment firms), which in certain exceptional cases and for limited purposes are legally permitted to grant loans to their clients. Please note that Law no. 4261/2014 provides that, in case of non-EU credit institutions, a special authorisation by the Bank of Greece is required. Apart from the aforementioned lenders, Law no. 4261/2014 also provides that lending is permitted between members of the same corporate group. In addition to the above, please note that, by virtue of Law no. 4354/2015, a new legal framework for the management and transfer of claims from non-performing loans ("NPLs") has been introduced into the Greek market, so as to help credit institutions clean up their balance sheets from non-performing, or so-called "red", loans. Law no. 4354/2015 has also introduced two new types of companies into the Greek legal system, in relation to the management and transfer of claims arising from loans and credits, i.e.: (a) Loans Management Companies ("L.M.C.s"); and (b) Loans Transfer Companies ("L.T.C.s"), which may under certain conditions provide new loans to the debtors of such NPLs. As far as the licensing of said companies is concerned, please note that L.M.C.s must be granted a special operating licence by the Bank of Greece for the purpose of the NPLs' management. As for the L.T.C.s, they are not required to obtain any operating licence from the Bank of Greece. However, if the L.T.C.s include loan/credit acquisitions within their scope of activity, they must enter into a loan management agreement with an L.M.C. which is properly licensed and supervised by the Bank of Greece.

Finally, in the case of a lender not appropriately authorised, that nonetheless makes a loan to a company, under Greek law, there are specified provisions for administrative sanctions, including but not limited to pecuniary ones (i.e. fines), which are imposed by the respective supervisory authority.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do

you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

With respect to the wholesale banking market, COVID-19 did not materially change the procedure of documents execution and delivery. Although the legal framework in Greece (i.e. Presidential Decree no. 150/2001 along with Regulation 910/2014 EU) provides that loan agreements as well as security agreements created by virtue of a private agreement, if signed by a qualified electronic signature, have legal validity and enforceability equivalent to a handwritten signature (article 25 (2)), the banking institutions in Greece have not yet adopted relative procedures and actions. Therefore, so far, all the relevant documents are signed by the parties by a handwritten signature usually in different places and before the legal counsel acting for the bank in order to avoid meetings. A very significant development in Greece is that the vast majority of certificates issued by the Greek Public Authorities which are necessary for the disbursement of a loan to a corporate entity are issued electronically. We do not anticipate any significant improvements in the execution and delivery procedures kept by the banks for wholesale and corporate lending, while some improvements are anticipated in the retail banking market.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

There are no other material considerations which should be taken into account by lenders when participating in financings in Greece.

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Sardelas Petsa Law Firm has established a leading position in Greek legal services as a business law firm with a strong international dimension, and is well known in Greece and abroad for its top-drawer specialised professional service in complex cross-border and domestic transactions, as well as commercial litigation. The firm is recognised by international legal directories and is considered by clients and peers alike as a legal practice with high expertise and experience, which comes up with innovative, practical and legally sage solutions in relation to complex transactions, some of which are considered to be innovative not only by Greek but also by international market standards. Its highest quality and innovative brand has been internationally recognised by experts and peers as it is consistently recommended in prestigious legal directories, such as the *IFLR1000*, *The Legal 500* and *Chambers & Partners*, while in 2009 it was selected on the IFLR Awards shortlist for the most innovative debt and equity-linked transaction in Europe.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Throughout 2020, understandably, the market has shown more restructuring of existing financings due to the COVID-19 pandemic.

At the same time, the Indonesian Government has seemed to focus on equity crowdfunding lending markets through the issuance of several new regulations in 2020 by the Financial Services Authority (Otoritas Jasa Keuangan or "**OJK**"). On 11 December 2020, OJK issued OJK Regulation No. 57/POJK.04/2020 concerning Securities Offering through Information Technology-Based Equity Crowdfunding ("**OJKR 57**"), revoking and repealing its predecessor, OJK Regulation No. 37/POJK.04/2018 on Equity Crowdfunding. OJKR 57 introduces a new type of securities that can be offered through equity crowdfunding, to include bonds, commercial papers, and collective investment contract participation units.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Due to the COVID-19 pandemic, only a few mega financing deals closed in 2020, including a major power project and the biggest (and first of its kind) advance smart and sustainable Transit-Oriented Development ("**TODs**") by Mitbana Pte. Ltd. ("**Mitbana**"). The deal involved a joint venture company of Mitsubishi Corporation and Surbana Jurong (a wholly owned company of Temasek Holding) in BSD City, Jakarta, where Mitbana formed a significant partnership with an Indonesian leading property developer, namely PT Sinar Mas Land, which will transform hundreds of hectares of greenfield land into TODs, including residential areas, green-park offices, digital hubs, a convention centre, railways and public transport nodes to enlarge BSD City's footprint of 200,000 residents to a total land area of 6,000 hectares.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Subject to certain qualifications on corporate benefit issues, generally it is common in Indonesian practice for an Indonesian company to provide guarantees to its subsidiaries.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Indonesian law recognises the corporate benefit concept where every corporate action of a company must be in line with its constitutional documents and it must give a justification of its benefits. Therefore, when a company enters into a guarantee or a security arrangement, lenders must carefully observe: (i) the company's articles of association; and (ii) a justification stating the company's commercial benefit from the transaction for which the guarantee and/or the third-party security is issued.

In practice, to minimise the risk of challenge, written consent from each of the company's organs (i.e. the general meeting of shareholders, board of directors, and board of commissioners) must be obtained.

2.3 Is lack of corporate power an issue?

While the guarantee may still be binding if the parties are acting in good faith, the board of directors may be considered negligent and may be personally liable for any losses suffered by the company with respect to the relevant guarantee.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

This very much depends on the company's line of business and its constitutional documents. As a general rule under Indonesian

company law, if a company's guarantee obligation constitutes more than 50% of the company's net assets, the company is required to obtain approval from its general meeting of shareholders. In addition, if the guarantee is provided in favour of foreign creditors, the guarantor must submit a periodical report to the Central Bank of Indonesia of its contingent liability.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, but under the Indonesian Civil Code, a guarantor is not liable for anything more than the amount owed by the borrower, and it may guarantee only a part of the amount owed. The guarantor may also need to check any negative pledge/covenant under its existing agreements that may contractually impose certain limitations relating to providing a guarantee for any other party's payment obligation.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control obstacles under Indonesian law, but obstacles may occur in the enforcement timeframe. The enforcement of a guarantee is basically similar to the enforcement of a valid contract. A claim/suit must be filed with the court having jurisdiction over the guarantor's domicile or another court agreed by the parties in the guarantee agreement. There are three levels of court (i.e. District Court, Court of Appeal (High Court), and Supreme Court) in Indonesia, each level of which could take quite some time to complete.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are a number and various classifications of security, depending on the type of asset, but the most common *in rem* security rights in Indonesian financing include:

(1) Immovable assets: mortgage (*Hak Tanggungan*); hypothec (for vessels).
(2) Movable assets: fiduciary security; pledge (*Gadai*).
(3) Intangible movable assets: pledge (*Gadai*).

Personal security is in the form of a guarantee (either a personal or corporate guarantee).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Different types of assets require different types of security agreements.

Mortgage for land (with or without any building upon the land)

The signing of the mortgage deed must be in the form of a notarial deed in Bahasa Indonesia, made before the Land Conveyancer Officer ("**PPAT**") with jurisdiction over the land to be mortgaged. The executed mortgage deed must then be submitted to the Land Office ("**BPN**") by PPAT at the latest seven days after the execution date.

The mortgage is established once registered in the BPN's land book (the seventh day after the BPN receives the complete mortgage application). The BPN would then issue the mortgage certificate as evidence of registration. In total, from a practical point of view (before issuance of Regulation 5/2020 discussed below), the issuance process of a mortgage certificate may take up to eight weeks depending on the process with the relevant land office. On 8 April 2020, the Ministry of Agrarian and Spatial Plan/National Land Agency introduced Regulation No. 5 of 2020 on Electronically Integrated Mortgage Service ("**E-mortgage**") ("**Regulation 5/2020**"), revoking the Ministry of Agrarian and Spatial Plan/National Land Agency Regulation No. 9 of 2019 on the same subject matter. The E-mortgage is intended to accelerate the service process of registration, assignment, rectification, amendment and deregistration of mortgage through an electronic system. One of the features of the E-mortgage system is that a qualified secured creditor can directly access the E-mortgage certificate and attach it to the relevant land certificate. Based on the Technical Guideline of Regulation 5/2020 issued by the Ministry of Agrarian and Spatial Plan/National Land Agency, as of 8 July 2020, land offices throughout Indonesia must implement E-mortgages.

Hypothec for vessels

Hypothec over vessels should be made by signing a hypothec deed prepared by a Vessel Registration Official at the relevant Director General of Sea Transportation office where the vessel is registered and listed in the Master List of Vessel Registration. The hypothec is effective once registered in the List of Indonesian Vessels (Buku Daftar Kapal Indonesia). The registration process takes from three days to two weeks.

Pledge (*Gadai*)

There is no prescribed form; in practice, a pledge is created by a deed of pledge (notarised or executed privately), followed by registration of the pledge in the company's shareholders' register (for pledge of shares) or notification and/or acknowledgment (for pledge of bank accounts). Pledge over tangible assets requires the secured objects to be kept in the pledgee's possession. Once the possession is re-transferred to the pledgor, the pledge will cease.

Fiduciary security

Unlike a pledge, fiduciary security over tangible assets allows for the security provider to keep the secured objects under its possession and utilise them for its day-to-day operations. A fiduciary transfer takes the form of a notarial deed in Bahasa Indonesia, under which the transferor (borrower) transfers to the transferee (lender) its legal title for security purposes for the period during which the debt remains outstanding. The fiduciary is effective once registered in the Fiduciary Registration Book kept by the Fiduciary Registration Office. On acceptance of the registration application, the applicant will obtain a Fiduciary Security Certificate. It can take from one to five business days for issuance of the certificate. The certificate will be dated the same as the application for registration.

Guarantee

A guarantee is mutually agreed by the parties, and there is no specific prescribed form for such. In practice, a guarantee is created by a written agreement (notarised or privately) between the guarantor and grantee.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes; in the same way and procedures as described in question 3.2 above. Mortgages apply to land (either with or without buildings

upon the land), and fiduciary security applies for buildings/plant (secured separately from the land), machinery, and equipment.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes; the most common form of security over receivables is a fiduciary transfer. Please refer to our answer in question 3.2, under the heading "Fiduciary Security".

In the case of a transfer of receivables, notification from the fiduciary grantee and/or acknowledgment from the debtor on the creation of the fiduciary security plays a significant part for enforcement purposes. However, the absence of notice and/or acknowledgment will not invalidate the fiduciary security, yet without a notice and/or acknowledgment, the lender will not have a direct claim against the debtor under the receivables.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

The most common form of security over cash deposits is a pledge over a bank account using the formalities referred to in our answer to question 3.2 under the heading "Pledge". Although theoretically a bank account can also be secured by way of fiduciary security, nonetheless, the Fiduciary Registration Office does not consider a bank account as an object of a fiduciary security; therefore, the validity of creation of a pledge over a bank account is doubtful.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes – the most common form of security over shares is a pledge as per question 3.2 under the heading "Pledge".

Not all shares have certificated forms, depending on the company's articles of association, but all shares must be registered in the shareholders' register maintained by the director of the company. The pledge takes effect upon notification of the pledge to the company in which the shares are held, which is normally done by annotation of such pledge in the company's register of shareholders. For enforcement purposes, all Indonesian security agreements must be governed by Indonesian law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, inventory is commonly subject to fiduciary transfer using the formalities referred to in our answer to question 3.2 under the heading "Fiduciary Security".

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, subject to the security interest meeting the corporate benefit requirement.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Mortgage

The cost of granting a mortgage consists mainly of the fees payable to the PPAT and BPN which includes the fees for preparation, execution, and registration of the mortgage deed. The fees are generally calculated on a percentage basis of the amount secured by the mortgage (which is commonly chosen by the lender based on the actual value of the assets or the principal amount of the loan).

Hypothec

The main fees are for the creation of the hypothec deed and the registration fees, generally calculated based on the size of the vessel, payable to the relevant Vessel Registration and Listing of Transfer of Transfers of Ownership Official (*Pejabat Pendaftar dan Pencatat Balik Nama Kapal*).

Fiduciary

The costs are nominal – mainly notary and registration fees.

Pledge

Costs are very nominal – commonly only the notary fees when the parties opt to sign the pledge in a notarial deed.

Stamp Duty

Stamp duty is at a very nominal amount of IDR10,000 (less than US$1).

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

This depends on the type of security; the most significant would be a mortgage over land.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Yes; please refer to our answers to questions 2.2 and 2.4.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

A security interest is of an accessory nature and is conditional upon the existence of the underlying secured obligation(s). Due to its accessory nature, an Indonesian security cannot secure a future obligation not yet in existence at the time the security is created, and the security will be valid as long as the revolving credit facility is valid. Therefore, if the loan is a revolving facility, the lenders need to carefully ensure that the loan is not fully repaid, and the secured object(s) remain in existence until the period of the loan lapses.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Yes; please refer to our answers to questions 3.2–3.9.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

There is no strict regulatory prohibition, but in the case of the above, theoretically, there is uncertainty as to whether the issuance of the guarantee can be regarded as in line with the objective and purpose of that company (*Ultra Vires Doctrine*).

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes, the role of an agent in relation to loans/financing (especially syndicated loans) is common in Indonesian financing, and as far as Indonesian law is concerned, the agent would be deemed to act for and on behalf of the lenders.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

As per our answer to question 5.1 above, the security agent role is common in Indonesian financing.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Loan transfers can be divided into: (i) assignment of receivables (only) or *cessie*; or (ii) transfer of obligations and rights (novation). If the former, the assignment is effectuated by an assignment instrument called a *cessie*. The assignment takes place when the assignment agreement is signed by Lender A and Lender B, but in order to bind the borrower to pay the debt directly to Lender B, the assignment must be notified to the borrower (in practice, lenders usually require acknowledgment from the borrower). In this case, the guarantee will automatically follow the assignment, securing Lender B. In contrast, in the event of a novation, the borrower's consent is required by law (by way of a tripartite novation agreement), and the existing guarantee will automatically cease when the novation takes place and therefore a new guarantee agreement must be signed by the guarantor in favour of Lender B.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

There are certain registration fees and notarial fees for creation of security interests, but they are relatively nominal, except in the case of land mortgage, the costs of which would depend on the secured amount. As for withholding tax-related matters, this needs to be assessed and confirmed by a qualified tax consultant.

6.2 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

The most significant cost would be in the case of a registration of mortgage over land, as it would depend on the secured amount, which, in practice, is calculated on a percentage of either the actual market value of the land or the total loan amount. In practice, the registration cost is normally borne by the borrower.

6.3 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Strictly from a non-tax regulatory perspective, the answer is negative.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, a choice of foreign law for finance documents (other than Indonesian security interests documents, which should be governed by Indonesian law) would be honoured and recognised as binding under the laws of the Republic of Indonesia except (i) to the extent that any term of those documents is manifestly incompatible with the public policy of the Republic of Indonesia, and (ii) if the Indonesian court gives effect to mandatory rules of the laws of another jurisdiction with which the situation has a close connection, if and so far as, under the laws of that other jurisdiction, those rules must be applied, whatever the chosen law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A judgment of a non-Indonesian court will not be enforceable in the Republic of Indonesia, although such judgment could be admissible as non-conclusive evidence in proceedings on the underlying claim in an Indonesian court. Re-examination of

the merits of the case would be required before an Indonesian court in order to enforce the claim underlying the foreign judgment in the Republic of Indonesia.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Theoretically, the litigation process in a District Court may take up to five months, and if there is further appeal, it would take the maximum three months in the court of appeal and 250 days in the Supreme Court. Nevertheless, in practice this may take more than the above timeframe given the uncertainty of the Indonesian litigation process.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Yes, enforcement of security interests in Indonesia should involve public auctions and, in practice, some auction companies require a court order to proceed. Depending on the type of security interest, private enforcement is generally possible, subject to the consent of the borrower or the relevant security provider and certain public announcements; as an example, for fiduciary security, a private sale is allowed provided that the fiduciary grantor has consented to such private sale and it can be done after one month following the announcement of such proposed sale in two daily newspapers and provided that there is no objection from any interested party.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No, there is no legal restriction for foreign lenders to file a suit in Indonesia.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

There is a moratorium procedure called the Suspension of Debt Payments under Law No. 37 of 2004 on Bankruptcy and Suspended Debt Repayments, but this does not apply to the enforcement of security interests. The suspension can be filed by a debtor or a lender to the commercial court if the debtor: (i) has at least two creditors; and (ii) cannot continue to repay one of its debts that have become due and payable, during which period the debtor cannot be forced to repay the debts.

Additionally, bankruptcy does not apply to collateral security unless it is during the "stay period" of 90 days that commences when a verdict pertaining to a declaration of bankruptcy is read out (the lender can execute its right over the relevant collateral security on the 91st day, and must exercise this right no more than two months after the insolvency condition ("**Lender's Enforcement Period**"). Following the lapse of the Lender's Enforcement Period, the enforcement process by law will be managed by the appointed curator.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Indonesia is a signatory to the 1958 New York Convention and has adopted such convention into Indonesian law by way of Presidential Decree No. 34 of 1981. Therefore, any final international arbitration award would be recognised without re-examination of the merits pursuant to Law No. 30 of 1999 and the 1958 New York Convention on the Recognition of and Enforcement of Foreign Arbitral Awards (the "**1958 New York Convention**"). However, enforcement of an arbitral award may be denied if:

(a) the award is issued by an arbitrator or arbitration tribunal in a foreign country which is not a signatory to an international convention on the recognition of foreign arbitral awards to which Indonesia is a signatory, or does not have a bilateral arrangement with the Republic of Indonesia on the recognition of arbitral awards on a reciprocal basis;
(b) the award is not on commercial law matters; or
(c) the award is against the public policy of the Republic of Indonesia.

To enforce the award, it is necessary to register the award with the Clerk of Central Jakarta District Court, obtain a writ of execution (known as an Exequatur) from the Chairman of the Central Jakarta District Court or, in case the award involves the Government of the Republic of Indonesia as one of the parties in the dispute, from the Supreme Court of the Republic of Indonesia (through the Central Jakarta District Court).

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Please refer to our answer to question 7.6.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Bankruptcy creditors are ranked in three categories, in the following order: (i) those with special rights based on laws and regulations (e.g. tax claims and collections); (ii) preferred creditors (i.e. secured creditors); and (iii) concurrent creditors (i.e. non-secured creditors).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

There are no entities excluded from bankruptcy proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

There are no other proceedings available to a creditor.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes; as long as it does not contradict Indonesian public policy. Under Indonesian law, parties to an agreement are free to choose the laws which govern their agreements, provided that the law chosen has a relationship with the agreement or to the parties to that agreement and provided that the choice of law is not contrary to Indonesian public order.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes; however, sovereign immunity has not been explicitly regulated in Indonesia, although the Republic of Indonesia has subscribed to the doctrine of restrictive sovereign immunity by its entry into the Convention on the Settlement of Investment Disputes between States and Nationals of other States of 1965.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

It is not necessary for a foreign lender to establish a place of business (or be licensed) for merely extending a loan to an Indonesian borrower, unless it has an actual business operation in the Republic of Indonesia.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

There has been no specific relaxation on the method for executing notarial deed documents, but there has been a significant change in relation to registration of land mortgages, whereby, as of 8 July 2020, the registration of land mortgages is processed through E-mortgages (an online system), which aim to replace the lengthy process of manual registration. Please refer to our answer to question 3.2 under the heading "Mortgage for Land" for further details on E-mortgages.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The regulation requires that each DULN in the form of a fund originates from (i) an offshore loan based on a non-revolving agreement which is not used for re-financing, or (ii) an offshore loan based on debt securities, and the difference between the new value of the offshore loan and refinancing over the previous value of the offshore loan is to be withdrawn through a Foreign Exchange Bank in Indonesia (a bank licensed by Bank Indonesia to carry out foreign exchange banking activities).

Currency conversion for repayment

There are some requirements for conversion of IDR into a foreign currency. The regulations allow a party to purchase foreign currency up to maximum amount of or equal to:

(i) USD 25,000 per month for each customer for spot transactions; and

(ii) USD 100,000 per month for each customer for derivative transactions.

A party may purchase foreign currency exceeding the above threshold, but in doing so, supporting documents as listed below must be presented to Bank Indonesia, and with a maximum amount required under the underlying transaction:

(i) a copy of the underlying agreement, i.e., the loan agreement;

(ii) a copy of the tax registration number (*Nomor Pokok Wajib Pajak*); and

(iii) a duly stamped and signed statement from the party:

  (1) confirming that the underlying agreement is an authentic and valid document and the utilisation of the underlying transaction for the purchase of foreign currencies against IDR shall not exceed the nominal value of the underlying transaction;

  (2) setting out the required amount, purpose of utilisation and date of foreign currencies utilisation, in case the underlying transaction is an estimation; and

  (3) setting out the source of funds, sales amount and time in obtaining the foreign currencies, in case the underlying transaction is an estimation.

Offshore loan report

A borrower obtaining an offshore loan is subject to certain reporting requirements, which must be submitted to Bank Indonesia on a monthly basis at the latest on the 15th day of the following month.

Prudence Principles requirement and report

In addition to the above report, a borrower receiving an offshore loan in foreign currency must implement certain principal requirements:

(i) **Minimum hedging ratio**

The borrower must meet a minimum hedging ratio of 25% of the negative difference between its foreign exchange assets and its foreign exchange liability exceeding USD 100,000 (or its equivalent), which is due (i) within three months ahead the end of the relevant quarter, and (ii) in the next three to six months ahead of the end of the relevant quarter.

In doing so, the borrower is required to enter into a hedging transaction (in the form of foreign exchange derivative transaction against Rupiah, i.e., forward, swap and/or option) with Indonesian banks. Exemptions to the above regulation apply if the borrower: (i) maintains

financial records in USD; (ii) has previous year export income 50% greater than its other business revenues; and (iii) obtains an approval from the Ministry of Finance to maintain USD financial records (the borrower must submit this approval to Bank Indonesia for the exemption).

(ii) **Minimum liquidity ratio**
The borrower must maintain at least a 70% liquidity ratio of foreign exchange assets to foreign exchange liability, which is due within three months as of the end of the relevant quarter.

(iii) **Minimum credit rating**
The borrower must have a credit rating of at least "BB-" issued by a credit rating company acknowledged by Bank Indonesia.

In relation to the above, the borrower is required to submit: (i) quarterly and annual reports on the implementation of the Prudence Principles (for the annual report: it must be assessed through an attestation procedure by an independent public accountant); (ii) reports of the credit rating, including information on the credit rating, time of rating, and name of the rating agency, by the end of the following month after the execution of the loan agreement or disbursement; and (iii) a quarterly unaudited financial report and an annual audited financial report. The quarterly report must be submitted at the latest in the third month following the relevant quarter and the annual report is to be submitted at the latest by the end of June after the end of the relevant year.

Enforcement of fiduciary security

Enforcement of security interest has always been challenging in Indonesia due to many factors, including a non-transparent enforcement system and case precedence where borrowers raise legal suits against their lenders during an enforcement event.

Many practitioners consider the situation to have been worsened by the Indonesian Constitutional Court, when in 2019 it rendered a controversial binding decision stating that the executory title contemplated in the fiduciary certificate is enforceable and valid *only to the extent that*: (i) it is mutually agreed by the fiduciary security grantor and the fiduciary security grantee on the occurrence of default; and (ii) the fiduciary security grantor willingly surrenders the fiduciary secured objects to the fiduciary security grantee, which contradicts the self-execution right of a lender provided by law (*recht van parate executie*).

Miriam Andreta is an Indonesian qualified lawyer with extensive knowledge and experience in M&A, banking and finance, oil and gas, and antitrust matters. She graduated from the University of Gadjah Mada and attended a one-year undergraduate exchange programme at the University of Tokyo. Ms. Miriam Andreta has just been shortlisted in the Women in Business Law Awards Asia 2020 for the Rising Star Award in two categories: Corporate and Finance. She was one of the finalists in the Woman Lawyer of the Year category for the *Asian Legal Business* Indonesia Law Awards 2020, was regarded by *Asia Business Law Journal* 2020 and 2019 as one of Indonesia's A-List Top-100 Lawyers, has been listed as an *Asian Legal Business* Rising Star Indonesia 2019, and was one of the top five finalists for the Young Lawyer of the Year category, as well as a contender in the Woman Lawyer of the Year at the *Asian Legal Business* Indonesia Law Awards 2018. She was also listed in the "40 Under 40" list of outstanding legal professionals in Asia by *Asian Legal Business* in 2018.

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Walalangi & Partners (in association with Nishimura & Asahi) ("**W&P**") was founded in 2017 by Mr. Luky I. Walalangi, a highly regarded lawyer with two decades of experience. W&P is a corporate firm focusing on M&A, Banking & Finance, Real Property, Project Development, Foreign Direct Investment, Antitrust, Debt & Corporate Restructuring, Capital Market (Debt and Equity), Employment, General Corporate, TMT, Energy & Natural Resources and Constructions.
W&P is in full association with Nishimura & Asahi (N&A), the largest law firm in Japan with more than 550 experts in various legal matters, including cross-border transactions and Asian practices. With this association and combination of talents, W&P can offer extensive international resources and a highly responsive client support centre.
W&P is: ranked by *Chambers Asia-Pacific* 2020 and *Chambers Global* 2020 in Corporate/M&A; regarded by *IFLR1000* 2021 as a Recommended Firm; regarded by *Asialaw Profiles* 2021 as a Recommended Law Firm; a winner of Equity Market Deal of the Year at the *Asian Legal Business* Indonesia Law Awards 2020; regarded by *Asia Business Law Journal* as Competition & Antitrust Law Firm 2020/2021 and Real Estate Law Firm 2020/2021 at the Indonesia Law Firm Awards; ranked by *Asian Legal Business* in M&A Rankings 2020; and a finalist for the Rising Law Firm at the *Asian Legal Business* South East Asia Law Awards 2020.
W&P expanded and doubled its office space in 2019, from 689 sq. m. in 2018 to almost 1,400 sq. m. now, and has 25 lawyers and counsels, with a total of almost 50 employees.
W&P's team comprises prominent and qualified lawyers, led by Mr. Luky I. Walalangi, a leading lawyer in Corporate, M&A and Banking & Finance, with two decades of experience in law practice.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Lending activity in Ireland, like business activity more generally, was significantly impacted by the COVID-19 pandemic. As the year went on, however, activity levels improved and a number of sectors showed considerable resilience, including lending for real estate development (particularly in the residential sector and notably for social and affordable residential developments), lending to investment funds and leveraged/acquisition finance as M&A and management buyout activity held up well. However, many lenders in the Irish market – as across the globe – spent a considerable amount of their time in 2020 managing the fallout from the pandemic. This was particularly notable in those sectors most immediately impacted by restrictive measures, such as leisure, hospitality and childcare.

There continues to be an active tertiary market where the funds that acquired portfolios of non-performing loans in the 2012 to 2015 period are exiting their positions.

Green finance remains to be an area of significant interest for lenders and this is only likely to grow in importance given the zero emissions targets by 2050 set by the EU for Member States. These targets are set to be incorporated into Irish law by the Climate Action and Low Carbon Development (Amendment) Bill 2020.

The consequences of Brexit for the Irish economy generally remain to be seen, notwithstanding the Trade and Co-operation Agreement concluded between the EU and the UK. While some welcome clarity has been given to Irish companies trading in goods with UK counterparties, the position regarding trade in services, and financial services in particular, is subject to further agreement between the EU and UK.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Despite the COVID-19 pandemic, there was a reasonable level of transactional activity, both domestically and cross-border, across multiple asset classes in 2020. Real estate finance continued to be an area of focus, although activity slowed during the first lockdown when construction activity was largely suspended. Nonetheless, Dillon Eustace acted for a lender which completed a significant financing for a mixed-use development in central Dublin during that period. Dillon Eustace has also advised Allied Irish Banks, p.l.c. and Ulster Bank Ireland DAC among others on multiple residential developments and we have advised, and continue to advise, a number of investors on the acquisition, development and leasing of portfolios of social housing units.

Leveraged/acquisition finance activity proved resilient as well, particularly for businesses in the transport, logistics and related sectors. Dillon Eustace acted on two notable transactions in this space, one for a lender supporting the acquisition of a group involved with refrigerated containers and the other acting for Principal Logistics Technologies in its acquisition of Brentech Data Systems. Other standout transactions included Deutsche Bank's provision of financing to the Seniors Money group which facilitated the return of lifetime loans to the Irish market; Dillon Eustace acted for Deutsche Bank.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes; however, this is subject to the corporate benefit rule (discussed at question 2.2 below), to certain provisions of the Companies Act 2014 (as amended) (the "**Act**") relating to the provision of financial assistance (discussed at question 4.1 below) and to certain provisions of the Act relating to transactions with directors which require, among other things, that both the guarantor and the borrower fall within the concept of "group" companies for the purposes of the Act.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Although not specifically addressed in the Act, it is generally accepted that Irish companies must derive some form of

corporate benefit from transactions into which they enter. Accordingly, prior to authorising the provision of a guarantee/ security to a third party, directors should consider, and document such considerations of, the commercial benefit that will accrue to the company as a result of providing such security. Directors who authorise a transaction which does not benefit the company may be liable for breach of their statutory and fiduciary duties. In the context of a guarantee of the borrowings of another corporate group member, it is often possible to establish sufficient corporate benefit if the provision of the guarantee/ security would benefit the group as a whole. For example, a holding company which guarantees the obligations of its subsidiary could feasibly expect to benefit from the success of that subsidiary through increased dividends.

2.3 Is lack of corporate power an issue?

Generally no, as the doctrine of *ultra vires* has been abolished by the Act and accordingly an Irish company limited by shares has, subject to all applicable laws, the same capacity as an individual. However, the Act introduced a new type of private company – a Designated Activity Company ("**DAC**") – which must (similar to a public limited company) have an objects clause which sets out the specific powers of the company. If it is not specifically stated in the objects clause of such a company that it has the power to issue a guarantee or grant security, then any such action by the company could be subject to challenge. While this in itself should not impact the validity or enforceability of the guarantee/security, there is a risk that the third-party lender may become indirectly involved in a dispute. In addition to this, any liquidator appointed to a company, which has granted security in breach of its objects clause may, in certain circumstances, have clawback rights under the Act which could potentially result in the security being set aside (see question 8.2 below).

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Generally no, subject to the provisions of the Act relating to financial assistance and transactions with directors. However, if the company is regulated or subject to the supervision of the CBI or some other regulatory authority, additional consents may be required. For example, an Irish regulated fund cannot give "guarantees" to support the obligations of a third party (which may include another sub-fund within the same umbrella fund structure). While the term "guarantees" when used in this context is not defined, it is generally accepted that this term includes any security provided to support the obligations of a third party. In terms of formalities, a guarantee must be in writing and must be executed as a deed. Execution as a deed is important for a number of reasons; for example, to remove any concerns about the adequacy of the consideration passing to the guarantor.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No; however, in certain circumstances a guarantee may be set aside as an unfair preference or due to the insolvency of the company (see question 8.2 below).

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Generally, no (subject to the application of anti-money laundering, counter-terrorist financing, anti-corruption and human rights laws and regulations, and any restrictions on financial transfers arising from any United Nations, EU and/or Irish sanctions).

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

In principle, all assets of an Irish company are available to secure lending, subject to any contractual restrictions to which a company might be bound. The most common forms of security taken by a lender are:

(i) **Mortgage**: there are essentially two types of mortgage – a legal mortgage and an equitable mortgage. A legal mortgage involves the transfer of legal title to an asset by a debtor, by way of security, upon the express or implied condition that legal title will be transferred back to the debtor upon the discharge of its obligation. An equitable mortgage on the other hand involves the transfer of the beneficial interest in the asset to the mortgagee with legal title remaining with the debtor and, as such, creates an equitable security interest only. Mortgages are commonly taken over shares, aircraft and ships.

(ii) **Charge**: this represents an agreement between a creditor (chargee) and a debtor (chargor) to appropriate and look to an asset and its proceeds to discharge indebtedness. The principle difference between a mortgage and a charge is that a charge need not involve the transfer of ownership in the asset. A charge may be fixed (i.e. security attaches to a specific asset) or floating (i.e. security floats over the asset leaving the chargor free to deal with it until, upon the occurrence of certain defined events, the charge crystallises into a fixed charge) in nature. A fixed charge can be created by a company or an individual, whereas a floating charge can only be created by a company. It is also worth noting that a floating charge ranks behind certain preferential creditors such as the Irish Revenue Commissioners ("**Revenue**") and employees of the chargor in respect of unpaid wages, etc.

(iii) **Assignment**: this is akin to a mortgage in that it transfers the legal or beneficial ownership in an asset to the creditor upon the understanding that ownership will be assigned back to the debtor upon discharge of the secured obligation owing to the creditor. Assignments are most commonly utilised in the context of intangible assets such as receivables, book debts and other choses in action. Assignments to a creditor are sometimes referred to as security assignments to distinguish them from absolute assignments where the ownership is being assigned by way of sale for value. In order to be a valid and effective legal assignment, as opposed to an equitable assignment, there must be absolute assignment (although it can be stated to be by way of security), it must be in writing under hand of the assignor, and express notice in writing must be given to the third party from whom the assignor would have been entitled to receive or claim the right which is assigned.

(iv) **Others**: to include a pledge, lien, chattel mortgage, bill of sale and retention of title.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Security over all, or substantially all, of a company's assets usually takes the form of an "all-assets" debenture, which is a

single security document entered into by a company in favour of the secured party(-ies) to create security (e.g. a combination of mortgages, assignments and/or fixed and floating charges) over the borrower's assets. The debenture will usually include: (i) a fixed charge over specific assets which are identifiable and can be controlled by the lender (e.g. buildings, restricted accounts, intellectual property assets); (ii) a floating charge over fluctuating and less identifiable assets (e.g. inventory); (iii) an assignment of any interest in receivables, contracts, insurance policies and bank accounts; and (iv) a mortgage and/or charges over real estate and shares.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Security over real property, plant, machinery and equipment is most commonly taken by way of fixed charge (and security over Irish real estate must be taken by way of charge). Where security is created over real estate which is registered in the Property Registration Authority of Ireland ("**PRAI**"), an additional prescribed form is also required to validly create the security.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables most commonly takes the form of a legal assignment and is permitted so long as the underlying contract creating the receivable does not contain a prohibition on assignment. In order to be a valid legal assignment, certain requirements (as outlined in question 3.1 above) must be adhered to, including the provision of written notice to the third party from whom the assignor would have been entitled to receive or claim the assigned right (the "**Underlying Debtor**"). An assignment not meeting these criteria is deemed to be an equitable assignment. One of the disadvantages of an equitable assignment is that the rights of the assignee will be subject to any equity (such as rights of set-off) already vested in the Underlying Debtor. In addition, should the Underlying Debtor pay off a debt due to the assignor and claim a good discharge of this debt, in circumstances where no notice of the assignment was given to the Underlying Debtor, then the assignee would be solely reliant on the assignor passing this payment on.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. This can take the form of a security assignment, fixed charge or floating charge. Taking a fixed charge over a "blocked" account would generally be considered the most effective form of security a lender could take. A blocked account is one where the chargor is prohibited from withdrawing, transferring or otherwise dealing with the account without the prior consent of the chargee. Given that commercial borrowers generally need ready access to their bank accounts for normal trading purposes, it is more usual that the chargee will accept a floating charge over the trading bank account which allows the chargor to retain control over the cash until such time as a trigger event (e.g. an event of default under the loan documents) causes the floating charge to crystallise.

For a security assignment, a notice of assignment must be served on the account-holding bank informing them that the account has been assigned in order to create a legal security interest. In some instances, the secured party(-ies) and the account-holding bank may agree an account control agreement or similar document regarding the operation of the assigned account.

A notification in relation to book debts should also be filed with Revenue, under s.1001(3) of the Taxes Consolidation Act 1997 within 21 days of the creation of the charge to put it on notice of the creation of the charge and to protect the chargee's interests should the chargor default on certain tax obligations in the future.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Security can be taken over shares issued by an Irish company. There are two main types of security over shares: a legal mortgage and an equitable mortgage. An equitable mortgage – which does not transfer legal ownership and as such does not require the lender to be registered in the company's share register as owner of the shares – is the most common. This is effected by delivery of share certificates and signed but undated share transfer forms, irrevocable proxies and various other deliverables which authorise the lender to complete the undated stock transfer form and any formalities required to become legal holder of the shares if the security becomes enforceable. Prior to the security becoming enforceable, all voting rights, dividends and any communication about the shares will remain with the chargor. It is common for a lender to also take a fixed charge over shares issued by an Irish company. This is commonly taken alongside an equitable mortgage.

Shares may be issued in certificated or uncertificated form; however, ordinarily in the case of a private limited company (which includes a DAC), shares will be issued in certificated form. A public limited company whose shares are listed on a Stock Exchange will issue shares in uncertificated form (which will be held in a clearing system).

While Irish law does not strictly require that share security be granted under an Irish law-governed document, it is almost always the case that Irish law-governed security is taken over shares in an Irish incorporated company, given that Irish law is likely to govern the validity and perfection requirements of the security.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, this typically takes the form of a floating charge given that the chargor trading company needs to retain sufficient freedom to deal with inventory in the ordinary course of business.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, subject to certain provisions of the Act relating to transactions with directors and the prohibition on the provision of financial assistance (discussed at question 4.1 below), the corporate benefit rule (discussed at question 2.2 above) and solvency considerations (see question 8.2 below).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Subject to certain exceptions set out in the Act, particulars of charges created by an Irish company over its assets must be registered at the Irish Companies Registration Office ("**CRO**") in the form prescribed within 21 days of its creation. This does not apply to security over certain financial assets, such as cash and shares. Failure to do so will render the charge void against any liquidator or creditor of the company. A filing fee of €40 is payable to the CRO in respect of each security registration. As mentioned in question 3.5 above, where security comprises a fixed charge over book debts, a notification should be made to Revenue within 21 days of the creation of the charge. No fee is incurred in respect of such notification.

Security over real property must be registered at the PRAI and security over certain other assets, such as IP, ships and aircraft, needs to be registered at applicable registries. There are no notarisation requirements for security documents under Irish law.

See section 6 regarding stamp duty.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Generally no, as prescribed forms are provided in most instances and filing fees are nominal. However, the filing requirements (for example of the CRO and PRAI) are very prescriptive and any errors in the forms can cause delays, extra expense and in the worst case may render the security void, necessitate an application to court for an order rectifying the particulars or require the parties to put new security in place.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally no, assuming the underlying contracts do not require any such third-party consents. See also question 2.4 above in relation to regulated entities. Regulated entities may be restricted from creating security over certain assets.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Generally no, provided the security is properly perfected at the time it was granted and the underlying security documents stipulate any repayment under the facility does not serve to extinguish the security, which should be expressed to secure all amounts owing from time to time.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In general, Irish law security documents are executed as deeds to remove any concerns about the adequacy of the consideration. Other guidelines should be considered, such as Law Society of Ireland practice notes and recent case law in relation to virtual completion and signing; for example, the decision in the English case of R *(on the application of Mercury Tax Ltd) v Revenue and Customs Commissioners [2008] EWHC 2721*. It is generally accepted in Ireland that a previously executed signature page from one deed may not be transferred to another deed, even where the documents in question are simply updated versions of the same deed.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company
Yes, s.82(2) of the Act creates a general prohibition on the provision by a company (either directly or indirectly) of financial assistance – whether in the form of loans, guarantees, the provision of security or otherwise – for the purpose of the acquisition of its own shares or the shares in its holding company. There are exceptions and s.82(5) allows financial assistance where the company's principal purpose in giving the assistance is not for the purpose of the acquisition or where it is incidental in relation to some larger purpose and the assistance is given in good faith. S.82(6) also provides a list of exemptions to the prohibition which includes the carrying out of a "Summary Approval Procedure" which allows an otherwise prohibited transaction to proceed.

(b) Shares of any company which directly or indirectly owns shares in the company
Yes, s.82 of the Act applies in respect of the acquisition by a company of shares in its holding company.

(c) Shares in a sister subsidiary
No – this is not applicable.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. Syndicated lending arrangements involving the appointment of a security agent to hold any security on trust for the benefit of all lenders and any other parties entitled to benefit from the security are common in the Irish lending market. However, it is worth noting that under Irish law it is usually the receiver appointed by the lender/security agent over the secured assets who realises the same on behalf of the secured parties. The Irish security document will usually provide for the appointment of a receiver and will usually provide that the receiver is the agent of the borrower rather than the lender(s)/security agent – this is noteworthy as it means that the lender/security agent is protected against any potential claims arising from the actions of the receiver as part of the enforcement.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Ireland.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Secured debts can be assigned, transferred or novated under Irish law. As the security provider must be provided with notice of the assignment, it is not unusual for the security provider to be a party to the transfer or novation.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) Interest payable on loans made by domestic or foreign lenders

A company making a payment of yearly interest from an Irish source is required to withhold Irish income tax from that interest at a rate of 20%.

For these purposes, yearly interest is taken to be interest on a debt, the duration of which is at least one year, or is capable of lasting for a year or more. Interest will have an Irish source if it is paid by an Irish company or branch or the debt is secured on Irish land or buildings.

Notwithstanding the above, there are extensive exemptions under Irish tax legislation from the obligation to withhold tax where interest is paid to domestic or foreign lenders such that, in many circumstances, Irish withholding tax does not apply (assuming relevant conditions are met).

(b) Proceeds of a claim under a guarantee or the proceeds of enforcing security

From relevant case law in the area, it is not clear as to whether a payment made under a guarantee should constitute an interest payment (i.e., the guarantor being deemed to step into the shoes of the borrower) or, alternatively, whether it should be considered a payment derived from a separate and distinct legal obligation. If the former, the analysis at (a) above should apply. Conversely, if the latter applies (such that the payment is not considered interest), Irish withholding tax should generally not apply.

With regard to the proceeds of enforcing security, to the extent that the security being disposed of is Irish lands or buildings or shares deriving their value from Irish land or buildings, there is a requirement for the purchaser to withhold tax at the rate of 15% from the proceeds. This withholding tax can be avoided if (i) the proceeds from the sale do not exceed €500,000 (€1,000,000, in the case of the disposal of residential property), or (ii) assuming certain conditions are met, the vendor applies for and obtains a CGT Clearance Certificate from Revenue and the vendor provides this certificate to the purchaser.

Where security is enforced, tax must be paid by the vendor on any gains arising in priority to any secured liability.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no tax incentives provided preferentially to foreign lenders and no taxes generally apply to their loans, mortgages and security documents for the purposes of effectiveness or registration.

No Irish stamp duty arises on the origination or novation of a loan. However, in very limited circumstances, stamp duty might arise on the acquisition of a loan by way of assignment.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Pursuant to general Irish tax rules, unless otherwise exempt, any foreign lender in receipt of Irish source interest income would be liable to Irish income tax. Notwithstanding this, Irish domestic tax legislation provides for exemptions from such income tax where the lenders are resident in EU Member States or in a territory that has signed a double taxation agreement with Ireland. In addition, an exemption may be available under a double taxation agreement itself.

Based on current Revenue guidance, a gain arising on the disposal by a foreign lender of a loan secured on Irish land or buildings may be subject to Irish capital gains tax. In addition, there may be a requirement for the purchaser to withhold tax at the rate of 15% on the proceeds (please refer to question 6.1 above and the discussion there regarding withholding tax on the proceeds of enforcing security). This is a highly technical area and, where applicable, specialist advice should be sought.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No; see question 3.9 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

In certain cases, interest paid to a foreign lender which owns 75% or more of the shares in the relevant Irish borrower could be regarded as a distribution and, therefore, would not be tax deductible for the borrower. Notwithstanding this, there are various circumstances where these rules are disapplied, including where the lender is resident in an EU Member State or pursuant to the provisions of a double taxation agreement.

In addition, as part of the implementation of the EU's Anti-Tax Avoidance Directives ("**ATAD**"), anti-hybrid rules have been recently introduced into Irish tax legislation. Broadly speaking, these rules are intended to prevent arrangements that exploit differences in the tax treatment of a financial instrument or an entity under the tax laws of two or more jurisdictions to generate a tax advantage. The rules apply to arrangements between associated enterprises and to certain "structured arrangements".

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The Irish courts will, as a general rule, respect and recognise

the governing law chosen by the parties. Regulation (EU) No. 593/2008 ("**Rome I**") governs the position with respect to contracts relating to civil and commercial matters involving EU Member States and provides that, subject to certain limitations, a contract will be governed by the law chosen by the parties. Under Rome I, Ireland recognises choice of law clauses, regardless of whether the applicable law is that of another EU Member State or of a "third country" such as the US and now the UK, having left the EU. The choice of law in contract disputes falling outside of Rome I will be determined by common law, unless there is a specific law or convention which deals with the particular contract in question. The common law recognises and enforces the choice of governing law provided for in the contract, subject to certain qualifications such as where there are public policy issues. The Irish courts can enforce a contract that has a foreign governing law. However, the party seeking to rely on the foreign law will need to prove to the satisfaction of the Irish courts what the foreign law is. Generally speaking, the Irish courts will not research the foreign law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Yes, where certain criteria are met. The recognition and enforcement of foreign judgments in Ireland is determined by international conventions and treaties. Foreign judgments fall broadly within one of three categories, being: (a) judgments from courts of EU Member States; (b) judgments from countries which are party to the Lugano and/or Hague Conventions; and (c) judgments from all other countries to which (a) and (b) do not apply. Irrespective of which category of jurisdiction a judgment falls within, an application can be made to the Irish courts to have the foreign judgment recognised in Ireland without having to re-litigate the facts of the case.

As New York falls within category (c), an application can be made to have the New York foreign judgment recognised in Ireland. In order for the judgment to be recognised and enforceable in Ireland, the Irish courts will have to be satisfied that: (i) the court in which the judgment is made had competent jurisdiction; (ii) the judgment is for a definite sum of money; (iii) the judgment is final and conclusive; and (iv) it is not contrary to public policy in Ireland.

As regards the Irish courts' recognition of a judgment of the English courts, given the terms of the UK's departure from the EU on 31 December 2020, the position has become less clear. The future mutual recognition and enforcement of judgments as between Ireland (as a remaining EU Member State) and the UK has ended.

For judgments given in proceedings which began in the UK courts by 31 December 2020, Regulation (EU) No. 1215/2012 ("**Brussels I Recast**") will apply and those judgments will, in effect, fall within category (a) above and by virtue of Brussels I Recast should be treated as a judgment made by a court in Ireland. Similarly, it will only be possible for UK judgment creditors to continue to use the European Enforcement Order relating to uncontested money judgments where an EEO certificate was applied for by 31 December 2020. For judgments obtained in English proceedings commenced after 1 January 2021, the recognition and enforcement in Ireland, as within the other remaining EU Member States, has become more complicated.

The UK applied to join the Lugano Convention in April 2020; however, its accession has not been ratified by the EU as yet. While the Lugano Convention is not identical to Brussels I Recast, if the UK's accession is ratified it would allow for the mutual recognition and enforcement of judgments as between the UK and EU. The UK and EU are signatories to the Hague Convention. Under the Hague Convention, Ireland should, subject to certain exceptions, recognise and enforce judgments made in the English courts where those judgments were made pursuant to an agreement that contains a choice of court provision granting the English courts exclusive jurisdiction. The protections afforded by the Hague Convention to a UK judgment creditor before the Irish courts are much more limited than under Brussels I Recast. There are also a number of uncertainties regarding the protections of UK judgment creditors under the Hague Convention which ultimately may not be resolved until such time as applications for recognition by English creditors on this basis come before the Irish courts for determination.

For judgments granted by the English courts that do not fall within the ambit of Brussels I Recast or the Hague Convention (or the Lugano Convention where it has come into force with respect to the UK), then the recognition and enforcement of judgment of the English courts by the Irish courts will be considered in the same way as a judgment of, for example, the New York courts and the four criteria for enforcement referred to above will apply.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Where the Irish courts have jurisdiction to determine the matter, the timing for obtaining a judgment on foot of a debt outstanding pursuant to a loan agreement or guarantee will firstly depend on the monetary amount for which the creditor is seeking judgment, as the court system is divided into a number of courts, with each having different monetary jurisdiction. Each of the courts also has its own distinct rules but each has a special procedure available to creditors to recover a debt or liquidated amount. Furthermore, obtaining judgment will depend on whether the debtor enters an appearance to the proceedings or not. In broad terms, where debt proceedings are brought against a company for a debt owing to a foreign lender of over €75,000 and the company does not enter an appearance to the proceedings, judgment may be obtained within six to nine months of the proceedings issuing. However, there is a Commercial division of the High Court in Ireland which can fast-track commercial cases. Upon proceedings issuing, an application can be made to the Commercial Court for a case to be heard by it and, if a case is transferred to the Commercial Court list, this will likely significantly reduce the time within which judgment would be obtained. There is no automatic entitlement for a case to be heard in the Commercial Court. Commercial disputes, where the value of the claim is more than €1 million and where there has not been undue delay in applying to have the case heard are the types of cases that are admitted to be heard by the Commercial Court.

There are a number of options with respect to post-judgment enforcement or execution. If a debtor company owns immoveable property/real estate, a foreign lender can register the recognised judgment as a judgment mortgage over any real estate owned by the Irish company in Ireland. This will entitle the foreign creditor, as the judgment mortgagee, to the proceeds of sale after all prior encumbrances on the real estate have been

discharged. In relation to moveable property, an enforcement order can be obtained, pursuant to which assets of the company may be seized. A foreign creditor with a recognised judgment can also make an application to court for the appointment of a receiver by way of equitable execution. Where a court finds it just and convenient to do so, it can order the appointment of an equitable receiver over the assets held or income to be received by the debtor company to pay down the debts owing to the foreign creditor via the equitable receiver. If it is believed that the Irish company is insolvent, a foreign lender who has obtained judgment for more than €10,000 (this minimum amount has been temporarily increased to €50,000 with respect to one or more in aggregate creditors as part of the COVID-19 emergency measures currently proposed to run until June 2021) can issue a statutory demand to the debtor company calling on it to discharge the amount due pursuant to the judgment within 21 days. Where that 21-day statutory demand is not met, then there is a presumption that the debtor company is insolvent and a petition can be brought by the foreign creditor to have the company wound up by the Irish courts and have all assets liquidated to attempt to satisfy all creditors of the Irish company. It may take two to three months following the expiry of the 21-day demand letter for a liquidator to be appointed over the Irish company.

In terms of the time period for enforcing a foreign judgment, as noted in answer to question 7.2 above, that will depend on the jurisdiction in which the judgment has been obtained. Where the judgment has been given in an EU Member State, Brussels I Recast applies and the judgment against the Irish company is essentially enforceable as if it were a judgment made by an Irish court, meaning that the enforcement procedures, as described above, can be invoked.

In relation to judgments made by courts of non-EU Member States, an application has to be made to the Irish courts before the judgment can be enforceable. Where the judgment has been given in a state which is a party to the Lugano Convention (being EU Member States, Iceland, Norway, and Switzerland), an application is made to have the foreign judgment declared enforceable in Ireland. It may take one to two months to have the foreign judgment declared enforceable, following which it can be enforced against a company as set out above. In relation to judgments from non-EU and non-Lugano Convention member countries, which now includes the UK with respect to any judgment proceedings not issued before the UK courts on or before 31 December 2020, an application can be made to have the foreign judgment recognised in Ireland. However, unlike a judgment from a country which is a party to the Lugano Convention, the application to have the judgment recognised is made on notice to the judgment debtor, which brings with it practical issues such as serving the proceedings. Furthermore, the judgment debtor, being on notice of the application, may attend and oppose the application to have the judgment recognised. Therefore, whilst the application may get a first return date within one to three months from the date of issuing proceedings, the application may not proceed on the first return date if it is opposed, as the judgment debtor will be given the opportunity to challenge the application, and the foreign judgment holder could be significantly delayed in having the judgment recognised, depending on the extent of the challenge. Once the judgment has been declared enforceable or is recognised by the Irish courts, it can be enforced as set out above.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

The circumstances in which a lender can enforce its security under Irish law are largely dependent on the type of security the creditor holds and the terms of the underlying security documents. The most common method of enforcement by the holder of a legal fixed or floating charge over the assets of a corporate debtor is by way of the appointment of a receiver. The appointment of a receiver, or receiver and manager, is a reasonably straightforward process. The appointment can be effected by way of a deed or instrument of appointment between the secured creditor and receiver at any time after the enforcement powers have become enforceable under the terms of the collateral security and at law. S.439 of the Act provides that in selling property of a company, a receiver must exercise all reasonable care to obtain the best price reasonably obtainable for the property as at the time of sale. This may involve recourse to expert opinions and valuations of company property which, depending on the circumstances, could lead to a recommendation that a public auction is necessary in order to achieve the best available price for the respective property. This would have a consequent effect on the timing of any enforcement. The timing of enforcement could also be impacted by the appointment of an examiner (see question 7.6 below).

Where the collateral security held is in the form of a pledge, lien or equitable/possessory security, the creditor's entitlement is to possession only of the asset until the obligations for which the asset are held are discharged. If the holder of equitable security wishes to be able to force the sale of the asset to pay down its debt, an application has to be brought to court to have the security converted to legal security and then often an order of the court for the sale of the asset is also required. These applications can take up to two to three years to complete.

While not necessarily resulting in a significant restriction impacting on the timing and value of enforcement, collateral security holders of certain asset classes may be impacted by any specific regime applicable to those assets. As an example, Ireland had adopted Alternative A of Article XI of the Aircraft Protocol of the Cape Town Convention on International Interests in Mobile Equipment. The regime creates an aircraft-specific international framework for the formation, registration (through an international registry), protection and enforcement of certain international interests in airframes, aircraft engines and helicopters.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No. Foreign lenders are subject to the same statutory limitation periods within which a claim must be brought and the same rules of court as those imposed on Irish lenders seeking to file suit against a company and enforce security through the courts.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes. Irish companies may enter examinership, which is a court-enforced moratorium on creditor action which allows a certain period during which a company can be restructured. This process almost always results in creditor balances being reduced, while assets of the company are protected, investment is obtained and the company can continue to trade. The examiner is typically appointed for 100 days or thereabouts (this protection period has been temporarily increased to 150 days as part of the

COVID-19 emergency measures currently proposed to run until June 2021), during which time the lender will not be permitted to take any enforcement action against the debtor company, save in respect of a security financial collateral arrangement as defined in the Financial Collateral Arrangement Regulations. Pursuant to the recast EU Insolvency Regulations, this moratorium is also ineffective in relation to rights *in rem* of creditors or third parties by way of security in assets situated outside of Ireland and does not affect the right of creditors to exercise their right of set-off against the claims of a debtor. A lender's rights against a guarantor of the debtor company are also preserved if the lender complies with certain strict requirements.

There is another statutory corporate restructuring process in Ireland, being a scheme of arrangement under Part 9 of the Act. A scheme of arrangement in Ireland is similar to a scheme of arrangement in England and Wales. Although there is no automatic stay on enforcement action, an application can be made to court (almost always by the debtor company that is proposing the restructure) for a stay on court proceedings issuing as part of the scheme of arrangement process. An order of the Irish court made in these circumstances could temporarily prevent certain secured creditor enforcement action by way of court proceedings. However, a secured creditor would not be prevented from enforcement of its collateral security by way of appointment of a receiver (see question 7.4 above).

In addition to the above, there are certain other laws and codes that apply in the context of lending to natural persons and/or small- or medium-sized enterprises ("**SMEs**") (and the enforcement of such loans), many of which must be adhered to by foreign lenders lending into Ireland.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes, subject to certain conditions being satisfied. Ireland ratified the New York Arbitration Convention under s.24 of the Arbitration Act 2010. The Arbitration Convention provides for the recognition and enforcement of domestic and international arbitral awards. Pursuant to s.23 of the Arbitration Act 2010, an award made by an arbitral tribunal under an arbitration agreement shall be enforceable in this jurisdiction either by action or leave of the Irish High Court. For enforcement of foreign arbitral awards, the award must be in writing and be signed by the arbitrator or arbitrators. In arbitral proceedings with more than one arbitrator, the signatures of the majority of the tribunal will suffice, so long as the reason for any omitted signature is set out. The award should also state its date and the place of arbitration.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In Ireland, bankruptcy proceedings in respect of a company are called liquidations. The capacity of a lender to enforce its rights as a secured party over collateral security is not affected by liquidation proceedings being entered into by a company. Should the enforcement of collateral security fail to discharge the total debt owed to the lender, the balance may be an unsecured claim of the secured party in the liquidation process. However, the rights of a secured lender will be affected where the company has entered examinership proceedings, as discussed in answer to question 7.6.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Yes. Pursuant to s.597 of the Act, a floating charge will be invalidated where it has been created within 12 months of the company entering into insolvency proceedings unless it is proven that the company was solvent immediately after the creation of the charge. This period will be extended to two years where the floating charge has been created in favour of a connected person.

The Act also provides for certain clawback rights where a fraudulent or unfair transfer of company property has occurred. For example, pursuant to s.604 of the Act, any transfer of company property to a creditor will be invalidated where such transfer was made with the dominant intention of securing a preference over other creditors in the company and was made within six months of the insolvency of the company (the period will be extended to two years where the transfer was made to a connected person).

With regard to preferential creditors, the expenses relating to an examinership or liquidation, together with certain taxes, rates and employee claims have priority over floating charge security holders. If, however, a floating charge has crystallised in advance of a company going into liquidation, that floating charge becomes a fixed charge and ranks accordingly ahead of all preferential and unsecured creditors.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The Irish courts have jurisdiction to place the following into liquidation proceedings under Irish company law: Irish registered companies; entities to which the recast EU Insolvency Regulation applies and whose centre of main interests or establishment is in Ireland; foreign-registered companies with sufficient connection to Ireland; and certain types of investment vehicles such as Irish Collective Asset-management Vehicles. While not excluded from liquidation proceedings *per se*, the Irish insolvency regime has been tailored in certain sectors such as insurance, banking, credit institutions and investment services. Specific provisions relating to the insolvency of businesses in these sectors are contained in the Act, related EU regulations and in sectoral-specific regulatory conventions or regimes. The objective of these modified sectoral regimes is primarily to prevent, as opposed to necessarily exclude, insolvencies because of the systemic or societal impact that could result.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Secured creditors may exercise set-off rights and appoint receivers without recourse to court proceedings. Unsecured creditors cannot seize secured assets of a company without a court order authorising them to do so. However, unsecured creditors may be able to repossess goods/assets which have not been paid for in full by the debtor company where the goods/assets supplied are subject to a valid retention of title clause in the supply documentation.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Generally speaking, yes.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, Ireland accepts the recognised principles of international law as the rule of conduct in its relations with other countries and accordingly, in principle, an Irish court will recognise a party's waiver of sovereign immunity.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Until recently, commercial lending was not a regulated activity in Ireland and, unless the lender was a bank, there was generally no requirement to obtain a licence. However, the regulatory regime in Ireland has been the subject of significant debate in recent years leading, most recently, to the enactment of the Consumer Protection (Regulation of Credit Servicing) Act 2018 (the "**2018 Act**"). While not imposing any additional licensing requirements, the 2018 Act does require unregulated entities (other than securitisation special purpose vehicles which are exempt) that hold legal title to loans to Irish consumers or SMEs and/or control the overall strategy or key decisions relating to such loans to be authorised and regulated by the CBI.

In addition, lenders may also be subject to various other reporting and regulatory requirements, such as:

- the Credit Reporting Act 2013, which requires that lenders – both regulated and unregulated – collect and report to the CBI certain information relating to credit advanced to non-consumer borrowers, which includes companies, limited liability partnerships, etc.; and
- lenders are typically required to comply with the CBI statistical reporting requirements.

Lenders (including unregulated lenders) providing certain services, which are already obliged to comply with Irish anti-money laundering and counter-terrorist financing obligations even though they are not authorised or licensed by the CBI, are required – unless they qualify for an exemption – to register with the CBI by virtue of new legislation passed to transpose the Fourth Anti-Money Laundering Directive into Irish law.

In addition, many lenders may find that they fall within the scope of regulation by virtue of other activities carried out by them; for example, taking deposits. Any lender in Ireland which provides banking services, which includes the taking of deposits, is required, on application to the CBI, to obtain a licence from the European Central Bank. Carrying on a banking business in Ireland without a licence is a criminal offence. Banks licensed in another EU Member State may also be required to passport into Ireland in order to carry on a lending activity in Ireland that would otherwise be unregulated.

There are no specific licensing requirements that apply to a security agent under a syndicated facility. However, such an agent would be subject to regulation if it carries on any regulated activities; for example, accepting deposits. Any person or entity carrying on the business of a trustee of a trust or a "Company Service Provider" (as defined in the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (as amended)) may be required to obtain an authorisation to do so from the CBI (if it is a subsidiary of a credit or financial institution) or the Minister for Justice and Equality (in all other cases).

As regards the position of a foreign lender, if lending to persons in Ireland, they would generally be subject to the same conduct of business rules as an Irish lender, and are also required to hold the appropriate licence/authorisation if carrying on a regulated activity (albeit their regulatory status in their home country may have a bearing on the latter, e.g., passporting rights if carrying on passportable activities).

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

Following the outbreak of COVID-19 and the consequential restrictions which have been put in place on travel and "in-person" meetings, there has been a substantial increase in the use of e-signatures in Ireland. Many documents are capable of being executed using an e-signature, provided that appropriate execution formalities are fulfilled and there are no constraints on the use of e-signatures in the relevant document in question.

The use of e-signatures in Ireland is governed by both domestic and EU legislation; namely:

- the Electronic Commerce Act 2000 (the "**2000 Act**"); and
- the Regulation (EU) No. 910/2014 on electronic identification and trust services for electronic transactions in the internal market (the "**eIDAS Regulation**").

The 2000 Act provides that, subject to certain exceptions, an e-signature shall not be denied legal effect, validity or enforceability because it is electronic. The eIDAS Regulation also gives effect to the use of e-signatures and creates a system of mutual recognition of e-signatures throughout the EU in order to facilitate cross-border transactions. The eIDAS Regulation came into force on 1 July 2016 and has direct effect throughout the EU since that date. Importantly, where there is a conflict between the eIDAS Regulation and the 2000 Act, the provisions of the eIDAS Regulation will prevail. However, where the 2000 Act and the eIDAS Regulation provide for separate (rather than conflicting requirements), both must be complied with.

The eIDAS Regulation defines three key types of e-signatures:

- Electronic signature: meaning data in electronic form which is attached to or logically associated with other data in electronic form and which is used by the signatory to sign (for example, .jpeg images or a typed signature).

- Advanced electronic signature: meaning a signature that meets the following requirements:
  (a) it is uniquely linked to the signatory;
  (b) it is capable of identifying the signatory;
  (c) it is created using electronic signature creation data that the signatory can use under his/her sole control; and
  (d) it is linked to the data signed in such a way that any later change in the data is detectable.
- Qualified electronic signature: meaning an advanced electronic signature that is created by a qualified electronic signature creation device and which is based on a qualified certificate for electronic signatures.

The 2000 Act simply provides for "electronic signatures" and "advanced electronic signatures" and has not been updated to replicate the three-tier electronic signature framework introduced by the eIDAS Regulation. While comparable, they are not direct equivalents to those specified under the eIDAS Regulation.

The formalities for the execution of a deed in Ireland are set out in s.64(2) of the Land and Conveyancing Law Reform Act 2009 (as amended). In the case of an Irish registered company, a deed must be executed under the company's common seal. Unless the company's constitution provides otherwise, any document to which the common seal is affixed must be signed by a director and countersigned by the company secretary, a second director or another person appointed by the directors for that purpose.

Accordingly, regarding the execution of documents which require signatures to be witnessed, where a signatory uses an electronic signature (e.g. an individual executing a deed on his/her own behalf, or an attorney executing a deed on behalf of a body corporate), the witnessing requirement is met where either:

- the witness is physically present when the signatory applies his/her electronic signature, and the witness then applies his/her electronic signature underneath as witness; or
- the witness is physically present when the signatory applies his/her electronic signature, but does not have his/her own electronic signature, and therefore prints the electronically signed document and witnesses using a wet-ink signature.

In addition, documents executed by an Irish company which must be witnessed may be executed by way of e-signature. An advanced electronic signature based on a qualifying certificate (as defined in the 2000 Act) or a qualifying electronic signature (as defined in the eIDAS Regulation) are both effective in this regard.

Importantly, where documents require execution by an Irish company under its common seal, the 2000 Act does not provide for the electronic equivalent of a company seal. In light of current restrictions, Irish companies, as a practical alternative, have begun to execute deeds by way of a power of attorney. A power of attorney does not need to be executed under the common seal of a company. The power of attorney permits one or more individuals, usually a director or secretary, to execute deeds on the company's behalf. The attorney then executes the document (using his/her electronic signature where appropriate) without any requirement for the company seal to be affixed (but his/her signature must be witnessed if the document is a deed as outlined above).

Under Irish law, counterparty consent is required to a party using an electronic signature. This consent may be implied; however, best practice is to obtain the express consent of the counterparty where possible.

It should be noted that despite the increase in the use of e-signatures, there are still circumstances where they are not sufficient. Certain documents, such as documents transferring or creating interests in real property, cannot be executed using an electronic signature and, for those, a wet-ink signature is still required.

Registries, including the CRO and the PRAI, require certain filings to be delivered as wet-ink originals. Furthermore, where a document is required to apostilled for use abroad, the Department of Foreign Affairs still requires a wet-ink signature in order for an apostille to be affixed. A notary public will generally still require a wet-ink original signature to be applied in their presence also.

Given the current restrictions, documents are usually circulated electronically for closing (regardless of whether documents are executed electronically, or comprise scanned copies of wet-ink documents) with the originals to follow in due course when it is practicable to do so. In this regard, parties should ensure that they comply with guidance on the "virtual" execution of documents issued by the Law Society of Ireland.

It is anticipated that the use of e-signatures will continue to be prevalent in 2021.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Notwithstanding the measures referred to at question 10.1 above, the regulatory regime in Ireland relating to lending largely focuses on lending to natural persons and SMEs at present and there is various legislation, regulation and codes of which lenders would need to be cognisant if originating loans to such persons or to SMEs (or acquiring loans originated to such persons or to SMEs).

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The authors would like to acknowledge the assistance of their colleague Shona Hughes in the preparation of this chapter. Shona acts on a wide range of banking transactions for both financial institutions and corporates, both domestic and foreign, on an extensive range of banking law matters. She provides advice on matters in relation to borrowings and the provision of guarantees and security in respect of such borrowings, pre-conditions of security documentation and perfection of security.

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The Dillon Eustace banking team advises domestic and international financial institutions and corporates, for both transactional work and banking regulatory matters. Transactional expertise includes advising both lenders and borrowers on credit facilities (including term, revolving and composite facilities whether on a syndicated, club or bilateral basis) as well as on associated security, credit support and enforcement issues. In addition to secured property lending, we work on debt financings for investment funds and pension funds and acquisition finance for M&A transactions. Our regulatory practice includes advising on the establishment of banks and branches of EU and non-EU credit institutions in Ireland and on their acquisition and sale. We also advise on e-banking, consumer credit and banking regulation and licensing generally.

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Italy

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

With a view to increasing the competitiveness of the Italian lending market during the credit crunch, a number of laws have been introduced by the Italian legislator in the last decade. In particular:

- new players have been given access to the lending market by including them among the entities licensed to lend directly to Italian entities (for further details, see section 10);
- non-listed companies have been given access to bond financings; and
- the tax regime has been rendered more favourable by extending the application of certain tax benefits (*i.e.* the exemption from withholding tax over interest and the substitutive tax regime).

Furthermore, new and more flexible types of *in rem* security interests have been introduced into the Italian legal system:

- the non-possessory pledge over movable assets (for further details, see question 3.7); and
- the security transfer of real property (*patto marciano*) (for further details, see question 3.3).

Moreover, an organic reform of the Italian bankruptcy law was adopted by the Italian Government at the beginning of 2019 (after consultation with the Parliamentary Committees) and is expected to come into force on 1 September 2021, save for certain specific provisions which entered into force in March 2019 and those which may be approved by the competent bodies in the near future. The main features of the reform include, *inter alia*: (i) the introduction of the notion of group insolvency; (ii) an "early warning" system aimed at anticipating and preventing the occurrence of insolvency situations; (iii) several amendments to the rules governing composition agreement with creditors (*concordato preventivo*), debt restructuring agreements (*accordo di ristrutturazione*) and judicial liquidation proceedings (previously *fallimento*); and, more generally, (iv) the introduction of a coherent and uniform legislative framework of insolvency in Italy. Until the proposed reform enters into force, the current provisions of the Italian bankruptcy law still continue to apply (for further details, see section 8). For the sake of brevity, this chapter does not include the changes which will be brought by the abovementioned reform.

Finally, the Italian lending market is expected to be affected by Brexit.

With the ratification of the agreement for the UK's withdrawal from the EU, as of 1 February 2020, the UK is no longer a member of the EU. With the purpose of avoiding a cliff-edge scenario in the bilateral relations between the EU and the UK, a transition period of up until 31 December 2020 was provided in the withdrawal agreement. During such transition period, negotiations were carried out between the UK and the EU in order to regulate their future bilateral relations. In Italy, contingent transitional measures to ensure the operational continuity of intermediaries and markets are contained in Law Decree No. 22 of 25 March 2019, converted into Law No. 41 of 20 May 2019.

On 31 December 2020, the transition period expired and on 1 January 2021, Law Decree No. 183 of 31 December 2020 (the so-called *Milleproroghe* decree) entered into force.

The decree allows UK banks, UK e-money institutions with a branch in Italy and UK investment firms to continue operating in Italy to a limited extent for six months post-Brexit, provided that they have filed an application for obtaining a local licence with the relevant Italian regulator by 31 December 2020.

During the six-month period, only ordinary management of pre-existing contracts and/or positions is allowed (*i.e.* the entering into of new contract/position or the amendment of any provisions of pre-existing contracts shall be forbidden) with the exception of OTC derivatives for which the management of life cycle events is permitted even if it may imply amendments to existing positions or entering into new contracts. Moreover, the performance of MiFID investment services and/or activities to Italian retail clients and/or professional clients upon request on a cross-border basis by UK banks and UK investment firms is forbidden, which therefore must be terminated.

Further requirements and restrictions may apply to UK banks and UK investment firms when operating in Italy through a local branch.

In cases where the authorisation to operate in Italy as a third-country intermediary is rejected, the UK entities must cease the performance of their services and/or activities to Italian clients as soon as possible and, in any case, no later than three months from the date on which the relevant Italian regulator has notified its intention not to grant the local licence.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Some significant transactions that have taken place recently are as follows:

- A EUR1bn sustainability-linked loan facility, structured as a club deal, granted by a pool of lenders (advised by Allen & Overy) to Enel. The loan is part of Enel's "Sustainability-Linked Financing Framework" and meets ICMA's "Sustainability-Linked Bond Principles" and the LMA's "Sustainability-Linked Loan Principles".

- A EUR1.7bn revolving credit facility granted by Crédit Agricole CIB, as global coordinator, and a pool of nine Italian and international banks (advised by Allen & Overy) to Italian telecoms operator TIM. The credit line was structured as a bridge to bond.
- A financing granted by Natixis and UniCredit, as MLAs (advised by Allen & Overy), to Phoenix Tower International for the acquisition of TowerTel S.p.A. from EI Towers S.p.A., a portfolio company owned by F2i sgr.
- An up to EUR940m refinancing of CDP Reti's existing loan facilities (which we originally advised on), granted by a pool of nine Italian and international banks and Cassa depositi prestiti (CDP) (advised by Allen & Overy) as well as a new unsecured financing.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

An Italian company can guarantee borrowings of one or more other members of its corporate group subject to certain limits. See questions 2.2, 2.5 and section 4 for further details.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In order for an Italian company to grant a guarantee or security, there must be a corporate benefit. Whilst corporate benefit for a downstream guarantee or security is usually self-evident, the validity and effectiveness of an upstream or cross-stream guarantee or security granted by an Italian company depends on the existence of an actual benefit as direct or indirect "consideration" for entering into the guarantee or security.

Undervalue guarantees or security may be a breach of the directors' duties to act in the interests of the company, which can sometimes render them personally liable. The "business judgment" rule is strict and the risk of director liability can be high. Common directorships (conflicts of interest) increase risk – arrange for independent boards, if possible. Guarantees by companies whose directors have an interest in the guaranteed or secured company have increased risk.

Italian law does not, except for certain limited and specific purposes (such as antitrust law), recognise the concept of the "group" or "group interest" and, therefore, the group interest in a transaction is not a sufficient ground to exclude the application of the *ultra vires* doctrine.

Articles 2497 *et seq.* of the Italian civil code set out the general rules applying to any entity which, by virtue of a controlling or similar relationship (not necessarily granted by a majority stake), exercises the activity of direction and coordination (*attività di direzione e coordinamento*) over the companies in its group. In particular, article 2497 provides that if the holding company, in the exercise of the activity of direction and coordination, breaches the principles of the correct corporate and entrepreneurial management in order to pursue its own interest (or the interest of a third party), it is directly liable *vis-à-vis* the shareholders of the subsidiary for compromising the profitability of the subsidiary, as well as towards the subsidiary's creditors for having put at risk the integrity of the share capital of the subsidiary. In the case of bankruptcy of the subsidiary, the action pertaining to the creditors against the holding company may be exercised by the insolvency receiver of the bankrupt subsidiary.

2.3 Is lack of corporate power an issue?

According to articles 2384 and 2475-*bis* of the Italian civil code, lack of corporate power deriving from the by-laws or a corporate resolution of a joint stock company or limited liability company, as well as the existence of a director's personal or a third party's interest in a transaction, cannot be raised against a counterparty unless it proves that the counterparty has acted for the purpose of damaging the company.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

The granting of a guarantee must be permitted under the by-laws of the company. Management bodies' and shareholders' resolutions may be required, in accordance with the by-laws.

The granting of guarantees *vis-à-vis* the public is considered a form of lending and, as a consequence, it is an activity that can be carried out exclusively by entities licensed to carry out lending activities in Italy. For further details, see section 10.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

The most relevant limits on the amount of a guarantee that can be issued are:

- limits arising from financial assistance provisions. For further details, see section 4;
- limits arising from corporate benefit rules. For further details, see question 2.2 above; and
- pursuant to article 1938 of the Italian civil code, the guarantor may only guarantee future obligations if an overall maximum guaranteed amount is set.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Under Italian law, there are no exchange control or similar restrictions to the enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

The forms of collateral mainly used in Italian financing transactions are the following:

- Mortgage over real property, ships or aircraft.
- Security transfer of real property (*patto marciano*).
- Special privilege over certain movable assets.
- Pledge over a private company's shares.
- Pledge over marketable securities.
- Pledge or assignment by way of security of receivables.
- Pledge over bank accounts.
- Pledge over intellectual property.
- Pledge over goods.

Non-possessory pledge over movable assets (subject to the implementation of the relevant register).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Italian law does not provide for a universal corporate security interest covering all existing and future assets generically. But most common assets can be the subject of separate security.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Real property mortgage

The mortgage deed must be signed before an Italian notary and the mortgaged property must be specified in detail. After-acquired property, including unplanned buildings, must be mortgaged when acquired. The deed should be registered in the local land registry to be enforceable against third parties (renewable after 20 years). Priority ranks from the date and time of registration. There is no advance priority reservation.

Security transfer of immovable property (*patto marciano*)

A loan granted to an entrepreneur by a bank, or another entity authorised to grant loans to the public in Italy, may be secured by transferring to the creditor (or to a company in the creditor's group authorised to purchase, hold, manage and transfer rights *in rem* in immovable properties), the ownership of a property or of another immovable right of the entrepreneur or of a third party. The transfer is subject to the condition precedent of the debtor defaulting.

Special privilege over certain movable assets

The special privilege deed must be signed before an Italian notary and can only be granted by the debtor to secure facilities with an overall maturity longer than 18 months granted to it by Italian or other EU banks.

The special privilege may cover: (a) existing and future equipment, concessions and produced goods of the enterprise; (b) raw materials, semi-manufactured goods, stock, finished goods, fruit, livestock and goods; (c) goods purchased with the loan in respect of which the special privilege is intended to be granted; and (d) present or future receivables arising from the sale of the assets and goods listed in (a) to (c).

For validity against creditors, the special privilege must be registered in the special register kept at the competent local court.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Present and future receivables arising under an existing contract can be pledged or assigned.

Special rules apply to receivables against public authorities.

The deed of assignment of receivables arising out of rental leases having a remaining term exceeding three years must be executed in front of an Italian notary and registered.

Receivables arising under future contracts must be pledged/assigned upon their coming into existence. See section 2 for the implications.

The deed of pledge must be in written form.

Formalities for rendering the pledge/assignment enforceable against third-party creditors of the pledgor/assignor (including a receiver in the pledgor/assignor's insolvency) are either a notice of the assignment to, or an express acknowledgment by, the obligor, in each case bearing a date certain at law (*data certa*) pursuant to Italian law.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A pledge can be granted over cash deposited in bank accounts. For the perfection formalities, see question 3.4. New formalities must be put in place every time the account balance changes. There is a risk – also for claw-back purposes – that the pledge purported to be created over each increase in the balance of the relevant account may not exist until the above formalities are carried out and that each pledge should be considered a new and different pledge for all intents and purposes. See section 2 for the implications. Any utilisation of the money standing to the credit of a pledge account will likely amount to a release of the relevant sum from the security interest.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Pledge over shares of a *società per azioni*

The deed of pledge can be non-notarial but must bear a certain date. The pledge must be: (i) registered on the certificates representing the shares – whether by endorsement (*girata*) performed by the pledgor or by annotation performed by a director of the issuing company; and (ii) annotated in the shareholders' book of the company for enforceability against, respectively, the creditors and the issuing company. The creditor (directly or through a depository) must take possession of the pledged share certificates.

The pledge can cover distributions, new issues of shares and exchanges. The creditor can (and typically does) authorise the debtor to exercise voting rights and collect distributions until the occurrence of a default. Where the creditor has voting rights, consider consolidation, loss of group tax relief, etc.

The market seems to tolerate the practice of granting security on Italian shares by a foreign law-governed document; however, for the principle of *lex rei sitae*, the pledged shares must be transferred to the country of applicable law. Please also take into account the perfection formalities required.

Pledge over quotas of a *società a responsabilità limitata*

The quotas are not represented by certificates. The deed of pledge must be in notarial form and should be registered with the companies register in order for the pledge to be enforceable against third parties. Significant tax implications arise in connection with such registration (for further details, see question 6.4).

The pledge must be annotated in the quotaholders' book of the company in order to be enforceable against the issuing company.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Pledge over goods with dispossession

The deed of pledge can be non-notarial but must bear a certain date. This can cover present movable and unregistered assets of the company. Future assets must be separately pledged under new security. See section 2 for the implications. A right of

substitution of the pledged assets may be provided, subject to the value of the replacing goods not exceeding the value of the replaced ones. As from the date of perfection of the pledge, the goods are not available to the pledgor without the cooperation of the secured creditor. The goods must at all times be identifiable.

Special rules apply if the assets are deposited with a *magazzino generale*.

Non-possessory pledge over movable assets

At the present date, it is not possible to create such a pledge since the relevant electronic register set up by the Italian tax authority (*Agenzia delle Entrate*) has not been created. Once this is available, the non-possessory pledge may be established:

- to secure financings, whether present or future, granted in order to run the business. A maximum secured amount must be set;
- over unregistered movable assets (including receivables and other immaterial assets), whether existing or future and whether determined or determinable, also by making reference to one or more categories of products or to an overall value; and
- by entry on the aforesaid electronic register. From the date of registration, the pledge acquires its ranking and is enforceable against third parties and in insolvency proceedings. The entry lasts for 10 years and is renewable before expiry.

The pledged assets can be transformed or sold. The pledge is automatically transferred onto the product resulting from the transformation, the consideration deriving from the sale or the substitute asset purchased with that consideration, as applicable, without giving rise to the creation of new security.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes. For limitations, see questions 2.2, 2.5 and section 4.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Excluding taxes (in this respect, see section 6), the fees that could arise in relation to securities relate to the following:

- Notarisation may be necessary for the validity and enforceability of a security agreement (*e.g.* real property mortgages) or to certify the date of the security agreement.

Stamp duties apply to security agreements, which are subject to registration. Stamp duties are based on the number of pages of a security document and are generally not material.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Yes, depending on the type of security. However, certain security must be registered in Italy for perfection purposes. In such cases, Italian registration taxes will apply.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In general, no consent is required. However, consent to the assignment of receivables against public authorities may be required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Certain security documents must be executed in notarial form. For notarial security documents, the parties should provide evidence of their signatory powers.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company
An Italian company, whether an S.p.A. or S.r.l., is prohibited from providing financial assistance (*i.e.* granting a loan or providing a guarantee or security) to any entity for financing or refinancing the direct or indirect acquisition or subscription of its own shares. Whitewash for S.p.A. is allowed under certain conditions.
Various structures have been implemented in order to mitigate the impact of the financial assistance prohibition. The most frequently used structure involves the merger of the target company into the acquisition vehicle after closing. However, any risk of voidness must be assessed on a case-by-case basis by looking at the transaction as a whole.

(b) Shares of any company which directly or indirectly owns shares in the company
The same rules described in (a) above apply.

(c) Shares in a sister subsidiary
In principle, there are no restrictions with respect to security or guarantees granted over shares in a sister subsidiary (subject, in any case, to the corporate benefit analysis). However, any risk of voidness must be assessed on a case-by-case basis by looking at the transaction as a whole.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Security must be granted to, and perfected in favour of, each creditor individually. Trusteeship and parallel debt arrangements are generally not recognised in Italy. In syndicated loans,

secured creditors appoint an agent on the basis of a mandate (*mandato con rappresentanza*). The agent is entitled to exercise the secured creditors' rights and to enforce the security on the basis of the intercreditor arrangements. However, each secured creditor should intervene in the judicial enforcement.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

See question 5.1.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Perfection requirements change depending on whether the transfer made by Lender A to Lender B is by transfer of contract (*cessione di contratto*) or assignment of receivables (*cessione del credito*).

A transfer of contract requires the consent of all parties, including the assigned debtor and guarantor. This can be provided ahead of the assignment, by including an express consent in the relevant loan agreement or guarantee, as applicable.

An assignment of receivables:

- does not require the consent of the assigned debtor and guarantor, unless the loan agreement or the guarantee, as applicable, expressly prohibits the assignment of the receivables arising therefrom; and
- must be notified to the debtor and the guarantor, as applicable, or accepted by it.

In order for the assignment to be enforceable against third parties, the notice or acceptance must bear a date certain at law pursuant to Italian law.

If the loan is secured, perfection formalities will need to be carried out in order to render the transfer of such security interest enforceable against third parties. However, if the assignment of the loan is carried out pursuant to article 58 of Legislative Decree No. 385 of 1 September 1993 (the **Italian Banking Act**) or to an Italian securitisation vehicle pursuant to Law No. 130/1999 (the **Italian Securitisation Law**), no perfection formalities need to be carried out.

Should the receivables be governed by a law other than Italian law, the provisions of article 14 of Council Regulation (EC) No. 593/2008 of 17 June 2008 on the Law Applicable to Contractual Obligations (the **Rome I Regulation**) will apply, pursuant to which such law will govern the assignability of the receivables and the rights and obligations between the assignee and the assigned debtors (including the enforceability of the assignment against the assigned debtors).

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

As a general rule, no withholding tax is chargeable on interest payable on loans made to resident lenders. A withholding tax (generally at the rate of 26%) is chargeable on interest payable to a non-Italian resident lender (unless it is lending through an Italian branch to which the loan is effectively connected). The withholding tax can be reduced under the provisions of the double tax treaty applicable between Italy and the country of residence of the beneficial owner of the interest.

Moreover, no withholding tax applies to interest paid by Italian entrepreneurs on medium/long-term loans if extended, *inter alia*, by credit institutions established in the EU, insurance companies incorporated and licensed under the laws enacted by EU Member States and institutional investors subject to regulatory supervision established in countries that allow an adequate exchange of information with Italy.

In case of proceeds of a claim under a guarantee or proceeds of enforcing security, in accordance with one interpretation of Italian tax law, any such payment would be equal to the payment under the loan and therefore may be subject to the same withholding tax.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Substantial registration taxes, depending on the nature of the security and the features of the facility agreement, may apply. In certain cases, a substitutive tax regime (the **Substitutive Tax**) may be applicable in order to reduce the indirect taxes ordinarily applicable to the loan and the security package (*e.g.* registration and mortgage taxes).

The Substitutive Tax (generally at the rate of 0.25%) applies, upon the option of the parties, if the loan: (i) is granted, *inter alia*, by Italian banks (including Italian permanent establishments of EU and non-EU banks), EU banks, securitisation companies under Law No. 130 of 30 April 1999, insurance companies incorporated and licensed under the laws enacted by EU Member States and collective investment funds (OICR) established in EU or EEA countries included in the whitelist; (ii) is entered into within the territory of Italy; and (iii) has a duration exceeding 18 months.

Where Substitutive Tax does not apply, the securities are subject to indirect taxes varying from EUR200 (generally where the guarantor is securing its own obligations) to 0.5% (generally where third parties' obligations are being secured), while mortgage tax is generally levied at a 2% rate on real estate mortgages.

Registration taxes may not be payable if the security agreement is executed outside Italy (unless specific events occur, *e.g.* case of use, explicit reference or voluntary registration). However, certain security must be registered in Italy for perfection purposes, *e.g.* real estate mortgages, special privileges (certain movables), pledges of quotas of an S.r.l., pledges of intellectual property and mortgages of ships and aircraft. In particular, the granting of a pledge over quotas of an S.r.l. attracts registration tax equal to 0.5% of the amount of the secured obligations where third parties' obligations are being secured.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Generally, a foreign lender granting a loan to an Italian resident entity does not meet the concept of permanent establishment and therefore the lender remains a taxpayer not resident in Italy for fiscal purposes.

Please see question 6.1 above for the withholding tax treatment of interest paid by an Italian resident entity to foreign lenders.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Security agreements which have to be notarised may be either a public deed executed before a notary or a document with the signatures of the parties certified by a notary. Notarisation may be necessary for the validity of certain security agreements (*e.g.* real property mortgages) or to certify the date of the security agreement. Notarial fees can be material, especially in case of real property mortgages, although they are generally negotiable with the public notary.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

As of 2016, no specific adverse consequences are provided by Italian law in case of loans extended by foreign lenders (until 2015, a specific blacklist costs regime was applicable).

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

According to article 3 of the Rome I Regulation on the law applicable to contractual obligations, the parties to an agreement are generally free to choose the law governing the agreement.

However, pursuant to article 3.3 of the Rome I Regulation, if a contract is in breach of Italian public policy (*ordine pubblico*) or mandatory rules (*norme di applicazione necessaria*), Italian Courts will not enforce such agreement.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

European countries

Article 36 of EU Regulation No. 1215/2012 (the **Recast Brussels Regulation**) provides that a judgment issued by the court of an EU Member State shall be recognised and enforced in the other Member States "without any special procedure being required". After expiration of the transition period provided in the withdrawal agreement between the UK and EU, the Recast Brussels Regulation has ceased to apply to the UK; as a consequence, the regime for non-European Courtiers will apply to the UK.

Non-European countries (*e.g.* New York)

The recognition and enforcement of decisions issued by courts belonging to jurisdictions outside of the EU (including the UK) is generally governed by Law No. 218 of 31 May 1995, unless international agreements are in place. The decisions issued by courts belonging to non-European countries are generally recognised in Italy, subject to certain requirements. The enforcement of a foreign decision in the Italian territory requires the filing of a petition before the Court of Appeal of the place where the enforcement shall then take place. Such proceedings are aimed at ascertaining some criteria set out by Law No. 218 of 31 May 1995 and do not imply any re-examination of the merits of the case. Such proceedings usually last one to one-and-a-half years, and the order authorising the enforcement of the foreign decision in Italy fully entitles the creditor to seek enforcement over the debtor's assets.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The average length of first instance proceedings in Italy is approximately four years. Although a judgment issued at the end of first instance proceedings is normally enforceable, it would take approximately 10 years to obtain a final and binding judgment (due to appeals, the complexity of the case at stake or a court with a busy docket).

The Recast Brussels Regulation, in the absence of any contestation raised by the defendant, should theoretically speed up the proceedings aimed at the recognition and enforcement of a judgment granted in a Member State. On the contrary, the so-called acknowledgment proceedings of a judgment granted in a non-European country usually last one to one-and-a-half years, depending on the agenda of the court and issues relating to the complexity of the case at stake.

Enforcement proceedings last approximately three to four years and the duration is largely linked to the specific type of assets foreclosed by the creditor.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

The enforcement of collateral security normally depends on the nature of the secured assets as well as on the ranking of the security itself. In particular, a security interest may be enforced:

- by means of a forced sale of the charged assets;
- for certain assets by means of a private sale, if so agreed by the parties in the original security agreement or at any time thereafter (pre- or post-default);
- through a public notary, a lawyer or an accountant, in certain stages of the enforcement proceeding; or
- in the case of marketable securities with an available market value, by an authorised broker on the market.

Financial collateral created under Legislative Decree No. 170 of 21 May 2004 (the **Financial Collateral Decree**, which has implemented the financial collateral directive in Italy) may be enforced by appropriation or private sale.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Generally, no restrictions apply for foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The bankruptcy of the debtor, as well as its submission to insolvency proceedings (*i.e. concordato preventivo* and *accordi di ristrutturazione*), affect the secured creditor's right to enforce the security. Upon the commencement of such proceedings, and subject to certain exceptions (see question 8.1), all the enforcement actions made by creditors are stayed and creditors must file a claim within a defined period.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Italy is party to the 1958 New York Convention, which establishes the conditions under which arbitral awards can be recognised and enforced within the contracting states.

An Italian Court will declare the effectiveness of arbitral awards *inaudita altera parte* provided that: (i) the litigation falls within the scope of the arbitration agreement pursuant to Italian law; and (ii) the contents of the arbitral award comply with Italian public policy. The counterparty is entitled to challenge such decision before the competent Court of Appeal within 30 days from its notification.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Upon the declaration of bankruptcy, enforcement and preservation actions (*azioni esecutive e cautelari*) on a debtor's assets are stayed, with very few exceptions, such as: (i) enforcement actions on mortgaged assets according to mortgage credit rules (*credito fondiario*) as set out in the Italian Banking Act; (ii) in very limited cases and under certain circumstances, creditors secured by a lien (*pegno*) or a privilege (*privilegio*); and (iii) enforcement of financial collateral arrangements pursuant to the Financial Collateral Decree.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Some acts, transactions and security interests may be subject to bankruptcy claw-back actions if such acts have been perfected during the so-called suspect period (from six months to one year depending on the circumstances), with very few exceptions. In particular, payments of debts which are due and payable may be clawed back if made in the six-month period preceding the declaration of bankruptcy.

Acts through which the debtor disposes of its assets may, under some conditions, be declared ineffective as a result of an ordinary claw-back action.

Gratuitous acts (*atti a titolo gratuito*) and prepayments (*pagamenti anticipati*) are *ex lege* ineffective if such acts have been made during the two-year period preceding the declaration of bankruptcy. In particular, prepayments can be revoked during such two-year period irrespective of whether the recipient was aware of the state of insolvency of the debtor.

Certain claims – expressly identified by operation of law (such as claims accrued during the procedure (*prededucibili*), Italian tax and national social security contributions, employee arrears of wages or salary, etc.) – are preferred in the distribution of proceeds arising from the liquidation of the bankrupt's estate.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Companies carrying out commercial activity can be subject to the bankruptcy proceedings. Moreover, a company may be declared bankrupt when its size exceeds certain thresholds related to annual balance sheet assets, annual gross proceeds or indebtedness.

Italian companies which do not meet the above-mentioned thresholds (and physical persons in a situation of over-indebtedness) are subject to smaller bankruptcy proceedings (so-called *procedura da sovraindebitamento*).

In addition, special insolvency proceedings are applicable to large corporations (*grandi imprese*), public entities (*enti pubblici*) and regulated entities such as banks and insurance companies.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Pursuant to the Financial Collateral Decree, the beneficiary of financial collateral may, under certain conditions, satisfy its claims by way of appropriation or private sale without the involvement of the court, even whilst a bankruptcy proceeding is pending.

For certain types of security, such as pledges over shares, the parties may also agree – in the original security agreement or at any time thereafter – that the enforcement can take place by means of a private sale.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

An Italian Court will generally decline jurisdiction if the parties have submitted a dispute (either present or future) to the jurisdiction of a foreign court, subject to compliance with certain mandatory principles of law.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Italian companies are generally not subject to sovereign immunity. In principle, waiver of sovereign immunity is not prohibited under Italian law. However the possibility for governmental or other public agencies and relevant personnel to waive their sovereign immunity should be assessed on a case-by-case basis.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Lending activity in Italy, to the extent it is conducted on a professional basis and is addressed to the general public, is regulated by the provisions set out under the Italian Banking Act and its implementing regulations. Pursuant to these, the only entities authorised to carry out lending activities in Italy are the following:

- licensed banks, which include:
  - Italian banks;
  - EU passported banks; and
  - non-EU banks licensed in Italy;
- financial institutions enrolled in a special register held by the Bank of Italy pursuant to article 106 of the Italian Banking Act;
- EU-based financial companies that are controlled by a bank incorporated in the same EU country;
- securitisation special purpose vehicles incorporated pursuant to the Italian Securitisation Law;
- Italian insurance companies; and
- following certain relatively recent amendments introduced into the Italian legal system, Italian alternative close-ended investment funds and, subject to particular conditions, requirements and authorisation from the Bank of Italy, EU alternative close-ended investment funds.

Banks that are not established in an EU Member State may only engage in lending in Italy if they are explicitly authorised to do so (and granted a licence to this effect) by the Bank of Italy.

Lending activity (described in the relevant regulations as "the granting of finance in whatever form") includes the traditional direct granting of loans as well as other activities (including issues of guarantees, leasing, factoring and the purchase of receivables for consideration) which amount to lending.

The violation of the prohibition described above may lead to a variety of penalties and sanctions, depending on the actual circumstances of the relevant case and which, in addition to severe monetary penalties, may in certain cases also involve criminal charges.

A specific set of exemptions is provided for intragroup financings, where such financings are made in favour of parent companies, subsidiaries and affiliates and, more generally, to companies belonging to the same group, but with certain further restrictions if the lending is in the form of purchase of receivables.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

Enterprises have responded to the COVID-19 pandemic by devising new systems and procedures that enable them to continue their business while complying with the lockdown and social distancing rules.

Signing and closing procedures have been particularly impacted by COVID-19 restrictions.

Physical signings have been replaced (where possible) by remote signings and, to this end, the use of e-signing systems, which, under certain conditions, may entirely substitute handwriting, has increased.

The main e-signing solutions provided by Italian Law (Legislative Decree 7 March 2005 no. 82) and European legislation (Regulation (EU) no. 910/2014) are the following:

- Simple electronic signature (**SES**) is the less secure type of e-signature; it has limited evidentiary value, as the courts may freely assess the value of the specific SES adopted. SES includes, for example, credit card PIN.
- Advanced electronic signature (**AES**) may be tantamount to handwriting for signing certain agreements, but its use is currently subject to restrictions as it may be used in agreements entered into between a party providing the AES solution and the party entering into the agreement (as a matter of fact, it is commonly used in bank/client agreements and hospital/patient agreements). AES includes the graphometric signature on tablets.
- SPID is a system of electronic identification used for accessing public services in Italy. Specific guidelines have recently been enacted to use SPID as an e-signature which is, in broad terms, tantamount to AES.
- Qualified electronic signature (**QES**) is the safest type of e-signature and is generally equivalent to handwriting. It includes the e-signature systems adopted by certain professionals to submit documents to PA, such as, among other things, the e-signatures of lawyers on judicial acts to be filed with courts through the internet. The elements required for an e-signature to qualify as a QES are technically complex. The security of this type of e-signature resides in that: (i) it is created by a qualified electronic signature creation device (a token) ensuring that the electronic signature creation data used for electronic signature creation comply with certain requirements set out in Regulation (EU) no. 910/2014; and (ii) it is based on a qualified certificate issued by a qualified trust service provider included in a list provided by each Member State.

The safety restrictions imposed by the Italian Government during the pandemic have also affected the formalities related to signing and registration of agreements that must be signed physically before an Italian notary and registered with competent registers.

During the lockdown periods, notary offices were opened for business but at a reduced capacity and were often limited to dealing with "transactions that cannot be postponed". During these periods, certain land registries have stopped their activities and filing of certain deeds, for example deeds of mortgage (see question 3.3), was not possible.

The lockdown periods now having ended, notary's offices and land registries are now open for business and may carry out their activities regularly, requiring clients and the public to wear personal safety equipment and keep proper social distancing in their offices.

It is possible that some of the changes in document execution, in particular, the use of e-signing, implemented during 2020 due to COVID-19, may continue into 2021 and beyond.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Under Italian law, the granting of financings is subject to certain mandatory rules relating to:

- Usury: in Italian law financing transactions, the applicable rate of interest (plus applicable fees and expenses) cannot exceed a certain threshold (which varies depending on the type of financing transaction) determined by the Bank of Italy on a quarterly basis.
- Compounding of interest: this is generally prohibited in financing transactions, save for certain limited cases.
- Transparency: financing transactions entered into by banks and financial intermediaries where the terms and conditions are unilaterally imposed by such entities and are not subject to individual negotiation with the client are subject to certain mandatory rules enacted by the Bank of Italy, which are aimed at simplifying the understanding of the legal and economic terms of the financing transaction by the client.

Acknowledgment

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The biggest common concern of Japanese lenders in 2020 and 2021 is the COVID-19 pandemic. At the request of the Financial Services Agency (the "FSA"), banks are providing liquidity to help businesses survive by extending commitment lines and amending existing facility terms including repayment extensions.

Amendments to the Civil Code, which took effect on April 1, 2020, made it easier to grant security over trade receivables. *See* question 3.5 regarding security over receivables with contractual restrictions. A study group supported by the Ministry of Justice is discussing new legislation for security assignments over certain current assets, while another study group organised by the FSA released a report about a new legal system for an "all asset" type of security. These developments would boost asset-based lending ("ABL") and cashflow finance including leveraged buyout ("LBO") finance and project finance in Japan.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The project finance market has been actively funding solar, wind, biomass, and other renewable energy power plants. This trend is expected to continue as the national government continues to intensively promote renewable energy. In the autumn of 2020, the government declared that Japan will be carbon neutral by 2050.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes. There are no legal restrictions against a company guaranteeing the borrowings of its corporate group members.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

There are generally no enforceability issues, except for the possibility of avoidance (*see* question 8.2). Directors, however, have a duty of care and other duties under corporate law, which may affect their decision to approve such a guarantee or security.

2.3 Is lack of corporate power an issue?

Yes. A company must have corporate power to issue a guarantee.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In general, no governmental consents or filings are required to provide guarantees. However, there are extremely limited situations (such as guaranteeing a North Korea-related entity for a nuclear-related activity) where the Foreign Exchange and Foreign Trade Law (the "Foreign Exchange Law") requires prior governmental approval.

The Civil Code requires guarantees to be in written or electronic form. If the guarantor is a natural person and the guaranteed loan will be used for business, then the guarantor must prepare a notarial deed prior to signing the guarantee.

While shareholder approval is not necessary, a guarantor company may need the approval of its board of directors depending on the guaranteed amount.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no such legal limitations on the guaranteed amount.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Generally, there are no such obstacles to enforce a guarantee, except in extremely limited exceptions as discussed in question 2.4. The Foreign Exchange Law, however, requires a *post facto* report when offshore entities pay to, or receive from, onshore entities more than JPY 30 million (such as guarantee enforcement proceeds).

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Security can be created over various types of assets including (i) real property (i.e., land and buildings), (ii) inventory, equipment,

and other movables, (iii) trade receivables, bank accounts, and other receivables, (iv) shares and other securities, and (v) registered intellectual property such as patents and trademarks.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

In general, a floating charge or a blanket security over all or most assets of a company is not available under Japanese law. A different security, each with its own creation and perfection procedures and requirements, applies to different categories of assets. If a security is not perfected, the lender cannot assert its preferred position as a secured creditor against third parties, including those whose security or acquisition of the asset has been perfected and the bankruptcy trustee of the security provider.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

(a) Real property
Mortgage is the most typical form of security over real property. Lenders and security providers enter into an agreement to create a mortgage, and registration at the relevant legal affairs bureau is required to perfect the mortgage. *See* question 3.9 regarding registration tax. In Japan, land and the building on that land are regarded as separate real property. Accordingly, the procedure to create and perfect a mortgage is required for each of the land and the building.

(b) Plant
In general, lenders take security over a plant by a combination of (i) mortgages over the land and the building on it, and (ii) security assignments over movables (such as machinery and equipment) comprising the plant.
Japanese law also has two specific forms of security to secure a plant: a factory mortgage and a factory foundation mortgage. Under either form, all of the machinery, equipment, and other movable assets comprising the factory must be officially registered, and the registration must be updated when any of the factory's components changes. Due to the cumbersome procedures to create and maintain these types of security, they are used in relatively limited situations such as project finance transactions.

(c) Machinery and equipment
Machinery and equipment, which are generally considered movables, are commonly covered by security assignments. These security assignments are created by an agreement between lenders and security providers, and are perfected by either (i) the registration of the assignment, or (ii) the physical or constructive delivery of the collateral.

Identification of the collateral is the key factor for valid and perfected security assignments; broad descriptions like "machinery" or "equipment" are insufficient. The collateral must be identified in both the security agreement and the registration of the assignment by specifying either (i) the types and traits (such as serial numbers) that distinguish the collateral from other movables, or (ii) the types, locations and volumes of the collateral.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Receivables such as trade receivables and insurance claims can be taken as collateral except where a law specifically prohibits security over certain receivables (such as liability insurance claims). *See* question 3.5 regarding bank accounts.

Pledges and security assignments are used to create security over receivables. An agreement between lenders and security providers is necessary to create the security, which can be perfected by either (i) sending a date-certified notice to, or obtaining a date-certified consent from, the debtor of the receivables, or (ii) the registration of the security assignment or pledge. Although notice to the debtor is necessary for the lender to assert the security against the debtor, registration is sufficient to perfect the security against any third party other than the debtor, meaning that a security provider can grant and perfect the security without notifying the debtor. Therefore, registration is commonly used for security over trade receivables if the security provider is sensitive to its business relationship with the debtors.

In general, lenders can take security over future receivables, provided that the receivables are sufficiently identified. Security assignments over trade receivables including future receivables are commonly used in ABL and cashflow finance in Japan.

Subject to certain exceptions (*see* question 3.5 regarding bank accounts), security can be taken over receivables without obtaining the debtor's consent even if the underlying contract has a transfer restriction clause. This is a new rule under the amendments to the Civil Code which became effective on April 1, 2020. However, if receivables are collateralised in breach of a contractual restriction, the debtor may refuse to pay the secured lender when the security is enforced in certain situations. Although the usefulness of this type of security is somehow limited in this regard, some practitioners see new possibilities for secured transactions over receivables with contractual restrictions.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Security can be taken over cash deposited in bank accounts by way of pledges over receivables against the account banks. Generally, Japanese bank accounts are subject to contractual limitations on the creation of security over and the transfer of the receivables related to the bank accounts. Even under the amended Civil Code (*see* question 3.4), the lenders cannot take valid and enforceable security without obtaining the consent of the account bank. Japanese banks are generally reluctant to give consent unless they are the secured lenders taking the pledge.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes. Pledges are the most typical form of security over shares. The necessary procedure differs depending on the type of shares.

In Japan, listed companies must have their shares in electronic form under the book-entry system managed by the Japan Securities Depositary Centre, Inc. Pledges over those shares can be created and perfected by recording them in the book-entry system.

An unlisted issuer can choose whether or not to issue physical share certificates in its articles of corporation. If the issuer does not issue share certificates, the share pledge is created by an agreement between the lender and the security provider, and is perfected by recording the pledge on the issuer's shareholders

ledger. However, if the issuer issues share certificates, the physical delivery of the certificates to the lender is required to create a pledge over the corresponding shares. While the lender holds the certificates, the pledge is perfected against any third party other than the issuer. Once recorded on the issuer's shareholders ledger, the pledge covers dividends and other claims against the issuer.

Although the articles of incorporation of unlisted companies often contain restrictions on share transfers, the shares themselves can be subject to a valid share pledge. However, lenders often request the issuer to give prior consent to share transfers when the pledge is enforced or to amend its articles of incorporation to facilitate the enforcement of the pledge.

Based on the conflict of laws principles under Japanese law, the law which governs the incorporation of the issuer company governs the pledge over its shares. From this perspective, a pledge over shares in Japanese companies should be governed by Japanese law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. As inventory is classified as movables, a pool of inventory can be collateralised in the form of security assignments. *See* question 3.3(c). Once security assignments are established and perfected by identifying certain factors such as the type and storage location of the pool of inventory, they will cover future acquired inventory that falls within the identified pool. Until the security is enforced, the security provider is generally allowed to use and remove inventory from its location in the ordinary course of business. Therefore, security assignments of inventory are used for ABL and cashflow finance in Japan.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes. A company, whether as borrower or third-party security grantor, can grant security.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Registration is required (i) to perfect a real property mortgage, and (ii) to create and perfect a pledge over patents, trademarks, and certain types of intellectual property rights. The registration tax for each mortgage and pledge is equal to 0.4% (but 0.25% for a mortgage over a factory foundation) of the amount of the secured obligation. Hence, in practice, provisional registration is often used to reduce cost. A provisional registration preserves the priority of the secured claims but a formal registration is required for enforcement. Therefore, lenders must ensure that they always retain all documents necessary to allow them to change a provisional registration to a formal registration.

A registration system is also available to perfect security assignments over receivables and movables. The registration taxes are relatively inexpensive: (i) JPY 7,500 for each filing of up to 5,000 receivables, and JPY 15,000 for each filing in excess of 5,000 receivables for security assignments over receivables; and (ii) JPY 7,500 for each filing (which cannot exceed 1,000 movables) for security assignments over movables. In addition, a security over receivables can be perfected by either giving notice to or obtaining the consent of the debtor of the receivables, and the notice or consent should be made with a certified date. Obtaining a certified date is relatively easy, and the fee is JPY 700 for each document.

See question 6.2 regarding stamp duty.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

See question 3.3(b).

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory or similar consents are generally required to create security.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Depending on the nature of the secured obligations, security is classified into (i) "ordinary security", which secures specified and fixed obligations such as term loan facilities, and (ii) "revolving security", which secures a designated group of unspecified obligations such as revolving facilities and derivatives. For some types of revolving security such as revolving mortgages over real property, the amount of the secured obligations is capped at the registered maximum amount.

Where a lender assigns a revolving facility, the revolving security securing the facility is not automatically assigned to the new lender, unlike an ordinary security. The consent of the security provider is necessary, unless the underlying secured claim has been crystallised in situations provided by law or the security agreement.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In general, there are no particular documentary or execution requirements for security documents.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

None for the stated three cases.

In Japan, there are no laws on financial assistance that generally limit the ability of companies to guarantee or provide collateral for the debt of a parent company or other affiliates to finance an acquisition.

Under general corporate law, however, directors have certain duties that may affect their decision to approve a grant of

guarantee or collateral to secure the borrowing of a third-party borrower, unless the guarantor is a wholly owned subsidiary of the borrower.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

In practice, agents are commonly appointed in syndicated loan transactions as the lenders' representative. Agents are typically engaged in corresponding with the borrower, and receiving loan repayments and distributing them to the lenders. However, agents' roles are limited to administrative functions and do not cover discretionary judgments, such as deciding to declare the loan in default and to enforce security.

Under Japanese law, in principle, a security cannot be separated from the underlying secured obligations and, therefore, the holders of the security must also be the creditors in respect of the secured obligations. In most cases, although each lender holds and enforces its security on its own behalf, inter-creditor agreements restrict the exercise of its rights, such as the enforcement being prohibited in the absence of the majority lenders' consent.

An exception to the above principle is a security trust structure which is recognised under Japanese law. That structure allows a security trustee to independently hold and enforce a security for the syndicated lenders (as the beneficiaries of the trust), and, thus, each lender is not a security holder under the structure. Once the security trustee enforces the security, it distributes the proceeds to each lender to be applied to their secured obligations.

In Japan, a security trust is used in limited situations such as large-scale LBOs and project financing transactions. As the trust business requires a licence in Japan, lenders must appoint a licensed trust company or a licensed trust bank as security trustee. In this regard, cost-effectiveness should be considered when organising a security trust structure.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Although agents and security trustees are recognised under Japanese law, each lender holds security on its own behalf in most cases (*see* question 5.1). An alternative is the use of a "parallel debt" structure, where a security agent rather than each lender becomes the security holder securing its own claim against the borrower created to mirror the lenders' loans. Although it is theoretically feasible to use a parallel debt structure, there are no widely reported domestic transactions using this structure governed by Japanese law.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The loan transfer must be perfected by a date-certified notice sent to, or a date-certified consent obtained from, the borrower. The transfer of the contractual status of a lender under the finance documents requires the consent of the borrower and the guarantor as counterparties. Accordingly, lenders generally obtain the date-certified consents of the borrower and the guarantor for the syndication process.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

A cross-border payment of loan interest by a Japanese borrower to a foreign lender is generally subject to Japanese withholding tax. If the interest is guaranteed or secured, the payment of the guarantee or the proceeds of enforcing security is also subject to withholding tax. The tax rate is 20.42%, unless an applicable tax treaty provides otherwise. However, if the lender and the borrower reside in Japan, no withholding tax applies to the payment of loan interest.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Generally, foreign lenders are subject to corporate taxation if they earn profits attributed to a permanent establishment (e.g., branch) in Japan. Corporation taxation differs depending on the status of the foreign lender, and applicable tax treaties may provide for special tax treatment. Overseas payments to foreign lenders from Japan are subject to withholding tax (*see* question 6.1).

A written loan agreement signed in Japan is subject to stamp duty, the amount of which depends on the loan amount and the type of facility. The maximum duty is JPY 600,000 per loan document. In addition, a guarantee agreement and a security assignment agreement signed in Japan are each subject to a JPY 200 stamp duty.

Other taxes and charges may apply to a loan transaction, including registration taxes and fees to acquire a certified date (*see* question 3.9) to create and perfect a security, and court fees to commence judicial enforcement of a security.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No. The income of a foreign lender does not become taxable in Japan solely because of a loan to, or guarantee and/or grant of security by, a Japanese company.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

In typical secured lending transactions, there are no significant costs that lenders should take note of, except for those discussed in the other questions in this chapter.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Foreign lenders face a licensing issue. To engage in a lending business in Japan, they must either get a licence as a "Branch Office of a Foreign Bank" under the Banking Act or be registered as a "Money Lender" under the Money Lending Business Act, depending on the lending business activities they will pursue. In general, "lending business" is broadly interpreted. Thus, lenders without a licence avoid making loans unless the lending falls within a statutory exception such as an intercompany loan.

The Foreign Exchange Law imposes certain reporting requirements (and approval requirements in extremely limited situations) for lending by a foreign lender to a domestic borrower. The requirements, however, are rarely triggered because of the wide range of statutory exemptions.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Japanese courts generally recognise the choice of foreign law as the governing law of a contract, but the parties cannot choose the governing law of a security under the conflict of laws principles under Japanese law. For example, security over real property and movables are governed by the law of the location of the assets.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Generally, courts in Japan will enforce either an English or a New York court judgment without re-examination of the merits of the case, provided that the following requirements are satisfied:

(a) the judgment of the foreign court has become final and conclusive;

(b) the jurisdiction of the foreign court is recognised under Japanese laws, regulations, conventions, or treaties;

(c) the losing defendant has received service (excluding service by publication or any other similar service) of a summons or order necessary to commence the suit, or has voluntarily appeared in court without receiving such service;

(d) the contents of the foreign judgment and the court proceedings are not contrary to public policy and good morals in Japan; and

(e) judgments of Japanese courts receive reciprocal treatment in the foreign court's jurisdiction (note that New York and English courts satisfy this requirement).

In this regard, courts will examine the case to confirm whether the requirements are met.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Although it differs on a case-by-case basis, it would generally take six to 18 months.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Lenders can enforce security by private sale; that is, the lenders can enforce security without going through a public auction. For certain types of collateral (such as real property), however, the security provider's cooperation is necessary for such a private sale. The lender should consider seeking a judicial public auction if the security provider refuses to cooperate.

Acquiring, selling, or holding certain types of assets may be subject to regulations, which may apply in a security enforcement. For example, the Foreign Exchange Law restricts foreign entities from acquiring shares of companies that conduct certain businesses related to national security, including telecommunications, broadcasting, and aviation.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

In general, no. *See* question 7.4 regarding regulations that may apply in a security enforcement.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Unsecured creditors are generally stayed from enforcing their claims in insolvency proceedings. *See* question 8.1 regarding secured creditors.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Japan is a member state of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention"), with reservation of reciprocity in accordance with Article 1.3 thereof. Arbitral awards made in other member states can be enforced directly based on the New York Convention. Arbitral awards made in non-signatory states can be enforced based on the Japanese Arbitration Act and other

relevant Japanese laws, the requirements of which substantially mirror those of the New York Convention and the UNCITRAL Model Law on International Commercial Arbitration. Japanese courts are generally seen as taking a pro-arbitration approach to the enforcement of domestic and international arbitral awards.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The status of secured creditors differs depending on the type of in-court insolvency proceedings. Japanese law provides for two types of restructuring proceedings (civil rehabilitation and corporate reorganisation) and two types of liquidation proceedings (bankruptcy and special liquidation).

In civil rehabilitation, bankruptcy, and special liquidation proceedings, secured creditors may enforce their security outside of those in-court insolvency proceedings, except that in civil rehabilitation and special liquidation proceedings, the enforcement may be subject to an injunctive order of temporary suspension by the court in certain situations. Another exception is that courts in civil rehabilitation and bankruptcy proceedings may approve the extinguishment of security in certain circumstances provided that the secured creditors are paid based on the fair value of the collateral.

Corporate reorganisation proceedings generally prohibit the enforcement of security and allow the amendment of the terms of the secured claims in accordance with the corporate reorganisation plan approved by the court. However, these secured claims will still rank ahead of unsecured claims to the extent of the value of the collateral.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Japanese insolvency laws contain rules of avoidance. Transactions including the creation and perfection of security by a financially distressed obligor may be invalidated if they satisfy certain prescribed conditions under the relevant insolvency laws.

In insolvency proceedings, general unsecured claims are subordinated to (i) common benefit claims, such the bankruptcy trustee's fees, and (ii) preferred general claims, such as employees' wages and certain tax claims.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Civil rehabilitation and bankruptcy proceedings are available to juridical entities and natural persons. Meanwhile, only stock companies may avail of corporate reorganisations and special liquidation proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

See questions 7.4, 7.6 and 8.1.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, subject to certain prescribed conditions under the Code of Civil Procedure.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes. A waiver of sovereign immunity is valid and enforceable, provided that it is made in compliance with the requirements of the Act on the Civil Jurisdiction of Japan with respect to a Foreign State, which is based on the United Nations Convention on Jurisdictional Immunities of States and Their Property.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

A lender, whether domestic or foreign, is required to either get a licence under the Banking Act or register under the Money Lending Business Act in order to engage in a lending business in Japan. *See* question 6.5.

While an agent under a syndicated facility does not need any licence, a security trustee must be licensed under the Trust Business Act or the Act on Trust Business by Financial Institutions. *See* question 5.1.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

COVID-19 has not significantly impacted document execution and delivery requirements and mechanics in 2020. Lenders, however, became open to accepting copies to satisfy condition precedents. But even in those cases, it is still necessary to deliver the originals promptly after closing.

Currently, many financial institutions in Japan require document execution by officially registered corporate seals or wet-ink signatures. Meanwhile, the government has been actively promoting the use of electronic signatures and, at the end of 2020,

the FSA released a report regarding issues on utilising electronic signatures in financial transactions. A limited number of financial institutions now use electronic signatures, mainly in retail transactions. The FSA and some market participants hope that this practice will expand to wholesale deals.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

(a) Usury laws
Japan has usury laws. Although multiple laws address this issue in a complex manner, under the most notable law, the maximum loan interest rate is 15% p.a. for loans that are JPY 1 million or more. Under the usury laws, fees or other monies paid to a lender in respect of a loan are deemed to be interest for purposes of the interest rate cap. In this context, the scope of "deemed interest" often becomes a practical issue.

(b) Lien search
Unlike some jurisdictions, there are no comprehensive central lien registries for security over assets, although lenders can search security registrations based on the name of the security provider. While some registration systems are available for certain types of assets such as real property, lenders have to rely on the information provided by the security provider in respect of other assets to be collateralised.

Yusuke Suehiro mainly focuses on banking and financing transactions, including LBO financing, ABL (asset-based lending), project financing (e.g., infrastructure and power plant projects), securitisation, and other bespoke structured finance transactions. He has broad experience in cross-border secured transactions such as large-scale transactions of acquisition finance and project finance involving foreign lenders and borrowers. He was recognised as an "Up and Coming" lawyer (Project and Energy) by *Chambers Asia-Pacific 2021* and has received many other awards. He received his LL.B. from the University of Tokyo in 2006, and his LL.M. from the University of Chicago Law School in 2013. He worked at Morgan Lewis & Bockius LLP, New York, from 2013 to 2014. He is admitted to practise in Japan and the state of New York.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

COVID-19 put significant pressure on a number of businesses over 2020, resulting in an increase in complex restructurings – generally debt-for-equity swap transactions into a new or existing Jersey structure – many of which also included a new money element.

The fund finance market remained very resilient and a large number of new facilities were implemented over the period. This segment of the loan market was probably the most active in terms of new lending and work included subscription line facilities (the largest being over €1 billion), GP facilities, co-investment facilities and NAV facilities. This type of financing was an important tool in allowing funds to remain economically agile during the period.

There was also significant activity related to Government support measures following the business closures and suspensions as a result of the COVID-19 pandemic, in which Carey Olsen's role is described at question 1.2 below.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Due to the nature of the work, many transactions are highly confidential. Carey Olsen is active on 35 global bank panels. As part of bank panel terms, we are unable to disclose the names of these banks.

Carey Olsen played a leading role advising the Government of Jersey on its financing needs in response to COVID. Significant matters include:

- **States of Jersey & Ports of Jersey** – acted as lead counsel to the States and Ports of Jersey in relation to a £10 million loan to Blue Islands airline. The loan was to support Blue Islands to allow it to maintain air links between Jersey and certain UK destinations.
- **States of Jersey** – acting as lead counsel advising the States of Guernsey, the Government of Jersey and the Isle of Man Government (with the assistance of their Attorney General's Chambers) on the establishment of the Crown Dependencies £140 million loan guarantee schemes.

On real estate finance, Carey Olsen advised Sun Venture on the acquisition financing of One New Oxford Street, London as well as the £552 million acquisition of 1&2 New Ludgate, London, which was the largest UK real estate deal of 2020.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, guarantees are commonly used by group companies. They are usually created by written agreement. Corporate benefit should be considered and this is covered in greater detail at question 2.2 below.

The Security Interests (Jersey) Law 2012 (the "**Security Interests Law**") expressly provides that a security interest can be created to secure the obligation of a third party, which simplifies documentation and removes the need to include a limited recourse guarantee in Jersey security agreements.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

A Jersey company has unlimited corporate capacity under the Companies (Jersey) Law 1991 (the "**Companies Law**").

When a company enters into a finance transaction, a transacting party should consider whether there is corporate benefit for the company. There is a risk that a company could seek to have the transaction set aside on the basis that the directors approving the transaction were acting outside their statutory duty to act in the best interests of the company. This can happen where:

- there is little or no corporate benefit to the company; and
- the transacting party knows or ought to know that there is little or no corporate benefit.

This risk can be avoided if both:

- all the shareholders of the Jersey company authorise or ratify the particular transaction; and
- the Jersey company can pay its debts as they fall due at the time of, and immediately following, the entry into the transaction.

If there is no discernible corporate benefit to entry into a finance transaction, there is also a risk that a transaction could be set aside on the company's bankruptcy.

2.3 Is lack of corporate power an issue?

Article 18 of the Companies Law removed the concept of external *ultra vires*, meaning that nothing in a company's Memorandum or

Articles of Association can limit the power of a Jersey company. That being said, the Memorandum and Articles of Association should still be reviewed to ensure there are no limits on the authority of the directors to enter into the required documents.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

As per the above, shareholder approval is advisable if there are corporate benefit concerns. A guarantee does not need to be registered in Jersey.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, although the solvency of the company should be considered when entering into a guarantee. If a company enters into a transaction with a person for cause (similar to consideration under English law) the value of which, in money or equivalent, is significantly less than the value of the *cause* provided by that person, the transaction may be impugned as a transaction at an undervalue and challenged by (i) the Viscount of the Royal Court of Jersey (the insolvency officer of the Royal Court) (the "**Viscount**") in a *désastre* under the Bankruptcy (*Désastre*) (Jersey) Law 1990 (the "**Désastre Law**"), and (ii) by a liquidator in a creditor's winding up under the Companies Law.

A transaction may be challenged if it was entered into during the five years preceding the commencement of the *désastre* or winding up.

However, a transaction is not vulnerable to attack as a transaction at an undervalue if either:

- the relevant company:
  - was able to pay its debts as they fall due at the time it entered into the transaction; and
  - did not become insolvent on a cash-flow basis as a result of entering into the transaction; and/or
- the court is satisfied that both:
  - the company entered into the transaction in good faith for the purpose of carrying on its business; and
  - at the time it entered into the transaction, there were reasonable grounds for believing that the transaction would benefit the company.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

If court proceedings are brought against a guarantor company, the enforceability of that company's obligations can be qualified if the following Jersey customary law rights of a surety are available to it:

- *Droit de discussion* – this is the right to require that recourse is made against the assets of the borrower and that those assets are exhausted before any claim is enforced against the guarantor.
- *Droit de division* – this is the right to require that liability of co-guarantors is divided or apportioned between them.

It is market practice for a lender to require a specific waiver of these rights.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Common types of collateral that are secured are: real estate; shares; units in a unit trust; bank accounts; and contract rights.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is possible to take "a debenture-style" security under the Security Interests Law over all present and future intangible movable property held by the grantor in Jersey from time to time. The attachment of a security interest to collateral is not affected by the security agreement providing an express right of the grantor to deal with the collateral free from the security interest and without a duty to account for the proceeds or to replace the collateral. Jersey law does not have a concept of a floating charge. The security would be taken by way of a security interest agreement entered into under the Security Interests Law. In order for a security interest to attach to collateral (on which the security becomes enforceable against the grantor), the following conditions must be satisfied:

- Value must have been given in respect of the security agreement. Value means something sufficient to support an onerous contract, and includes an antecedent debt or liability.
- The grantor must have rights, or the power to grant rights to a secured party, in the collateral. A trustee can therefore grant valid security under the Security Interests Law.
- The secured party has possession or control of the collateral and/or the security agreement is in writing and contains a description of the collateral that is sufficient for it to be identified. Even where there is no agreement in writing, there must still be a "security agreement".

Perfection of a security interest is necessary for the purposes of priority and gives protection against third parties, which is particularly important in insolvency. The method of attachment and perfection will depend on the type of collateral secured. The three ways for the secured party to obtain perfection are:

- by possession of documentary intangibles such as negotiable instruments or bearer securities;
- by control of the collateral such as bank accounts (including security accounts) and investment securities; and/or
- by registration of a financing statement on the Jersey Security Interests Register in its favour in respect of the collateral.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

There are two main forms of security for real estate:

- **Hypothecs**. A hypothec is a right of security held by a creditor over the property of a debtor without possession of it, and is created either by agreement or by operation of law. A hypothec can attach only to immovable property; a hypothec can therefore encumber freehold and flying freehold property, and contract leases (but only where the terms of the lease expressly permit hypothecation). Paper leases cannot be hypothecated. Hypothecs can be specific (that is, over one property) or general (that is, attaching to all immovable property in Jersey owned by the debtor at the date of registration). There are two common types of hypothec:
  - **judicial hypothec**. This type of hypothec is created by the registration of an acknowledgment document (a "*billet*") in the Jersey Public Registry. The instrument of debt or obligation (for example, a bond, promissory note or guarantee) is not itself registered, rather the *billet* simply acknowledges the source of the indebtedness; and

- **conventional hypothec**. This type of hypothec is created by the passing of a contract before the Royal Court, which contract sets out the terms of the borrowing and includes an express acceptance of the hypothec from the borrower. Once passed before court, the contract is registered in the Jersey Public Registry, and is available for public inspection.
- **Share security**. In relation to share transfer properties, lenders require security in the shares of the company that owns the property. Share security would be taken by way of a security interest agreement entered into under the Security Interests Law.

In relation to plant, machinery and equipment, the only method of creating security over tangible movables in Jersey is by way of pledge. To pledge property there must be actual physical (as opposed to constructive) delivery of the tangible movable property pledged into the creditor's possession.

There is a right of retention. As a matter of customary law (absent any Jersey judicial authority on this point) the creditor should have an implied right of sale when the grantor is in default and there is likely to be an express power of sale in the pledge document.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Typically, security in respect of contract rights and receivables is created by way of a security interest agreement entered into under the Security Interests Law by way of description and registration. Although it is no longer necessary to give notice to the counterparty, there are usually advantages to doing so (for example, to obtain, by way of acknowledgment to the notice, a waiver of any conflicting provisions in the underlying contract and/or a confirmation that the counterparty will make payments directly to the secured party).

Common types of receivables include:

- Rent payable under a lease agreement.
- A general partner's right to call for capital from the partners of a limited partnership.
- Debts and other rights to the payment of money.
- Rights under performance contracts.
- Bank accounts into which the receivables are paid and other cash deposited with banks.

The Security Interests Law also contains specific provisions in relation to outright assignments of receivables, which are defined as monetary entitlements arising from the supply of goods and services (other than insurance services) or the supply of energy.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, this is a common form of security taken in Jersey. The method will depend on whether the account is with the secured party or a third-party bank.

Security will be created by way of a security interest agreement under the Security Interests Law. Control would be obtained by the:

- account being transferred into the name of the secured party with the written agreement of the grantor and the account bank;
- account bank agreeing in writing to act on the secured party's instructions directing disposition of funds in the account;
- account being assigned to the secured party and written notice of such being given to the account bank; or
- account bank being the secured party.

Typically, security over third-party bank accounts is taken by assignment. Although not necessary to perfect the security, it is usual to obtain an acknowledgment of the notice from the account bank, which will include, for example, a waiver of:

- Any terms and conditions which may restrict or prohibit the creation of the security.
- Its rights of set-off over the account.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes, security can be taken over shares in a Jersey company in a certificated format. Security would be taken by way of a security interest agreement under the Security Interests Law. Control would be obtained by the secured party either:

- being registered as the holder of the securities; or
- having possession of the certificate representing the securities.

Security cannot be validly granted over shares in a Jersey company under a New York or English law-governed document.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Jersey law does not have a concept of a floating charge. Therefore, security over tangible movables such as inventory in Jersey would have to be taken by way of pledge. Please see question 3.3 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes – a typical security package we see in Jersey is: (i) borrower grants security over any accounts it holds in Jersey; (ii) borrower's shareholder(s) grant(s) security in respect of the shares in the borrower; and (iii) the lender of any intercompany loans to the borrower grants security over those contract rights.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

There are registration fees associated with using the Jersey Security Interests Register. These are outlined on the Registry website:

- registration – £8 per year of registration up to a maximum fee of £165 if the registration will run longer than 20 years (there is no concept of infinite registration);
- discharge – no fee;
- amendment of registration – £25;
- extension of period of registration – same cost scheme as above;
- global change of multiple registrations (other than expiry date) – £110;

- search – £4 to view a financing statement; and
- filing a change demand – £25.

Stamp duty is payable when a lender registers security over real estate situated in Jersey. Stamp duty is calculated at the rate of 0.5% of the amount of debt secured over the property in favour of the lender, plus a court fee of £80.

Land transaction tax ("**LTT**") is payable when a lender takes security over a share transfer property situated in Jersey and is calculated at a rate of 0.5% of the amount of the debt to be secured, plus an administration fee of £80. LTT applies only in relation to residential property, where the articles of the property-owning company confer rights of occupation on their shareholders.

There are no relevant notary fees.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

For security which is created over intangible movable property under the Security Interests Law, the registration requirements do not involve a signification amount of time or expense.

For security that is registered over Jersey immovable property, the *billet* (the acknowledgment document creating a judicial hypothec) or the contract creating the charge (in the case of a simple conventional hypothec) must be registered with the Royal Court of Jersey, which can only take place on a Friday afternoon (subject to court holidays). The stamp duty must be paid at the time of registration. Once registered, the *billet* or contract (as the case may be) becomes a matter of public record.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

A consent should be obtained from the grantor prior to the registration of the security interest on the Jersey Security Interests Register, pursuant to which the grantor consents to the registration and for any personal data to be publicly available.

While no regulatory consents are required in Jersey for the creation of security generally, there may be additional steps required on creation or enforcement of, or other exercise of rights under, security over regulated groups.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

The definition of secured obligations/liabilities in the security agreement should provide for further advances to ensure that the priority of the original advance will not be lost in respect of further advances.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

No, there are not.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company
The concept of financial assistance was abolished in Jersey in 2008. Jersey companies are not prohibited from giving financial assistance for the acquisition of their own shares. If financial assistance raises questions relating to corporate benefit, or amounts to a distribution, the relevant statutory procedures must be complied with.

(b) Shares of any company which directly or indirectly owns shares in the company
Jersey companies are not prohibited from giving financial assistance for the acquisition of shares of any company that directly or indirectly owns shares in the company. If financial assistance raises questions relating to corporate benefit, or amounts to a distribution, the relevant statutory procedures must be complied with.

(c) Shares in a sister subsidiary
Jersey companies are not prohibited from giving financial assistance for the acquisition of shares in a sister subsidiary. If financial assistance raises questions relating to corporate benefit, or amounts to a distribution, the relevant statutory procedures must be complied with.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Jersey law recognises the concept of agency and trust relationships and accordingly an agent or trustee would be able to enforce the loan documentation and collateral security and apply the proceeds in the manner set out in the loan agreement or intercreditor agreement.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The transfer provisions will usually be set out in the loan agreement and guarantee, and these should be complied with.

If there are no such transfer provisions, the benefit of the loan and the guarantee should be validly assigned to Lender B in order to ensure that the guarantee is enforceable by Lender B. For completeness, notice of the assignment should be given to the company and the guarantor. If the loan is not fully utilised and Lender A was under an obligation to make further advances,

the loan would require to be novated as opposed to transferred. If the loan is not novated to Lender B, this could have implications on the enforceability of the guarantee.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

No, there are not.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Foreign lenders do not receive tax incentives when compared to Jersey lenders. However, Jersey can generally ensure tax neutrality, and avoidance of double taxation.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No, it will not.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please see questions 3.9 and 3.10 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The courts in Jersey will recognise a foreign governing law provided it is a valid choice of law for the issue in question upon proof of the relevant provisions of the governing law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The enforcement of foreign judgments is governed by the Judgments (Reciprocal Enforcement) (Jersey) Law 1960. If a final and conclusive judgment under which a sum of money is payable (not being a sum payable in respect of taxes or other charges of a like nature or in respect of a fine or other penalty) were obtained in a Reciprocal Enforcement Court (as defined below) having jurisdiction in a case against a company, such judgment would, on application to the Royal Court of Jersey, be registered without reconsidering its merits and would thereafter be enforceable.

The Reciprocal Enforcement Courts means the following superior courts: (a) in England and Wales, the Supreme Court of the United Kingdom, the Court of Appeal and the High Court of Justice; (b) in Scotland, the Supreme Court of the United Kingdom, the Court of Session and the Sheriff Court; (c) in Northern Ireland, the Supreme Court of the United Kingdom and the Court of Judicature of Northern Ireland; (d) in the Isle of Man, Her Majesty's High Court of Justice of the Isle of Man (including the Staff of Government/Appeal Division); and (e) in Guernsey, the Royal Court of Guernsey and the Court of Appeal of Guernsey. The creditor of such a judgment must apply to have it enforced in Jersey within six years from the date the decision is handed down, or the date of the judgment on the last appeal. Such registration will not require the consideration of the merits of a case.

Where the above law does not apply, including New York judgments, foreign judgments will be recognised at customary/common law. Subject to the principles of private international law – by which, for example, foreign judgments may be impeachable, as applied by Jersey law (which are broadly similar to the principles applied under the common law rules of England) – if a foreign judgment were obtained, the judgment creditor must begin a fresh action in the Royal Court of Jersey, relying on the unsatisfied foreign judgment as a cause of action. The matter will usually be determined summarily without a full trial. The judgment debtor can oppose the application for summary judgment and/or defend the claim, but there are only limited grounds on which enforcement will be refused, and a full factual enquiry is rarely necessary.

The grounds for refusing to enforce a judgment are substantially similar to the grounds on which registration can be set aside (i.e. the foreign court had no jurisdiction, or there were procedural inadequacies in obtaining the foreign judgment). If the court is satisfied that the judgment must be enforced, it will be entered in favour of the judgment creditor and be enforceable in Jersey as a domestic judgment.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) Proceedings in respect of a debt for a liquidated sum can be commenced by way of a simple summons, which can be prepared and served within a few days. The summons must be served four clear days before the return date to which the company is summoned. If the company does not attend at the return date, judgment in default can be obtained (i.e. in as quickly as two weeks).

If the company defends the claim, the Royal Court of Jersey will place the action on the pending list (effective immediately). An application for summary judgment can be brought at this time, which we expect could be heard and determined within four to six weeks.

If the application for summary judgment is defended, and is unsuccessful, the matter would proceed to a trial and could take up to one year for it to be heard and a subsequent judgment to be issued.

The length of time to effect enforcement depends on the process used.

A monetary judgment is immediately enforceable by distraint against the judgment debtor's assets. The Viscount will take possession of and effect a sale of the debtor's assets and apply the proceeds in satisfaction of the judgment, subject to certain notification requirements. The timing of this process depends on the Viscount's availability and the number of assets to be dealt with.

If the debtor owns property in Jersey, orders can be sought one month following the issue of a court judgment (provided it remains unsatisfied), for an "*Acte Vicomte chargé d'écrire*". The effect of this declaration is that if the judgment is not satisfied within a further two months, the debtor's property will be deemed to have been renounced. At that time a creditor can seek orders for "*dégrèvement*" (for immovable property) and "*réalisation*" (for movable property). The timing of either of these enforcement processes once commenced is difficult to ascertain as once orders are made, the sale and dealing of the assets is conducted by the *Attournées*. However, we generally understand that, from the making of an order, a *dégrèvement* process (including the hearing) may take approximately four to six weeks. Following the hearing, the creditor who elects to take the property, subject to claims of superior lenders, will be immediately entitled to the asset. The timeframe for a *réalisation* may take approximately two to three months depending on the liquidity of the assets.

An application can also be made by a creditor of a company with a liquidated claim exceeding £3,000 that the assets of the company be declared *en désastre*, as it is unable to pay its debts as they fall due (please also see question 8.4). Such an application can be made quickly without notice to the debtor, usually on no more than 48 hours' notice to the court. If a declaration is made by the Royal Court of Jersey, and after a one-month period within which the debtor can object has expired, the Viscount will begin the process of collecting in the debtor's assets and distributing them to all creditors on the basis of a statutory waterfall. It is difficult to give an estimate to the Viscount's process, but typically a creditor can expect this to take no less than six months.

(b) Once a foreign judgment is registered under the Judgments (Reciprocal Enforcement) (Jersey) Law 1960 in Jersey, the creditor must serve a notice of registration on the debtor providing the timeframe (generally 14 or 28 days) within which the debtor may apply to have the registration set aside. Once the time for challenging registration has passed, the foreign judgment is enforceable from that point on in the same way as a domestic judgment.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

There is no requirement for a public auction in relation to the enforcement of security granted under the Security Interests Law. Generally speaking, enforcement does not require consent from the Viscount or an order from a court. Please also see question 8.4 in relation to enforcement of security.

However, enforcement of security over real estate in Jersey (see question 8.4 for further detail) will, if pursued under the Désastre Law, involve the Royal Court of Jersey and the Viscount and will be subject to the requirements of Article 27 of the Désastre Law, which provides that the Viscount may sell the property by public auction or public tender.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No restrictions apply to foreign lenders beyond those that apply to Jersey lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Pursuant to Article 10 of the Désastre Law, there is a statutory moratorium on actions and enforcement, with effect from the date of the declaration of *en désastre*. Legal/enforcement action may only be commenced or continued with consent of the Viscount or by order of the court. If the debtor is a company, any transfer of shares not made with the sanction of the Viscount or any alteration in the status of the company's members which is made after the declaration is void.

However, a secured party under the Security Interests Law is not prevented from exercising a power under Part 7 of the Security Interests Law in relation to the relevant collateral, including appropriating or selling shares. No consent of the Viscount or order of the court is required.

A similar moratorium applies pursuant to Article 159(4) of the Companies Law in the case of a creditors' winding up under Chapter 4 of Part 21 of the Companies Law. After the commencement of such a winding up, no action can be taken or continued with against the relevant company except by leave of the court.

However, similarly, no sanction of a liquidator or order of the court is required in order for a secured party to exercise enforcement rights under the Security Interests Law.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Arbitration is rarely used as a method of commercial dispute resolution in Jersey. However, domestic arbitral awards are enforceable in Jersey with leave of the court under the Arbitration (Jersey) Law 1998 (the "**Arbitration Law**").

In addition to the domestic procedure above, the Arbitration Law provides that a foreign arbitral award handed down in a country that is a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the "**New York Convention**") is enforceable as if it were a domestic arbitral award.

Further, other foreign awards from certain non-New York Convention states may also be enforceable under the Arbitration Law if the state in question is a signatory to the Geneva Convention on the Execution of Foreign Arbitral Awards 1927 in the same way as a domestic award or "by action".

Such awards must meet certain standards. They are recognised if the arbitration:

(a) was made pursuant to an agreement for arbitration that was valid under the law by which it is governed;

(b) was made by the tribunal provided for in the agreement or constituted in a manner agreed by the parties;

(c) was made in conformity with the relevant law governing arbitration;
(d) is final in the relevant jurisdiction;
(e) conforms to the definition of arbitration under Jersey law; and
(f) the enforcement of which would not be contrary to the law or public policy of Jersey.

Enforcement of foreign arbitral awards can be refused in limited circumstances as set out in the Arbitration Law.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In the event of a declaration of *en désastre* under Article 3 of the Désastre Law, the property and powers of a company vest in the Viscount and no further enforcement action may be taken against the company in respect of debts that are provable in a *désastre*. In the case of a creditors' winding up under Chapter 4 of Part 21 of the Companies Law, although there is no vesting, the liquidator has similar powers to the Viscount and the Companies Law provides that after commencement of the creditors' winding up, no further action shall be taken or proceeded with against the company except by leave of the court.

Notwithstanding the above, the Security Interests Law operates to allow a secured party to exercise a power of enforcement under the Security Interests Law in relation to the relevant collateral without the consent of the Viscount, and without an order of a court, so that a secured party's powers to appropriate or sell the collateral will not be affected by the insolvency.

Nevertheless, the powers to set aside transactions at an undervalue and preferences still apply. A security interest will be void against the Viscount or a liquidator and the company's creditors, if it is not perfected before the grantor becomes bankrupt.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Under the Security Interests Law, a secured party with a perfected security interest has priority over any other creditor. If the secured party has sold or appropriated the collateral and the net value or proceeds of sale (as appropriate) of the collateral exceeds the amount of the debt owed to the secured party, the secured party must pay the amount of any resulting surplus in the following order:

- Any person who has a subordinate security interest in the collateral and has registered a financing statement over that security interest (where the registration remained effective immediately before the appropriation or sale).
- Any other person (other than the grantor) who has given the secured party notice that that person claims an interest in the collateral, and in respect of which the secured party is satisfied that that person has a legally enforceable interest in the collateral.
- The grantor.

Under the Security Interests (Jersey) Law 1983 (the "**1983 Security Interests Law**"), the secured party must apply the proceeds of sale in the following order:

- Payment of the costs and expenses of the sale.
- Discharge of any prior security interest.
- Discharge of all monies properly due in relation to the obligation secured by the security agreement.
- Payment, in due order of priority, of the secured parties whose security interests were created after those being enforced under the security agreement.
- In relation to the balance (if any remains), payment to the grantor or, if the grantor is bankrupt or is subject to any other judicial arrangement due to its insolvency, to the Viscount, receiver or other proper officer.

  Money or monies in a bank account must be applied under the 1983 Security Interests Law as if they were proceeds of sale.

  If more than one creditor holds the same security interest (and each security interest is created under the Security Interests Law 1983) over the same asset, priority is determined by the date of creation of the security interest.

As stated above, if a declaration for *en désastre* is made, a secured party under the Security Interests Law is entitled to enforce their security over the collateral, which will not fall into the *désastre* estate. Once this has occurred, any surplus will fall into the *désastre* estate to be dealt with by the Viscount in the usual way.

Creditors who hold a judicial or conventional hypothec registered against real estate are entitled to a preference over the proceeds of sale of any property on which their charge is secured. If there are a number of registered hypothecs, preference is determined by the date of creation. This is not subject to any other preference or clawback rights. Where the asset owner has been declared *en désastre*, the collateral will fall into the *désastre* estate and the Viscount will take the collateral subject to the hypothec.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The Désastre Law sets out the persons in respect of whose property an *en désastre* declaration can be made, and includes any person:

(a) who is, or was, at any time within the period of 12 months immediately preceding the date of the application, ordinarily resident in Jersey;
(b) who carries on, or has carried on, at any time within the period of three years immediately preceding the date of the application, business in Jersey, whether or not they are domiciled in Jersey;
(c) who has in Jersey immovable property capable of realisation at the time of the application;
(d) who, being a company, is registered under the Companies Law or has been dissolved pursuant to that Law;
(e) who is an incorporated limited partnership; or
(f) who is a limited liability partnership,

whether or not the debtor is present in Jersey at the time of application for a declaration or at the time of the declaration.

No *en désastre* declaration may be made in respect of:

- Separate limited partnerships.
- Limited partnerships.

It is not clear as a matter of Jersey law whether or not the assets of a trustee as trustee of a trust can be declared *en désastre*. We are not aware of any instance in which such a declaration has been made. If, however, the assets of a trustee were declared *en désastre* and in the event that any document was held by the Jersey courts to constitute a transaction at an undervalue and/or the giving of a preference to any person, the Jersey courts would have the power, depending, *inter alia*, on the period of time elapsed since the transaction was entered into, to set aside such transaction.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The Security Interests Law allows a secured party to enforce by way of sale or appropriation of the collateral or proceeds. In addition, the secured party can take any of the following ancillary actions for the purpose of effecting a sale or appropriation:

- Take control or possession of the collateral or proceeds.
- Exercise any of the rights of the grantor in relation to the collateral or proceeds.
- Instruct any person who has an obligation in relation to the collateral or proceeds to carry out the obligation for the benefit of the secured party (for example, directing the actions of an intermediary who holds a securities account for the grantor).
- Apply any remedy that the security agreement provides for as a remedy that is exercisable pursuant to the power of enforcement, to the extent that it does not conflict with the Security Interests Law. Bespoke enforcement powers can therefore be included as appropriate to the collateral secured.

More than one enforcement option can be taken, and taking one or more of the enforcement options specified above does not preclude the exercise of other rights of the secured party.

The power of enforcement is exercisable once an event of default has occurred and written notice specifying the event of default has been served on the grantor by the secured party.

If enforcement is by way of sale or appropriation, the secured party must give the grantor 14 days' prior written notice. Importantly, in contrast to the 1983 Security Interests Law, the grantor can agree in writing (typically in the security agreement) to waive its right to notice of appropriation or sale.

The secured party is obliged on sale or appropriation, to give at least 14 days' prior written notice to any person who, 21 days before the sale or appropriation, has a registered security interest in the collateral, or any person other than the grantor who has an interest in the collateral.

There are specific carve-outs from the obligation to give notice, to the extent, for example, that the security property is a quoted investment security.

Self-sale is now expressly permitted.

On appropriation or sale, the secured party must:

- Take all commercially reasonable steps to determine or, in the case of a sale, obtain the fair market value of the collateral, as at the time of the relevant appropriation or sale.
- Act in a commercially reasonable manner in relation to the appropriation or sale.
- In the case of a sale, enter into any agreement for or in relation to the sale on commercially reasonable terms.

The duty of the secured party is owed to the grantor and also to any other person to whom the secured party was required to give notice of appropriation or sale.

If, in exercising its powers of enforcement, a secured party appropriates or sells collateral, it must, within the 14 days after the day on which the collateral is appropriated or sold, give a written statement of account setting out certain information in relation to that appropriation or sale to:

- The grantor.
- Any person with a registered subordinate security interest.
- Any person claiming an interest in the collateral.

If, in exercising its powers of enforcement, a secured party appropriates or sells collateral, it must pay to certain specified persons the amount of any resulting surplus by satisfying the claims of those persons in the prescribed order, or alternatively it can pay any amount of resulting surplus into the Royal Court of Jersey.

Security agreements under the 1983 Security Interests Law

For security created under and governed by the 1983 Security Interests Law, a power of sale is the only specified means of enforcement (other than in relation to cash or a negotiable instrument, which can be appropriated). A secured party's ability to enforce its security by a contractual mechanism is untested in the courts, but is often provided for in security agreements.

The power of sale can be exercised after the occurrence of a default event under the security agreement. The secured party must:

- Serve notice of default on the grantor.
- Require the grantor to remedy the default (if the grantor is capable of it).
  If the grantor fails to remedy the default within 14 days after notice, the power of sale becomes exercisable.
- The secured party must take all reasonable steps to ensure that the sale is made both:
  - Within a reasonable time.
  - For a price corresponding to the value on the open market at the time of sale of the collateral being sold.

Real estate

A secured creditor can enforce against Jersey real estate through either of the following:

Dégrèvement. *Dégrèvement* is a process whereby a particular immovable has its encumbrances removed so that a creditor can take it free and clear of all charges. It is a bankruptcy for the purposes of Jersey law, having the following features:

(a) The process is complicated and is carried out under Jersey's 1880 law on immovable property. It can only be commenced by a secured creditor and results in one creditor keeping the property.

(b) The creditor taking the property must pay off all earlier (i.e. prior ranking) charges on the property. The creditor is not required to pay or return to the debtor any difference between the value of the property and the level of his claim or charge by which he has taken. If a secured creditor does not take the property when required to in accordance with the priority ranking of his charge, he loses his charge and becomes an unsecured creditor.

Désastre. The entire property of the debtor is declared *en désastre*. This is a formal declaration of bankruptcy under Jersey law. It can be commenced by the debtor or by a creditor with a liquidated claim of £3,000 or more. All of the debtor's property vests in the Viscount. The Viscount must get in and distribute all of the debtor's assets for the creditors' benefit. This includes immovables (real property). On realisation of any immovables, creditors with security are paid under their security in respect of secured obligations before any amounts left over go into the bankrupt estate.

There is no equivalent to the English law concept of administration.

In certain circumstances, the courts of Jersey can permit a solvent or insolvent company that has not been declared *en désastre* to be wound up, if it is of the opinion that it is either:

- just and equitable; or
- expedient in the public interest.

The application to the court on these grounds can be made by the Jersey company (or its directors or shareholders) and certain government and regulatory officials.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Please see questions 7.1 and 7.2 above.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, it is.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licensing requirements in Jersey for foreign lenders lending to a Jersey company.

If a lender carries on business in or from within Jersey or is a Jersey company, it will be subject to the Proceeds of Crime (Jersey) Law 1999. Under the Proceeds of Crime (Supervisory Bodies) (Jersey) Law 2008, if the lender does not have a registered service provider in Jersey, it may need to apply to be registered with the Jersey Financial Services Commission (the "**JFSC**") to be supervised in relation to its compliance with relevant anti-money laundering and counter-terrorism legislation. Whether or not a lender must apply to be registered with the JFSC to be supervised, it is required to comply with relevant anti-money laundering and counter-terrorism legislation.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

COVID-19 is having a significant impact on document execution and delivery requirements and mechanics. A huge number of the workforce are working from home with social distancing and self-isolation measures in place and this raises a variety of issues for the execution and delivery of documents. Signatories may have limited or no access to printers and/or scanners and are, therefore, unable to physically sign documents. As a result, the legal profession has needed to adapt and find alternative means of signing documents. We have seen a huge rise in the use of electronic signatures as a result. In most cases, Jersey law documents can be executed by electronic signature. The main exceptions are (i) documents that are not usually relevant to corporate or financing transactions, such as contracts relating to Jersey land, and (ii) share certificates where they are provided to a secured party for the purpose of possession under the Security Interests Law. The position is unclear in Jersey as to whether a secured party having an electronically signed share certificate constitutes possession for the purpose of the Security Interests Law. This is due to the difficulties with demonstrating possession of a share certificate that has been signed electronically. Obtaining wet-ink signed share certificates can be challenging in the current climate but generally a solution can be found to obtain these. There are generally no notary requirements in relation to corporate or financing transactions in Jersey. We expect to see the use of electronic signatures extend beyond the end of COVID-19 but not to the same extent as they are currently being used.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Jersey is a politically stable and fiscally advantageous financial centre that has been at the forefront of the global finance industry for over 50 years. The Island enjoys economic stability, political independence, tax neutrality and sophisticated legal, regulatory and technological infrastructure. It has a global reputation founded on a robust legal framework and sound corporate governance practices.

Jersey's evolution as an international finance centre is founded on its close ties to the City of London and its growth as a jurisdiction of choice in the European as well as Middle Eastern, North American and Asian markets.

In 2016, the FATF confirmed that Jersey is compliant or largely compliant with 48/49 of the FATF recommendations in respect to anti-money laundering and combatting the financing of terrorism. In 2017, Standard & Poor's confirmed Jersey's credit as AA-, one of the highest possible ratings.

The International Stock Exchange offers an efficient listing service and has received a number of international recognitions, making it an attractive and increasingly popular option for listing debt securities.

Robin Smith is consistently recognised for his ability to deal with a wide range of international corporate and finance transactions. He has acted on numerous significant portfolio acquisitions and disposals. He often acts for both lenders and borrowers on complex financings, refinancings and restructurings and has significant experience in relation to the financing of investment funds.
Robin advises global banks and large corporates as well as smaller privately held entities and advises in relation to the establishment, transfer and redomiciliation of banking business in Jersey.
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Kate Andrews has over 20 years' experience of cross-border corporate finance transactions with particular experience in restructuring and corporate rescue (including debt-for-equity transactions), enforcement, insolvency, acquisition finance, fund finance and real estate finance. Kate has also been involved with a number of legislative proposals in Jersey. Kate is ranked as a 'Leading Individual' by *The Legal 500* and rated as a 'Leading Lawyer – Highly regarded' in *IFLR1000 2020*.

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Peter advises financial institutions, trustees, borrowers and other entities on all aspects of Jersey corporate, security and banking law. He advises on REIT structuring and listing and also advises local and international banking institutions on banking regulation matters.
Peter is rated as a 'Leading Lawyer – Highly regarded' in *IFLR1000* and ranked as a 'Leading Individual' by *The Legal 500*.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The first half of 2020 saw the continuance of an ever-growing fund market (and related financing), despite the economic downturn. The current COVID-19 situation has increased the need for liquidity, with a higher number of NAV facilities closed compared to previous years. The crisis has led to an increasing number of debt restructurings and enforcement of security interests. Additionally, a surge in environmental, social and governance ("**ESG**") lending has been noticed. This trend is likely to be confirmed in the coming year.

The Luxembourg legislator has taken the opportunity of the crisis to implement a new type of professional guarantee by adopting the law dated 10 July 2020 on professional payment guarantees (the "**Professional Guarantee Law**"). Inspired by the Collateral Law (as defined in question 3.1 below), this new regime provides for a special regime of personal guarantees granted in a professional context, referred to as the professional payment guarantee (the "**PPG**"), supplementing the shortfalls of the existing regimes of first demand guarantee (*garantie à première demande*) and suretyship (*cautionnement*). It is a more flexible tool compared to suretyship, while granting to the beneficiary protections similar to a first demand guarantee, with additional protection in case of insolvency of the guaranteed debtor. Although expressed for use in a professional context, PPGs may be granted by any domestic or foreign natural persons, any type of legal entity and investment fund, and any form of co-proprietorship and institution.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Luxembourg has been a truly active jurisdiction for lending transactions over the last few years and remains a hub for many acquisition financings. Luxembourg has also proven to be a strong jurisdiction for enforcements, thanks to the Collateral Law. The most notable was the new ESG-linked subscription credit facility targeting the private equity industry granted to EQT. This ESG-linked fund bridge is the first of this size and largest of its kind on the global fund financing market, amounting to EUR 2.3 billion with a limit of EUR 5 billion. One other significant deal was the multijurisdictional debt restructuring of Galapagos, the holding entity of the Kelvion Heat Exchangers and Enexio wet and dry cooling systems business, implemented through the enforcement of Luxembourg security interests and the sale of the shares and notes issued by Galapagos.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

There is no legislation in Luxembourg that specifically regulates the establishment, organisation and liability of groups of companies. Consequently, the concept of group interest as opposed to the interest of an individual corporate entity is not expressly recognised.

To the extent permitted by its corporate object, a Luxembourg company may provide guarantees in favour of group companies in general. Where a Luxembourg company provides upstream or cross-stream guarantees for the obligations of its parent companies or sister companies, certain corporate benefit issues may arise (please see question 2.2 for further details).

These considerations also apply to PPGs granted in accordance with the Professional Guarantee Law (see question 1.1).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

The guaranteeing company must act in its own corporate interest (*intérêt social*), i.e. derive a certain benefit from the transaction.

Whether a guarantee is in the corporate interest of a company is ultimately a matter of fact. The management body of the company is responsible for this determination, which is made on a case-by-case basis, depending, for instance, on the arm's length conditions of the guarantee, and on any remuneration or benefit received by the guarantor.

A guarantee which is considered by a Luxembourg court as a misappropriation of corporate assets (*abus de biens sociaux*) or in respect of which it could be shown that the other parties to the transaction were, or should have been, aware of the absence of corporate interest, can be nullified or declared void on the ground of illegal cause (*cause illicite*) and result in the liability of the directors/managers of the company.

These considerations also apply to PPGs granted in accordance with the Professional Guarantee Law (see question 1.1).

2.3 Is lack of corporate power an issue?

Yes. In principle, a company is bound towards third parties by any acts of its management body or persons authorised to

bind the company, even if such acts exceed the corporate object (*ultra vires*), unless it proves that the third party knew that the act exceeded the corporate object or could not, in view of the circumstances, have been unaware of it, without the mere publication of the articles of association being sufficient to constitute such proof. However, the fact that the act is *ultra vires* does not impact enforceability (*mandat apparent*).

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

There are no governmental or other consents or filings required to grant and perfect a guarantee, unless the guarantee is granted by a regulated entity. The guarantee may need to be approved by the company's relevant management body. No shareholder approval is in principle required (unless the articles of association of the company state otherwise).

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

To the extent the granting of the guarantee is in the corporate interest (*intérêt social*) of the guarantor (see question 2.2), no net worth, solvency or similar limitations would apply, but in practice, in case of an upstream or cross-stream guarantee, the amount of the guarantee is often limited to a percentage of the own funds (*capitaux propres*) of the guarantor.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange controls in force that could prevent any repatriation of realisation proceeds or other payments to a beneficiary of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Financial collateral arrangements (*contrats de garantie financière*) (in particular pledges or assignments by way of security) governed by the Luxembourg law on financial collateral arrangements dated 5 August 2005, as amended (the "**Collateral Law**"), are the most commonly used form of security.

A mortgage (*hypothèque*) is the most common form of security over real property.

Less common types of security include civil law pledges (*gage civil*), commercial law pledges (*gage commercial*) and pledges over an ongoing business concern (*gage sur fonds de commerce*) (see question 3.3).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Apart from a pledge over an ongoing business concern (*gage sur fonds de commerce*), Luxembourg law does not provide for an all-asset security interest (i.e. floating charge). Security is typically granted on an asset-by-asset basis, where shares, receivables or bank accounts are concerned and the procedure for creating such security depends on the type of asset to be encumbered.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over real property may be created by way of a mortgage drawn up in a notarial deed. The mortgage deed must be registered with the tax administration (*Administration de l'Enregistrement, des Domaines et de la TVA*) and with the mortgage office (*Bureau des Hypothèques*) in charge of the district where the real property is located.

Machinery and equipment

Machinery and equipment is most commonly subject to a pledge over an ongoing business concern (*gage sur fonds de commerce*). Such pledge may be created by virtue of a private or notarial deed, and only for the benefit of certain authorised credit institutions and breweries. The mortgage deed must be registered with the tax administration (*Administration de l'Enregistrement, des Domaines et de la TVA*) and with the mortgage office (*Bureau des Hypothèques*) in charge of the district in which the business is located.

As an alternative, a security interest over machinery and equipment may be created by way of a possessory pledge governed by the Commercial Code (the "**CC**"). The possessory pledge does not need to be formalised in a written agreement but can be established by transfer of possession, or through a contract between the parties or any means permitted by the CC.

Mortgages over real property and pledges over an ongoing business concern are valid for 10 years following the date of their registration with the mortgage office (*Bureau des Hypothèques*) and require renewal to remain valid after this period.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. Receivables may be subject to a pledge or an assignment for security purposes governed by the Collateral Law or be part of a pledge over an ongoing business concern (see question 3.3).

Pledges/assignments for security purposes must be evidenced in writing. Such security interests are fully recognised and enforceable under Luxembourg law even if they have not been notified to the debtor. The debtor of the pledged/assigned receivable will be, however, validly discharged from its obligation *vis-à-vis* the security provider if it had no knowledge of the pledge/assignment.

Since Regulation (EC) No 593/2008 of 17 June 2008 on the law applicable to contractual obligations does not explicitly provide for any conflict of law rules in relation to the enforceability and invocability of a pledge over receivables against third parties, certain Luxembourg legal practitioners consider that the pledge would become invocable against third parties (other than the debtor) if the legal formalities applicable in the jurisdiction of the debtor are duly complied with.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. Security over cash deposited in bank accounts (held in Luxembourg) may be created by way of a pledge governed by the Collateral Law. The pledge agreement must be evidenced in writing. Account banks typically benefit from a first ranking pledge over the account arising from their general terms and conditions. The existence of the pledge must therefore be notified to, and accepted by, the account bank.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes, shares in Luxembourg companies can be subject to pledges/assignments for security purposes governed by the Collateral Law. Pledges/assignments for security purposes must be evidenced in writing. The applicable perfection formalities depend on the type of shares. Shares can be in registered form, bearer form or in dematerialised form.

Commonly, shares issued by a Luxembourg company are in registered form. In such case, the security interest will be perfected by recording the pledge in the register of shareholders of the company. Pledges over shares in dematerialised form require the recording in an account (for book-entry financial instruments, including dematerialised securities) or the execution of an agreement by the parties (for financial instruments other than those in book-entry form).

According to Luxembourg conflict of law rules, Luxembourg courts will generally apply the *lex loci rei sitae* or *lex situs* (the law of the place where the asset or subject matter of the security interest is located) regarding the creation, perfection and enforcement of such security interest. Thus, Luxembourg law will govern the creation, perfection and enforcement of security interests over shares issued by a Luxembourg company.

This does not completely exclude Luxembourg shares being subject to foreign security, but such security would have to comply with the Luxembourg creation, perfection and enforcement requirements.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, see question 3.3.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, provided that the security interest granted by the company falls within its corporate object and is in its corporate interest (please see questions 2.1 and 2.2).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

No stamp or registration duties are payable in relation to, and no notarisation or other similar formalities are required for, the entry into pledges and assignments for security purposes over financial instruments/claims (e.g. shares, receivables or bank accounts) falling within the scope of the Collateral Law.

Mortgages and pledges over an ongoing business concern must be registered with the tax administration (*Administration de l'Enregistrement, des Domaines et de la TVA*), which triggers an *ad valorem* registration duty (*droit d'enregistrement*) of 0.24% on the principal amount of the underlying secured obligation. In addition, mortgages and pledges over an ongoing business concern must be registered with the Luxembourg mortgage office (*Bureau des Hypothèques*) in charge of the district in which the asset or business is located, for which an *ad valorem* inscription duty (*droit d'inscription*) of 0.05% on the principal amount of the underlying secured obligation, notary fees and mortgage registrar fees are payable.

In case of renewal of mortgages over real property and pledges over an ongoing business concern (see question 3.3), similar registration and inscription duties will apply.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The perfection of security interests over shares, accounts or receivables is a straightforward process which does not trigger any registration costs. The acceptance of the account pledge by the account bank may, however, take up to a few days, depending on the account bank (see question 3.5). Most account banks in Luxembourg apply additional fees in relation to pledges over bank accounts.

Generally speaking, two to three weeks are necessary to create and register a mortgage over real estate. Prior lien searches must be carried out by the notary. See question 3.9 for expenses involved.

The approval procedure by the Luxembourg government and regulator regarding a new pledgee for the creation of a pledge over an ongoing business concern may take up to several months. See question 3.9 for the expenses involved.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally speaking, no regulatory consent is required, except for security provided by, and sometimes over, a regulated entity.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no special priority or other concerns.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

No, except for: (i) mortgage deeds (real estate, aircraft, etc.), which are subject to notarisation (see question 3.3); (ii) pledges over an ongoing business concern, which must be documented in writing either under seal or in a notarial deed (see question 3.3); and (iii) pledges/assignments for security purposes under the Collateral Law, which must be documented in writing (see questions 3.4 to 3.6).

Typically, powers of attorney are granted for the execution of notarial deeds for mortgages and pledges over an ongoing business concern and, depending on the place of execution or registration of the grantor of the power of attorney, additional notarisation and apostille requirements apply to such powers of attorney.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Certain Luxembourg companies (such as public limited liability companies – S.A.s, or partnerships limited by shares – S.C.A.s) may only advance funds, make loans or provide security interests, directly or indirectly, with a view to the acquisition of their own shares by a third party, if certain conditions ("white-wash") are met (this is rarely used in practice, and detailed in the law of 10 August 1915 on commercial companies, as amended (the "**Company Law**")). Unlawful financial assistance may result in the security interest being void and trigger the civil/criminal liability of the company's directors.

The financial assistance prohibition is generally considered as not being applicable to private limited liability companies (SARLs), even if the unfortunate residual drafting of the law has led to some discussions on the matter among practitioners.

This prohibition does not apply to direct or indirect shareholder(s) of the target company or sister subsidiaries.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Securities governed by the Collateral Law and guarantees governed by the Professional Guarantee Law may be granted in favour of a person acting for the account of the beneficiaries of the collateral or guarantee, a trustee or, under certain conditions, a fiduciary, to secure or guarantee the claims of third-party beneficiaries.

Luxembourg law does not contain similar provisions for security interest over other assets (see question 5.2).

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Luxembourg law does not contain any similar provisions as to those described in question 5.1 above for security interests over assets other than financial instruments and claims falling within the scope of the Collateral Law.

There is some uncertainty as to whether a security over movable or immovable property may be granted to a security trustee. For this reason, a parallel debt structure is used in practice but remains untested in court.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Transfers of loans do not require specific formalities to be valid against a Luxembourg debtor or a Luxembourg guarantor. However, the transfer will only be enforceable against the debtor and any third parties if the debtor has been notified of, or has accepted, the transfer.

Luxembourg law security interests or suretyship, as accessories to the loan, will automatically follow the main obligation. It is, however, common practice to require the relevant grantor to confirm such security interest or guarantee upon transfer. In case of transfer by way of novation, the security interests or guarantee shall also be preserved for the benefit of the relevant secured parties.

The benefit of the pledge over an ongoing business concern may not be transferred to non-approved credit institutions (or breweries).

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

In general, arm's length interest payments are not subject to Luxembourg withholding tax on profit distributions, whether made to a domestic or a foreign corporate lender. An exception applies, however, to certain securities which give rise to payments that vary depending on the distribution of profit by the debtor or are made under specific profit-participating debt instruments.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

The main tax advantage for corporate lenders, whether foreign or domestic, is the absence of withholding tax on interest payments which arise under most debt instruments.

Mortgages are, by operation of law, subject to notarisation and mandatory registration formalities entailing (i) registration duties (*droits d'enregistrement*) of 0.24% on the principal secured amount, (ii) inscription duties (*droits d'inscription*) of 0.05% on the principal secured amount payable to the mortgage office (*Bureau des Hypothèques*), and (iii) notary fees and mortgage registrar fees.

Under certain circumstances, loans and security documents are subject to mandatory registration formalities. Even if registration is not required by law, loans or security documents can be subject to voluntary registration. In case of registration, registration duties (*droits d'enregistrement*) will apply in the form of a fixed amount or an *ad valorem* amount depending on the nature of the document and the mortgaged asset (registration duties on a loan document, for instance, amount to 0.24% applied to the principal amount indicated in the document).

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

In the absence of a permanent establishment or permanent

representative of the foreign lender in Luxembourg to which the loan, the guarantee or the security is attributable, the income of the foreign lender should not become taxable in Luxembourg by reason only of the said instrument being granted to a Luxembourg company.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No stamp or registration duties are payable, and no notarisation or other similar formalities are required in general for the granting of a loan or guarantee. For security interests, please refer to question 3.9.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are no such adverse consequences.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The choice of foreign law as the law governing the contractual rights and obligations contained in a contract is, in principle, valid and binding under Luxembourg law, in accordance with, and subject to, the limitations set forth in Regulation (EC) No 593/2008 of 17 June 2008 on the law applicable to contractual obligations.

Luxembourg courts would not, however, apply a chosen foreign governing law if:

- the choice was not made *bona fide*;
- such chosen law was not pleaded and proven;
- such chosen law was pleaded and proven but held contrary to mandatory Luxembourg laws or manifestly incompatible with the public policy rules (*ordre public*) of the forum;
- at the time that the contract was entered into, all other elements relevant to the situation were located in a country other than the country of the chosen governing law, to the extent the parties' choice of governing law affects the application of the provisions of the law of that other country which cannot be derogated from by agreement, and which the court may then apply; or
- the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be, or have been performed, render the performance of the obligations under the contract unlawful and, regarding the means of enforcement and measures to be taken by a creditor in case of a default in performance, Luxembourg courts may apply the law of the country in which performance is taking place.

A Luxembourg court may also refuse to apply the chosen governing law if a person is subject to any insolvency proceedings, in which case it would apply the insolvency laws of the jurisdiction in which such insolvency proceedings have been opened to the effects of such insolvency proceedings, without prejudice to the exceptions set forth by Regulation (EU) No 2015/848 of 20 May 2015 on insolvency proceedings (recast).

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

New York judgments

A final and conclusive civil or commercial judgment obtained against the company in the competent courts of New York would be recognised and enforced by Luxembourg courts, subject to the applicable enforcement procedure (*exequatur*), detailed in the Luxembourg New Civil Procedure Code (the "**NCPC**") and Luxembourg case law.

In accordance with Luxembourg case law, the re-examination of the merits of the case in the *exequatur* proceedings is normally excluded.

English judgments

Judgments given in legal proceedings instituted before 1 January 2021 (i.e. before Brexit became effective) will continue to benefit from the advantageous recognition regime under Regulation (EU) No 1215/2012 of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

Following Brexit, a UK judgment is treated like a New York judgment (see above), except for judgments falling within the scope of the Hague Convention of 30 June 2005 on choice of court agreements (the "**Hague Convention**"), which applies to submission to exclusive jurisdiction only and to judgments given in legal proceedings instituted as from 1 January 2021. It should be noted that the criteria of exclusivity may be subject to differences of interpretation in the various contracting states, notably as regards asymmetric jurisdiction clauses.

It is worth noting that the above may change if the Lugano Convention is applied to English judgments in the future. On 8 April 2020, the UK applied to accede to the Lugano Convention as an independent contracting party. However, the application requires the unanimous consent of all other contracting parties (namely the EU, Denmark as an independent state because of its opt-out right, Iceland, Norway and Switzerland) and is therefore still pending.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

If the suit is filed pursuant to the commercial procedure rules, a decision can be obtained within six to 18 months. If the suit is filed pursuant to the civil procedure rules, court proceedings may take between six months and three years.

New York court decisions are subject to the *exequatur* procedure, which requires an *exequatur* judgment to be obtained first from a Luxembourg court. This can be obtained within a year. Following Brexit, English court decisions are now subject to the same *exequatur* procedure, except for judgments falling within the scope of the Hague Convention or resulting from proceedings instituted before 1 January 2021 (see question 7.2).

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Except for security interests over regulated entities, no regulatory consents are in principle required to enforce a Luxembourg collateral security interest. There is no requirement for public auctions.

Security interests subject to the Collateral Law may be enforced upon an event of default (freely determined by the parties) and without prior notice. The security taker may benefit from various enforcement methods (appropriation, private or public sale, netting) which do not require any court involvement. The Collateral Law does not provide for any specific timing for the enforcement of the security. Timing will depend in particular on (i) the enforcement method chosen, (ii) any possible recourse of the security provider, or (iii) the potential involvement of third parties.

A sole first-ranking mortgagee may enforce the mortgage by way of a fast-track procedure based on the notarial deed which constitutes an enforceable title (*titre exécutoire*). The notarial deed must provide that the mortgagee is authorised to sell the real property through a notary public without having to follow the statutory attachment procedure (*clause de voie parée*). If such a provision is not included in the mortgage deed or if the mortgagee is not a first-ranking beneficiary, it will have to organise a real estate attachment procedure (*saisie-arrêt*) involving court hearings in order to enforce the mortgage by way of a public auction.

For the enforcement of a pledge over an ongoing business concern, the pledgee must (i) serve a formal notice to pay (*mise en demeure*) to the pledgor, and (ii) attach (without any prior court authorisation) the assets subject to the pledge. The pledgee must then ask the president of the commercial court for an authorisation to sell all, or part, of the business through a public official (*officier public*) appointed by the court. The latter will then conduct the sale.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Foreign claimants may be obliged to elect domicile in Luxembourg, usually at an attorney's office. A Luxembourg court may order a foreign claimant to deposit a financial guarantee which is intended to cover the costs and damages to which it could be condemned.

No particular restrictions apply in case of foreclosure on collateral security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

In case of bankruptcy (*faillite*), controlled management (*gestion contrôlée*) and suspension of payments (*sursis de paiement*), as well as composition with creditors (*concordat préventif de faillite*), individual legal actions by privileged and unsecured creditors against the debtor are in principle suspended.

However, during a suspension of payments procedure, enforcement procedures initiated beforehand are not affected. In addition, the suspension of action does not apply to tax or other public charges, as well as certain privileged claims or certain secured creditors (in particular mortgagees or security takers under the Collateral Law).

Similarly, a composition with creditors (*concordat préventif de faillite*) has no effect on creditors who did not participate in the composition proceedings. Those creditors can continue to act against the debtor to obtain payment of their claims and can enforce their rights, obtain attachments and obtain the sale of the assets securing their claims.

These proceedings have no effect on security interests subject to the Collateral Law.

Unless otherwise agreed in the relevant agreement, PPGs subject to the Professional Guarantee Law remain unaffected by the above procedures, including when the claims involved have been subject to rescheduling, reduction or conversion to equity capital or any other instrument.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

At the request of the party who has obtained a favourable, enforceable, final and conclusive award, Luxembourg courts will enforce such award in accordance with articles 1250 and 1251 of the NCPC by way of *exequatur* proceedings. There will be no formal retrial or re-examination of the matters adjudicated.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy proceedings may entail a stay of enforcement rights (see question 7.6) as well as the application of the hardening period rules (see question 8.2).

However, Luxembourg law security interests falling within the scope of the Collateral Law, as well as all enforcement measures and valuation and enforcement measures agreed upon by the parties in accordance with the Collateral Law, are valid and enforceable even if entered into during the hardening period against third parties, commissioners, receivers, liquidators and other similar persons notwithstanding the insolvency proceedings (save in the case of fraud).

Secured creditors holding a pledge over an ongoing business concern may enforce their security regardless of the opening of bankruptcy proceedings against the security provider. The proceeds from the enforcement will be applied in priority to the debt due to the security taker (subject to mandatory privileges arising by law).

Mortgages are considered as being outside the bankruptcy estate (*hors masse*) and may freely be enforced in spite of the adjudication in bankruptcy of the mortgagor. The proceeds from the enforcement will be applied between the secured creditors (including the mortgagee), with priority over unsecured creditors, subject to any mandatory privileges arising by law.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Some creditors benefit from privileged rights by virtue of law and may take precedence over the rights of other secured or unsecured creditors (e.g. tax authorities, social security institutions or salaried employees).

Certain payments made, as well as other transactions (detailed in the CC) executed or performed by a bankrupt company (*faillite*) must (automatic claw-back events), or may (discretionary clawback events), be declared cancelled if made or performed during the hardening period, which is no more than six months (plus 10 days in certain circumstances) from the date on which the Luxembourg court formally declares the company bankrupt.

In addition, the bankruptcy receiver can challenge any fraudulent payments and transactions made before the bankruptcy, without any time limit.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Certain regulated entities are subject to specific insolvency legislation. In particular:

- Luxembourg credit institutions and certain professionals of the financial sector are subject to the provisions of the law of 5 April 1993 on the financial sector, as amended (the "**1993 Law**"), in relation to recovery planning, intra-group financial support and early intervention; and
- Luxembourg insurance companies are subject to specific reorganisation measures and winding-up procedures under the law of 7 December 2015 on the insurance sector.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes; see question 7.4.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Except for actions brought for non-contractual claims, a Luxembourg company's submission to a foreign jurisdiction would, in principle, be upheld by Luxembourg courts.

Such submission may, however, be limited or denied (i) by, *inter alia*, the rules on exclusive jurisdiction set out by the Brussels Ia Regulation or in the case of a submission to a non-EU Member State court, or if there is no close connection with the case in question and a hearing in such a country may appear impossible or unreasonable, or (ii) if proceedings have been commenced abroad between the same parties and on the same grounds as the proceedings in Luxembourg.

Notwithstanding the foreign jurisdiction clause, Luxembourg courts may also have jurisdiction under certain circumstances.

Foreign judgments in civil and commercial matters are generally recognised and enforced in Luxembourg, subject to the relevant *exequatur* procedure, which may be facilitated by EU regulations, or applicable international treaties.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A Luxembourg company is not entitled to claim immunity in Luxembourg from suit, attachment, execution or other legal processes with respect to any action or proceeding brought in connection with its commercial contractual obligations. Other entities that are vested with sovereign immunity in Luxembourg, such as, for example, foreign states, can under certain circumstances waive such immunity. To be legally binding and enforceable in Luxembourg, the waiver shall be certain, specific and formally valid.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Lending to "non-group" companies is subject to licence requirements, subject to certain limited exceptions.

Carrying on lending operations *vis-à-vis* the public without holding the appropriate licence may trigger administrative and criminal penalties.

There are no restrictions on granting security over movable or immovable property to foreign lenders. However, pledges over an ongoing business concern may only be granted to certain authorised credit institutions and breweries.

A security trustee/agent located outside Luxembourg is not required to meet any specific regulatory requirements to act as a trustee/agent.

At the EU level, there is a Proposal for a Directive on credit servicers, credit purchasers and the recovery of collateral, which was published on 14 March 2018 (the "**Proposal**"). The Proposal aims to foster the development of secondary markets for non-performing loans by removing undue barriers to credit servicing and to the transfer of bank loans to third parties across the EU ("passporting"). It also defines the activities of credit servicers, sets common standards for authorisation and supervision and imposes conduct rules across the EU. The Proposal is currently awaiting committee decision.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

The COVID-19 pandemic and the resulting restrictions and teleworking recommendations have considerably accelerated the existing trend of recent years to use electronic rather than wet-ink signatures for execution of private deeds (*actes sous seing privé*), and to deliver documents in electronic form only. This trend is expected to expand further in years to come.

Under Luxembourg law, electronic signatures are generally a valid means of signing private deeds (*actes sous seing privé*), but since the validity of the electronic signature (and therefore the validity or enforceability of the document or its formation) may be challenged, some notaries and lenders still prefer documents to be executed in handwritten form, or sometimes electronically but with hard copies being delivered subsequently.

Certain types of documents are not eligible for electronic signature under Luxembourg law, either due to their specific nature or their subject matter, including notarial deeds, guarantees and collateral guarantees provided by *non-professional persons*, contracts transferring ownership of (Luxembourg) real property and contracts which require the intervention of the courts, public authorities or public officers. In particular, documents under private seal that require legalisation/certification by a notary and apostille (e.g. special powers of attorney) must bear a handwritten signature.

Particular points of attention are the legal and technical requirements to be observed in order for an electronic signature to be considered as such under Luxembourg law, based mainly on Regulation (EU) No 910/2014 of the European Parliament and of the Council of 23 July 2014 on electronic identification and trust services for electronic transactions in the internal market (the "**eIDAS Regulation**"). The eIDAS Regulation defines three types of electronic signature: standard/simple electronic signature ("**SES**"); advanced electronic signature ("**AES**"); and qualified electronic signature ("**QES**"), but only a QES will have the equivalent legal effect of a wet-ink signature.

It should be noted that the list of trusted service providers for Luxembourg currently only mentions Be INVEST International S.A. and LuxTrust S.A. as active trust service providers delivering qualified certificates for a QES.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Compounding of interest

Under Luxembourg law, interest may not accrue on interest that is due on capital, unless such interest has been due for at least one year and subject to the conditions set forth in article 1154 of the Luxembourg Civil Code. The provisions of article 1154 are generally considered to be a part of Luxembourg internal public policy rules (*ordre public interne*). In the absence of case law, there are uncertainties as to whether such restriction will be upheld by Luxembourg court as being part of public international law and thus, if there is any provision to the contrary, it would be null and void.

GDPR consideration

When processing personal data, lenders must comply with Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data (the "**GDPR**") and the Luxembourg law of 1 August 2018 on the organisation of the National Commission for Data Protection and implementing the GDPR.

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Mexico

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

During the past 12 months, the lending and banking sector in Mexico has been marked by ups and downs due to the COVID-19 pandemic and the protectionist policies implemented by our federal government.

The first half of 2020 saw significant stagnation in banking lending activity, with banks being cautious to grant loans until the fog cleared and the landscape was more visible. Some governmental support (not significant) pushed banks over the hill and got the ball rolling – albeit slowly. The foregoing, paired with the fact that both companies and individuals have sought to maximise liquidity to meet short-term liabilities in these uncertain times, has allowed for a more positive outlook. It should also be noted that Mexican banks must comply with strict capitalisation, liquidity, and indebtedness requirements and, as such, they should be well equipped to withstand the recent turmoil.

The "non-banking" financial sector continued to show growth, given that – as mentioned before – "traditional" banks brought lending activity almost to a halt, and a huge percentage of Mexico's population does not have access to banks and thus seeks alternative financial services provided by non-banking financial entities. FinTechs have proven to be a great alternative to banks as they allow clients to easily and rapidly access financial services through technological platforms. Banks have identified this and have started to invest heavily in such platforms as well. For instance, 2020 saw a joint venture between Banorte, Mexico's second largest bank, and Rappi, the first unicorn in LatAm, to create what seeks to be the largest technological bank in our country; we had the honour of counselling Rappi in this landmark transaction.

In the context of the foregoing, we believe that the long-term effects of the pandemic and of the highly criticised policies of our federal administration are yet to be fully seen. Particularly there is concern that delinquency rates will skyrocket as a result of the overall blow to the economy and the significant loss of employment.

It is important to mention that this upcoming June, Mexico will have mid-term elections and, among others, several seats in the federal congress and the senate will be up for grabs. The results of this election could very well mark the future of Mexico and its economy as they will provide for an opportunity to counterbalance the MORENA party, which currently has the presidency and a majority of seats at the federal and the local legislatures.

On a positive note, the USMCA trade agreement is expected to continue increasing economic activity in Mexico across several sectors, and to maintain our country as one of the biggest economic partners of the U.S., which is one of the largest consumer markets in the world. Also, it is expected that the new U.S. President, Joe Biden, will exert pressure to revert many of the protectionist policies of our current government.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Below are some significant lending transactions that have taken place in our jurisdiction in recent years and in which we (Gonzalez Calvillo) have acted as counsel:

- Grupo Resuelve tu Deuda, the first and largest company in the credit repair sector in Mexico, with operations in six countries in Latin America and Europe – in the refinancing of certain financing arrangements granted by Alloy Merchant Finance, a leading cross-border financial company with operations in Mexico and the U.S.
- Rappi México, a leading global technology company with a presence in over 100 cities in Latin America and its subsidiary, Tarjetas del Futuro, the first fully-digital integrated financial company in Mexico, which looks to provide financial services to millions of Mexicans – in the USD$600 million financing by Grupo Financiero Banorte, S.A.B. de C.V., the second largest financial group in Mexico, with the largest business diversification in the market, to fund the credit origination operations of Tarjetas del Futuro.
- BANOBRAS – in the structuring, negotiations and documentation to provide a USD$124 million senior secured long-term financing to Gas Natural del Noroeste (GNN); and Gasoducto de Zapotlanejo (GAZA), part of Grupo SIMSA – for the comprehensive refinancing of approximately 30 existing bank credit facilities of GNN and to provide working capital to GNN.
- Rappi México – in the structuring, negotiation and implementation of a joint venture with Grupo Financiero Banorte, S.A.B. de C.V., through a USD$200 million convertible loan.
- IEnova, as borrower – in a series of independent but correlated green loan certified credit facilities comprising (i) a 15-year USD$241 million financing granted by U.S. International Development Finance Corporation (DFC – formerly OPIC), and (ii) a USD$100 million credit facility granted by Japan International Cooperation Agency (JICA), to finance four solar power plants with a total capacity of 376 MW across Mexico.
- Citibank, N.A., as, among others, administrative agent, and UMB Bank, National Association, as security trustee

– in the granting by a group of lenders of a series of loans for a total amount of USD$285 million, in favour of APR Energy LLC (APR), a worldwide leader in energy solutions.

- HIR Casa – in the structuring and obtainment of a revolving credit facility for an amount of up to Pesos $1,500 million to finance the granting of additional mortgage loans, through a ground-breaking off-balance fiduciary scheme, supported by mortgage collection rights regarding mortgage facilities previously granted by HIR Casa through its housing auto-financing system.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, both in domestic and cross-border transactions, subject to foreign law. In the event of the latter, certain provisions must be included in the financing documentation to ensure proper enforceability of a judgment in Mexico. These provisions in general refer to choice of law/forum, waiver of certain specific remedies provided under Mexican law and due service of process.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Enforceability of collateral or other guarantees in Mexico may be limited by bankruptcy (*concurso mercantil*), insolvency, dissolution and liquidation, reorganisation, moratorium, labour, and tax, among other laws of general application affecting the rights of creditors and obligations of debtors.

Regarding director liability, directors of a securing company, when assessing and approving a specific transaction, must comply with their statutory duties.

Such duties in private companies, among others, entail that a director must refrain from voting in any meetings on matters in which they have or may have a conflict of interest.

In the case of public companies, directors must meet the duties of loyalty and care. The duty of care consists of directors acting in good faith and in the best interest of the company, while the duty of loyalty consists of (i) maintaining the confidentiality of information received in connection with the performance of a director's duties while such information is not made publicly available, and (ii) abstaining from discussing or voting on matters where a director has a conflict of interest.

2.3 Is lack of corporate power an issue?

Yes. For a Mexican company to secure obligations/grant collateral, its corporate purpose must expressly contemplate such authority. The corporate purpose is included in the bylaws/articles of incorporation. In addition, certain corporate approvals (shareholder or board approvals) must usually be complied with. Finally, the securing company executing (directly or through a joinder agreement) the relevant guarantee/collateral documentation must do so through a duly appointed legal representative with sufficient powers and authorities pursuant to Mexican law. Additional requisites may apply for regulated Mexican securing companies.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

As mentioned above, certain corporate authorisations, including board and/or shareholder approvals, are usually required under the bylaws of the securing company.

Third-party consents may be required depending on the contractual obligations assumed by the securing company; for example, negative covenants under other financing arrangements.

Except for regulated entities, governmental authorisations are not generally required. Notwithstanding the foregoing, depending on the type of collateral being granted, certain formalities and filings with public registries may apply.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Generally, no. However, limitations on the enforceability of a guarantee must be taken into consideration.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No exchange controls apply.

On a separate note, when enforcement of a foreign judgment is sought before a Mexican court, certain requirements (set forth in article 1347-A of the Mexican Commerce Code) need to be met. These requirements are:

(a) the foreign judgment having to comply with the formalities set forth in the international treaties to which Mexico and the country issuing the judgment is a party;
(b) the foreign judgment being issued based on an *in rem* action (as opposed to an *in personam* action);
(c) the judge or court rendering the foreign judgment being competent to hear and judge on the subject matter of the case in accordance with accepted rules of international law that are compatible with Mexican law;
(d) service of process related to the foreign judgment being carried out personally on the parties or on their duly appointed process agents;
(e) the foreign judgment being final in the jurisdiction where it was obtained;
(f) the action in respect of which the foreign judgment was rendered not being the subject matter of a lawsuit among the same parties which is pending before a Mexican court;
(g) the foreign judgment not contravening Mexican law or public policy (*órden público*); and
(h) the foreign judgment complying with all necessary requirements to be considered as authentic.

In addition to the foregoing, other Mexican law limitations must be considered in any enforcement procedure, including, among others: (a) the possibility for debtors to discharge their obligations in Mexican Pesos, notwithstanding such obligations being agreed in a foreign currency; (b) the inability of lenders to collect interest-on-interest; (c) the impossibility to waive procedural rights protected under public policy; (d) the impossibility of enforcing claims outside the applicable statutes of limitations; (e) the need for judicial intervention for the taking of possession, entry or removal of property, or similar actions; and (f) the need of Spanish translations of all documents presented to Mexican courts.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

As a general rule and except for public assets (*bienes del dominio público*), collateral may be created over any type of asset, with the most common being pledges (over equity interests or movable assets), security trusts, and mortgages (over real estate).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Except in the case of a security trust agreement (as further detailed below), the use of general security agreements is not a common practice in Mexico, mainly due to the complexity in their enforcement in our jurisdiction. The usual way for creating collateral in Mexico is through the following:

Pledge over equity interests/shares

Equity interests that represent the capital stock of limited liability companies can be granted as collateral to guarantee payment obligations. The same applies for stock representing the capital stock of corporations. To fulfil the requirements set forth in the applicable law and to be consistent with market practice, the pledge agreement must be executed between the lender/security agent, as pledgee, and the borrower/securing company (holder of the issuing entity's equity interests/shares), as pledgor, with the appearance of the issuing entity. The pledge must be registered in the corporate book of the issuing entity.

In case it is deemed convenient for the pledge to have priority over tax credits, the pledge agreement must also be ratified before a Mexican public attestor (*fedatario público*) and registered before the Sole Registry of Movable Guarantees (*Registro Único de Garantías Mobiliarias*).

In addition, in the case of corporations, the stock certificates of the issuing company must be delivered and endorsed (*endosados*) in favour of the pledgee.

Finally, a recommended practice is for a power-of-attorney to be granted to the pledgee to exercise the voting powers of the pledged equity interests/shares in the event of a default (stock powers).

Pledge over movable assets

There are two ways to create pledges over movable assets: (a) a regular pledge (possession of the pledged assets is transferred to the pledgee); or (b) a floating/non-possessory pledge (possession of the pledged assets remains with the pledgor), the latter being more common in the implementation of Mexican collateral as it is less intrusive in the operations of the pledgor.

In both cases, a pledge agreement must be executed and thereafter ratified before a Mexican public attestor (*fedatario público*). Finally, the agreement must be registered before the Sole Registry of Movable Guarantees (*Registro Único de Garantías Mobiliarias*) in order for the collateral to be publicly registered and thus enforceable *vis-à-vis* third-parties. Also, other consents or registrations may be required depending on the specific collateral and/or grantor (e.g. in the case of pledges over IP, the pledge will need to be registered before the Mexican Institute of Industrial Property).

Mortgage

Mortgages are used to create collateral over real estate (e.g. land, buildings, etc.). Mortgages must be executed in a public instrument before a Mexican notary public. For a mortgage to be effective *vis-à-vis* third-parties, it must be duly registered in the public registry of property corresponding to the collateralised asset's location. Registration fees may vary depending on the secured amount and the Mexican state in which the corresponding asset is located.

Also, there is a form of mortgages known as "industrial mortgages", which allow the creation of a lien over all the assets located in the real estate being mortgaged.

Security trust

This is one of the most flexible structures as it allows for a single structure to be implemented pursuant to which different kinds of assets may be granted as collateral.

Likewise, it may encompass all (or most) of the assets of the grantor. Under this structure, the grantor transfers title of the collateralised assets to a trust (to be managed by a Mexican financial institution as trustee) for the benefit of the secured party. In other words, it has the purpose of securing the relevant payment obligations with the trust assets and of providing a servicing mechanism for the corresponding debt.

The formalities to implement a security trust depend on the assets being contributed thereto as collateral; however, these generally include (i) the implementation of a trust agreement, (ii) the granting/ratification of the agreement before a Mexican notary public, and (iii) filing of the trust with the applicable Mexican authorities/registries, provided that the nature of the filing depends on the type of assets being transferred to the trust (generally speaking, the trust has to be filed with the Sole Registry of Movable Guarantees (*Registro Único de Garantías Mobiliarias*); however, filing with other registries may apply (e.g. real estate assets; public registry of property, IP; Mexican Institute of Industrial Property, etc.)).

The main benefits of a security trust (versus a combination of pledges and mortgages) are: (i) the collateralised assets will generally be bankruptcy remote (except for transfers under clawback periods), thus protecting the secured party in the event of the grantor's bankruptcy or insolvency; (ii) the secured parties can exert a higher degree of control over the trust assets; and (iii) a non-judicial enforcement procedure may be agreed by the parties to the trust, thus allowing for a more efficient and structured enforcement of the collateral to take place.

That being said, the implementation of a trust agreement will imply a more expensive structure (given the applicable trustee, notarial and registration fees) and will definitely be more intrusive in the day-to-day operations of the borrower/guarantor.

This collateral structure is very common in project finance and is convenient to isolate the collateralised/project assets from the sponsor, and to have a greater control over these assets in an event of default.

Please note that other forms of security are applicable to regulated assets (e.g. airplanes and vessels).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Collateral over real property can be created by means of a mortgage or a security trust governed under Mexican law. Regarding the creation of a security interest over machinery and equipment, this can be done through a pledge, an industrial mortgage, or a security trust.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. It is important to note that debtors are not required to be notified for the perfection of collateral over receivables to be valid. That said, it is convenient to do so, so that they can acknowledge (i) the existence of the collateral, and (ii) that, in an event of foreclosure, they must pay any amounts under the receivables to the lenders. Otherwise, debtors would be released from their obligations by paying to the pledgor.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, traditionally through a pledge. It can also be implemented through a trust agreement.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Security can be taken over shares issued by a Mexican entity through a pledge agreement or a security trust as mentioned before. Note that in the case of security over shares being created through a trust, the relevant shares are transferred to the trust and thus the trustee becomes the actual shareholder/partner of the issuing entity.

It is not possible to create collateral over shares issued by a Mexican entity through foreign documents, due to the fact that such security would be unenforceable in Mexico.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, it can; either through a pledge, an industrial mortgage, or a security trust.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, it can. However, as mentioned above, the authority to secure third-party obligations should be permitted under the relevant company's corporate purpose.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

When granting collateral under Mexican law, the participation of a public attestor (notary public or commercial attestor (*corredor público*)) is usually required. The corresponding notarial fees will depend on the type of asset being collateralised and on the total value of the secured obligation. These fees are usually capped but, in some cases, can represent material amounts. These fees will usually be covered by the borrower.

Registration fees are generally required for security granted over real estate. These can be material and are associated with the registration of the collateral before the public registries where the assets are located. In most cases, these registration fees are capped by local authorities, and, in cases where the transaction is associated with benefits for the population or state, special discounts may apply.

Also, registration fees are generally required for security over movable assets. These are not material and are associated with the registration of the collateral before the Sole Registry of Movable Guarantees (*Registro Único de Garantías Mobiliarias*).

Please note that, in addition to the above, in some other cases and with respect to certain local jurisdictions, additional taxes or fees may be required to be paid for the perfection and/or registration of a security. Moreover, other forms of registration could be applicable to regulated assets (e.g. airplanes and vessels).

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The timing and expenses involved in the filing and registration of Mexican collateral can significantly vary on a case-by-case basis but, generally speaking and except for some cases of real state collateral, they should not be material.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

It depends if the collateral or overall financing involves regulated entities/assets. For example, security over permits, concessions, procurement contracts, licences and other regulated assets (such as pipelines, water treatment plants, energy plants, mining properties, highways, airports, and generally public infrastructure), or over companies or entities that use, procure, manage and/or operate such assets, will typically require prior governmental approval to create a security interest over them (or, at best, prior notice to the relevant authorities). If no regulated entities/assets are involved, then no regulatory consents are required. Also note that some types of regulated assets cannot be subject to collateral.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No. The same rules are generally applicable to credit facilities regardless of whether they are revolving or not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Refer to questions 3.2, 3.9 and 3.10 above.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Such prohibitions or restrictions are generally not applicable.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. It is customary. Depending on the transaction structure, the granting by the corresponding secured parties of a power-of-attorney to the agent to act on their name and on their behalf is advisable.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Mexico.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

For the transfer to be effective, the specific contractual provisions must be reviewed, and the requirements and obligations set forth therein must be met. Also, and except as provided otherwise in the relevant agreement, unless the borrower group is notified of the assignment to Lender B, they would be released of their payment obligations by paying any amounts under the loan to Lender A.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Withholding taxes apply as a general rule to interest payable by borrowers to foreign lenders and Mexican entities that are not banks or financial entities. These may also apply to financial entities but are normally preferential. The foregoing is also applicable to the proceeds of a claim or to the proceeds of an enforcement of security that are destined for payment of amounts other than principal (i.e. interests, commissions or fees). The withholding rate will strictly depend on the type and nationality of the lender, the nature of the transaction itself and the applicability of international treaties regarding double taxation, among others.

Withholding taxes do not apply to Mexican banks and certain types of financial entities. Such entities will calculate and pay their taxes in accordance with applicable Mexican tax laws.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Any tax incentives, privileges, restrictions, fees or exemptions thereof are provided for under specific international treaties entered into by Mexico to avoid double taxation and will depend on their applicability to a specific foreign lender.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Foreign lenders are required to pay income tax if they have a permanent establishment within the Mexican territory, or when the income comes from sources within the Mexican territory.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

As explained before, there are several costs and fees that will apply when structuring, implementing and perfecting collateral in Mexico.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes. Mexican law allows for the parties to contractually agree to governing law and forum in Mexico or abroad, provided that, for this submission to be valid, it must comply with the applicable requirements under Mexican law, including an irrevocable submission to the foreign governing law and courts and a waiver to any other jurisdiction to which the relevant party may be entitled to. Also, a reasonable point of contact must be established with the chosen forum (i.e. to avoid "forum-shopping").

Mexican judicial authorities would enforce a foreign judgment so long as the requirements for such enforcement are met (please refer to question 2.6 above).

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Yes, subject to: (i) the submission to the foreign court being valid (please refer to question 7.1 above); and (ii) the foreign judgment complying with the specific Mexican law-related requirements (please refer to question 2.6 above).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Timing depends on the circumstances of the particular case, the type of collateral securing the loan, applicable foreign governing laws, and applicable foreign jurisdictions, as well as on its consistency with Mexican law principles.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Yes, there are.

Foreclosure on a mortgage or "regular" pledge (i.e. where possession is effectively transferred to the creditor as the depository) will typically require a summary judicial procedure that would ultimately result in public auctions to sell (or transfer) the collateral with the proceeds being applied as payment to the lenders. For non-possessory pledges and security trusts, it is possible to choose between a judicial and a non-judicial procedure, but in most cases, they also imply public auction procedures.

Regarding regulatory consents, generally, the same consents required for the creation of security will apply to its foreclosure.

In addition, enforcement can be significantly affected or impacted in case of reorganisations or bankruptcy under applicable law.

Finally, foreign lenders may be restricted from owning certain assets (including stock) as result of limitations on foreign investment, or in the case of regulated assets. That said, lenders may foreclose on Mexican collateral looking to sell off the underlying asset to a third party without ever becoming the legal owner thereof.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Not generally. However, as set forth in question 7.4 above, certain restrictions will apply to foreign lenders looking to foreclose on restricted assets.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes. Under Mexico's Federal Bankruptcy Law (*Ley de Concursos Mercantiles*), as of the date of the bankruptcy judgment and until the end of the reorganisation stage, no claim or foreclosure will be enforceable against a company. A general clawback period of 270 days will apply.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Under Mexican law, courts have a legal binding obligation to recognise arbitration clauses, the contractual submission of potential controversies to arbitration and lastly the awards issued. The foregoing will be subject to compliance with procedural and formal requirements under the Mexican Constitution, the Mexican Commerce and Civil Codes and applicable international treaties.

In connection with the foregoing, please note that enforcement of an arbitral award may not be granted if, among others: (a) one of the parties to the arbitration agreement did not have adequate or sufficient legal capacity to enter into such arrangement or such arrangement is not valid under the laws chosen by the parties; (b) service of process is not correctly and legally carried out; (c) the award refers to a controversy which, under the terms of the arbitration agreement, was not subject to arbitration or contains a decision that exceeds the terms of such arbitration agreement; (d) the subject matter of the arbitration procedure cannot be arbitrated or the enforcement of the award is contrary to Mexican law or public policy, international treaties or agreements binding upon Mexico; or (e) the award is not final in the jurisdiction where it was obtained.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Mexico's Federal Bankruptcy Law is the general statute governing reorganisation and bankruptcy proceedings in Mexico. Reorganisation and/or bankruptcy proceedings will directly affect enforcement of a security by a lender depending on the kind of security interest granted to such lender.

Subject to applicable exemptions and specific rights, the aforementioned statute treats a lender secured under a security structure as a secured creditor. There are some important benefits afforded to a secured creditor, generally including priority ranking, continued ordinary interest accrual, loan currency protection and (subject to some exemptions) ability to participate or not in the eventual creditor agreement that concludes the reorganisation procedure. In the event no agreement is reached, and the relevant company becomes bankrupt, secured creditors have the right to foreclose on their security, and they have the same right if such an agreement is validly reached but not signed by the relevant creditor.

It is also important to note that, given that under a security trust structure, title to the assets that form the trust estate is transferred to the relevant trustee and, therefore, subtracted from the estate of the relevant grantor, lenders secured by or through a trust have, through this form of security, a vehicle that is remote to the bankruptcy of the grantor under applicable law. Please note, however, that in recent cases, while this remoteness has been generally accepted by Mexican courts, precautionary measures issued by Mexican courts have temporarily frozen enforcement and foreclosure of assets under trusts on the basis that, among others, the company subject to the reorganisation procedure needs to use such assets for its survival.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Yes. The Federal Bankruptcy Law and its associated regulations generally provide for a 270-day clawback period to protect creditors from fraudulent conveyance by the company subject to the reorganisation procedure.

Likewise, such statute, subject to exemptions and interpretation, sets forth the following ranking for creditor priority: (a)

singularly privileged creditors (i.e. burial and sickness expenses); (b) secured creditors (those secured with an *in rem* guarantee, such as the pledges and mortgages); (c) specially privileged creditors; and (d) unsecured creditors.

Please note that credits against the asset mass, such as certain tax or labour credits, debts incurred while at the reorganisation process, asset maintenance and other similar costs, may have higher ranking than secured credits and will typically be paid first.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Governmental entities (i.e., the union, states, municipalities, and certain government entities) are not subject to the Federal Bankruptcy Law. That said, governmental entities have implemented trust structures to, among multiple others, guarantee debt instrument offerings and other forms of financing.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes; nevertheless, Mexican law does not allow the actual seizing or taking of possession of assets through out-of-court proceedings; thus such seizure or taking of possession must be undertaken and approved by Mexican courts.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, it is, subject to compliance with certain requirements (please refer to question 7.1 above).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A waiver of immunity is traditionally valid in Mexico; thus, sovereign immunity is not recognised.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licensing or other eligibility requirements under Mexican law as a general rule.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

Lenders have tried to be more amenable to the use of digital signatures and similar mechanisms and that has provided a new level of efficiency to certain transactions. However, other players like trustees and notary publics are still on the formalistic end and still required "wet-ink" signatures as well as some burdensome requirements.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

No, there are not.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

We have seen the following recent trends and developments:

(a) COVID-19 had a significant impact on the loan markets in terms of deal activity, deal terms and documentation. Certain weaknesses in loan documentation were identified as a result of the stresses imposed on businesses and lenders caused by the effects of the pandemic. When the markets eventually stabilised, very strong borrowers were, to a certain extent, able to 'COVID-proof' their documents, e.g., financial covenants.

(b) The excess supply of credit continued to drive up competition for transactions and has pushed private equity players to increase origination sourcing capabilities, and where necessary, improve underwriting processes. This in turn has put pressure on pricing and debt terms, especially in the mid-market LBO space, where terms that were a few years ago reserved for large-cap and prime sponsor deals are now commonplace and considered the norm.

(c) The growth of green and sustainable lending, driven by investors, lenders and borrowers, has continued in 2020 and will likely only move higher up the agenda in 2021.

(d) Firms in the Dutch market that have international platforms and that are not just local players are continuing to flourish and work on truly international banking mandates.

(e) In line with global developments, the Dutch market is transitioning to LIBOR discontinuation by the end of 2021 and developing solutions such as forward-looking term rates.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Without singling out particular names, the use of TLB and high yield bonds remains commonplace. ESG-driven deals are now the norm. Traditional bank lenders are finding it difficult to compete with credit funds who have deeper pockets, can offer more flexible terms, can act faster and in some cases can show more business expertise. Asset-based lending alongside traditional cash deals is becoming more important as businesses seek to monetise their assets for more competitive financing.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

In principle, yes, a Dutch company can guarantee borrowings of one or more other members of its corporate group, provided that the objects clause in the guarantor's articles of association covers the issuing of guarantees. Restrictions apply; please refer to the responses to questions 2.2–2.5 and 4.1.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Under Dutch law, (the directors of) a Dutch company should in principle act in the interests of the company and its business. Additionally, the interest of the group to which the company belongs may be considered. In a group context, the common rationale as supported in case law is that the guarantor, as a shareholder or affiliated (group) entity, will benefit from the credit facility for which it assumes liability. In this context, it is generally held that group guarantees, and in particular parent guarantees, for debt of a group entity and/or subsidiary, serve the interests of an individual group company.

For purposes of establishing whether or not a guarantee granted in the context of a group financing serves the individual corporate interest of the guarantor, the following factors play a role: (i) whether the guarantor benefits from the loan (i.e., whether it will have access to the credit, either directly or indirectly); (ii) how much risk will be taken by entering into the guarantee and whether the group will be able to comply with its obligations for which the guarantee is provided; (iii) whether other group companies also provide a guarantee and/or accept joint and several liability; and (iv) what the consequences for the company would be if the loan was not granted to the group.

Finally, although there is no balance sheet insolvency test in the Netherlands, directors of a guarantor may be personally liable towards a creditor or a group of creditors of such company if they decided to continue the business past a certain point in time and such a decision resulted in damages to the creditors as a result of the company having insufficient assets against which the creditors can take recourse for the damages incurred. This may also lead to the guarantee being voided by creditors or the bankruptcy trustee of the guarantor on the basis of fraudulent preference.

2.3 Is lack of corporate power an issue?

Pursuant to Article 2:7 of the Dutch Civil Code, any guarantee given by a legal entity may be nullified by the legal entity itself or its liquidator in bankruptcy proceedings if the legal act was outside the company's objects and the other party to such legal act was or should – without investigation – have been aware of this. The determination of whether a legal act is within the objects of the company may not be based solely on the description of these objects in the company's articles of association, but must take into account all relevant circumstances, including in particular the question of whether the interests of the company are served by the relevant legal act.

In any event, if the contemplated transactions in the light of the benefits, if any, derived by the company from such transactions, would have a disproportionate adverse effect on the interests of the company, these transactions may be found to be outside the objects of the company and the counterparty may be held to have been aware of this.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental consents or filings are required for issuing a corporate guarantee. In principle, the only formalities are at the level of the guarantor and are limited to board approval and, if required on the basis of the articles of association, shareholder approval and approval of the supervisory board. Finally, if there is a works council with jurisdiction over the guarantor, it may have the right to advise on entering into the guarantee.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

If the guarantor is a legal entity, no net worth, solvency or similar limitations apply to the amount of a guarantee. However, please refer to our response to question 2.2.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Dutch law does not provide for any exchange control or similar obstacles to enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Collateral security can be taken pursuant to a right of pledge (*pandrecht*) or mortgage (*hypotheek*). The most common collateral being pledged are movable assets, shares and receivables. Bank accounts, insurance policies, intellectual property rights and certain subsidy grants are also capable of being pledged. Mortgages can only be established on property subject to registration, i.e. real estate or registered property (for example, seagoing vessels and aircraft). In addition, security over financial collateral can be created through a financial collateral arrangement (*financiëlezekerheidsovereenkomst*).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

In practice, omnibus pledges are used for creating non-notarial security documents (i.e., security over receivables, bank accounts, insurance policies, intellectual property rights). Please also see question 3.4. It is not possible to conclude a general security agreement for all types of assets in the Netherlands; a separate notarial deed of pledge or notarial deed of mortgage is required for creating security over shares or real estate. The specific requirements for creating a right of pledge or mortgage depend on the (type of) asset.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral security can be taken over real property located in the Netherlands. This security is created pursuant to a notarial deed of mortgage executed before a Dutch civil law notary. This notarial deed must be registered with the Dutch Land Registry Office.

Collateral security over plant, machinery and equipment (movable assets) located in the Netherlands can be taken by way of a:

- possessory pledge, where possession of the collateral is transferred from the pledgor to the pledgee or to a particular third party agreed upon by the pledgor and the pledgee. A possessory pledge does not require notarisation or registration; or
- a non-possessory pledge, where possession of the collateral remains with the pledgor. The deed of non-possessory pledge must either be drawn up in notarial form or registered with the tax authorities for the pledge to be valid.

As a possessory pledge requires the pledgor to hand over his collateral to the pledgee, non-possessory pledges are more usual. It is common practice to create a non-possessory pledge by way of a private deed of pledge to be subsequently registered with the Dutch tax authorities.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables is created by means of a right of pledge. There are two types of pledges over receivables: a disclosed right of pledge; and an undisclosed right of pledge, depending on whether the debtor of the receivable has been notified of the pledge. A disclosed pledge does not require notarisation or registration. An undisclosed right of pledge must either be drawn up in notarial form or registered with the Dutch tax authorities for the pledge to be valid.

When taking security over receivables by way of an undisclosed pledge, the pledge will only capture receivables arising directly from existing legal relationships. Receivables arising from a legal relationship that comes into existence after the execution of the deed of pledge fall outside the scope of the original (undisclosed) pledge. For purposes of creating an up-to-date security package, parties will need to 'repeat' the creation of the pledge by way of executing a supplemental pledge (which is to be registered with the Dutch tax authorities). For efficiency purposes, Dutch banks have established a practice whereby a

master deed of pledge (*stampandakte*) is created, in which the bank agrees with the pledgor that all its current and future receivables are pledged to the bank and in which the pledgor grants an irrevocable power of attorney to the bank, authorising the bank to create (on behalf of the pledgor) and register one daily supplemental pledge (*verzamelpandakte*) on behalf of all pledgors that granted such power of attorney.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Cash deposited in a bank account qualifies as a personal claim, capable of being pledged. Personal claims are in principle pledged by deed and notification of the pledge to the debtor of the pledged claim (disclosed pledge). However, it is also possible to create an undisclosed right of pledge by way of (i) a private deed of pledge registered with the Dutch tax authorities, or (ii) a notarial deed of pledge.

Pursuant to the Dutch general banking conditions, a Dutch account bank has security interests in the bank account of the pledgor (for example, a right of set-off and a right of pledge) and needs to provide consent for the creation of a right of pledge. It is therefore recommended to involve the account bank in the creation of such a disclosed pledge on a bank account.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

It is possible to take security over shares. In principle, shares in a Dutch private limited liability company (*besloten vennootschap met beperkte aansprakelijkheid*) and a Dutch public company (*naamloze vennootschap*) are registered shares (*aandelen op naam*).

To create a right of pledge over registered shares, a notarial deed is required. The articles of association may prohibit or restrict the encumbering of the shares and/or the transfer of voting rights attached to the shares. It is common that the rights to collect dividends and to exercise voting rights remain with the shareholder/pledgor until the occurrence of an event of default (which is continuing) and notice given thereof by the pledgee. A right of pledge over shares in a listed company can be created pursuant to a non-notarial deed and acknowledgment by the company.

To the extent shares in a Dutch public company are deposited in a securities account, they can be pledged accordingly. A right of pledge over securities which are transferable through book entries under the Dutch Securities (Bank Giro Transactions) Act (*Wet giraal effectenverkeer*) is created by a book entry in the name of the pledgee by the custodian bank or intermediary.

The shares are not in certificated form, but registered in the shareholders' register of the BV or NV. Any right of pledge over the shares should be duly recorded in the shareholder's register.

Security over shares in Dutch companies cannot be validly granted under a New York or English law-governed document.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Inventory qualifies as a movable asset. It is therefore possible to take security over inventory located in the Netherlands by way of a possessory or non-possessory pledge. Please see question 3.3 for a description of the procedure.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

This is possible if and to the extent that such transaction is within the corporate interest of the company and the corporate objects of the company allows such transaction. For Dutch public limited liability companies, financial assistance rules should be complied with (see question 4.1).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notarial fees are charged for all security created pursuant to a notarial deed, executed before a Dutch civil law notary. Notarial costs are normally charged in a manner consistent with legal fees; i.e., an hourly rate or a fixed-fee arrangement can be agreed upon. Compared to other jurisdictions, Dutch notarial fees are generally considered reasonable.

Registration fees are charged by the Dutch Land Registry Office for the registration of mortgages.

No stamp duties are levied on security rights over assets.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

This is a straightforward process, which does not involve a significant amount of time or expense.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally, negative pledge provisions may apply with respect to receivables, movables and shares, requiring the consent of the debtor/owner for creation of the security. In case of real estate that is to be encumbered with a mortgage, it is possible that the landowner will have to give its consent.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, such claims rank *pari passu* with any other secured facilities.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Security over real estate can only be created pursuant to a notarial deed, and for share pledges this is generally also the case (although exceptions apply, see question 3.6).

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance

the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company
Pursuant to Article 2:98c(1) of the Dutch Civil Code, a Dutch public company (an NV (*naamloze vennootschap*)) may not provide collateral, guarantee the price, act as surety or otherwise bind itself jointly or severally for the benefit of third parties, for the purpose of the subscription for or the acquisition of shares by third parties in its own capital or of depositary receipts issued therefor. The limitation does not apply to Dutch private companies (BVs), although the articles of a BV may still include provisions regarding financial assistance as a remnant of the financial assistance prohibition that used to apply to a BV (prior to 2012) on the basis of a provision equivalent to Article 2:98(c)(1) of the Dutch Civil Code. Where the text in the articles of association of a BV still includes a provision regarding financial assistance, it is advisable to amend the articles of association prior to the entering into of a transaction that may qualify as a violation of such provision.

(b) Shares of any company which directly or indirectly owns shares in the company
It is expressly provided that the prohibition set out above also applies to the (Dutch and foreign) subsidiaries of the NV, even if the subsidiary is a BV.

(c) Shares in a sister subsidiary
The financial assistance prohibition does not apply to sister companies.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Dutch law does not have an identical concept or doctrine to the concept of a trust. However, any trust validly created under its governing law is recognised by the Dutch courts pursuant to legislation implementing the Hague Trusts Convention. The agency concept, as a contractual arrangement, is recognised under Dutch law and also a common feature in Dutch syndicated lending transactions. Under Dutch law, security can in principle only be created for the benefit of the creditor(s) of the claim. As such, for purposes of enabling a security agent to enforce security created under Dutch law and subsequently apply the proceeds from the collateral to the claims of all the lenders, a parallel debt structure is used.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

In the Netherlands, a parallel debt structure is the standard mechanism in financing transactions to ensure that security interests governed by Dutch law can be held by a security agent for the benefit of the lenders. In a parallel debt structure, a borrower/guarantor at any time owes to the security agent in its individual capacity (i.e., acting in its own name and not as agent or representative of the lenders) an amount equal to the aggregate amounts owed by such loan borrower/guarantor to the syndicate of lenders under the loan documents (the 'parallel debt'). All security interests governed by Dutch law vest in the security agent as security for the parallel debt claim. No security interests are created in the name of the individual lenders. Each lender has a contractual claim against the security agent for payment of the amounts owed by the security agent to each of the lenders, as catered for in the loan documentation/intercreditor agreement.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

When transferring all rights and obligations under a contract (*contractsoverneming*), for the purposes of establishing the transfer requirements, Dutch private international law in principle follows the governing law of the contract. If Dutch law applies, the consent of the debtor to the transfer is required. No formalities apply to such consent, and the consent can also be implied or granted in advance. This form of transfer does not lead to a novation, and as such the same contract continues to be in place between the borrower/guarantor and the transferee.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

No, subject to the following exceptions.

As of 1 January 2021, interest paid by Dutch companies (or Dutch branches of non-Dutch companies) is subject to an interest withholding tax if the interest is paid to an entity that is (cumulatively) (i) related to the payer of the interest, and (ii) resident in, or lending through, a low-tax jurisdiction (which includes, amongst others, the United Arab Emirates, Jersey, Guernsey and the Cayman Islands) or a jurisdiction that is on the EU list of non-cooperative tax jurisdictions. Two parties are 'related' for these purposes if one party has influence over the activities of the other party (which is in any case assumed to be the case for any shareholders owning at least 50% of statutory voting rights), or if a third person has such influence over both parties. The rate is equal to the highest bracket Dutch corporate income tax rate (25% in 2021).

Interest paid on loans with certain hybrid elements (such as subordinate profit-sharing loans that are perpetual or have a maturity of more than 50 years) may be subject to dividend withholding tax (at a rate of 15% in 2021).

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no specific tax incentives for foreign lenders and no registration taxes or duties (or similar taxes or duties) apply in

the Netherlands (irrespective of whether (secured or unsecured) loans are provided by domestic or foreign lenders).

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No. If, however, a foreign lender (alone or together with affiliates) (i) owns a direct or indirect equity interest in the borrower of at least 5% (or has the option to acquire such interest), and (ii) holds the equity interest through a legal structure that is considered 'abusive', the income/gains derived by such lender from the debt funding provided to the Dutch borrower may become subject to Dutch corporate income tax.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are no other significant costs for foreign lenders.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are no such adverse consequences.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The choice of a foreign governing law governing contractual obligations will, in principle, be upheld by Dutch courts, on the basis of and subject to the limitations imposed by Regulation (EC) 593/2008 of 17 June 2008 ('Rome I').

The choice of a foreign governing law governing non-contractual obligations will in principle be upheld by Dutch courts, on the basis of and subject to the limitations imposed by Regulation (EC) 864/2007 of 11 July 2007 ('Rome II').

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

In the absence of an applicable treaty between New York and the Netherlands, a judgment obtained in the courts of New York will not be directly enforced by the courts in the Netherlands. In order to obtain a judgment that is enforceable in the Netherlands, the claim must be relitigated before a competent court of the Netherlands; the relevant Dutch court has discretion to attach such weight to a judgment of the courts of New York as it deems appropriate. Based on case law, the Dutch courts may be expected to recognise the binding effect of a final, conclusive and enforceable money judgment of a court of competent jurisdiction in New York without re-examination or relitigation of the substantive matters adjudicated thereby, provided that: (i) the relevant court in New York had jurisdiction in the matter in accordance with standards which are generally accepted internationally; (ii) the proceedings before such court complied with principles of proper procedure; and (iii) such judgment does not conflict with the public policy of the Netherlands.

A judgment obtained in the English courts is enforceable in the Netherlands on the basis of, and subject to the limitations and formalities imposed by, either:

- the Convention on Choice of Court Agreements of 30 June 2005 (the Hague Choice of Court Convention) (in case of claims related to payment of sums of money and exclusive jurisdiction clauses, which are not customary in standard international loan contracts as these often leave room for jurisdiction of other courts ('asymmetric jurisdiction clauses'));
- the Convention between the Kingdom of the Netherlands and the United Kingdom of Great Britain and Northern Ireland providing for the Reciprocal Recognition and Enforcement of Judgments in Civil Matters of 17 November 1967 (the Dutch British Execution Treaty) (in case of non-exclusive jurisdiction clauses and claims related to payment of sums of money); or
- in case both the Hague Choice of Court Convention and the Dutch British Execution Treaty do not apply, relitigation in Dutch courts on the basis of the method set out above in relation to New York judgments (i.e., in the absence of an applicable treaty).

The impact of Brexit has yet to crystallise in Dutch case law regarding the enforceability of judgments given by English courts.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Court proceedings on the merits take from at least six months up to multiple years before the judgment can be enforced against the assets of the company. It should be noted that the lender may be liable for any damages when enforcing a judgment that is overruled in appeal at a later stage.

If the lender has an urgent interest to enforce against the assets (*spoedeisend belang*), the lender can institute preliminary relief proceedings (*kort geding*). In such proceedings the lender can also ask for provisional measures to be imposed by the court on the company by way of an injunctive relief. Such measures can be executed directly against the company. These proceedings (which usually include a court hearing) take only about two to eight weeks before a judgment is obtained. If successful, the company may appeal or start proceedings on the merits to overrule the judgment.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

A holder of security that intends to enforce its security has several options. The main rule is enforcement by way of a public

auction, which has to be effected in accordance with the applicable provisions of the Dutch Civil Code and the Dutch Civil Procedures Code, and whereby the security holder may also bid for the secured asset. A sale by public auction may be cancelled at any time before the auction is held.

To the extent not excluded in a security agreement, enforcement can also be effected by way of a private sale. The terms of such private sale have to be approved by the competent Dutch court and subject to the terms of the security agreement; both the security holder and the security provider can request for such approval any time after the security has become enforceable.

With respect to a right of pledge (and to the extent it is not excluded in the pledge agreement), the pledgee can request the competent Dutch court to determine that the pledged asset, for a cost to be determined by the competent Dutch court, will stay with the pledgee. Furthermore, it is possible for the pledgee and pledgor to agree to an alternative enforcement procedure after the right of pledge has become enforceable. This option is not available in the context of real estate security.

Appropriation of a pledged asset is not permitted until the pledgee is authorised to sell that pledged asset. Appropriation of a mortgaged real property is never permitted.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

In principle, no restrictions apply to foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Under the Dutch Bankruptcy Act, the court may allow a general cooling-off period during a suspension of payments or bankruptcy for a period of up to two months, which can be extended by another two months. During the cooling-off period, the (collateral) security rights of lenders are suspended and cannot be foreclosed without court permission.

Under the new Dutch scheme, which entered into force on 1 January 2021, there is in principle no automatic stay. However, the debtor has the possibility to request the court to allow a stay for a maximum of four months, with the possibility of an extension of up to eight months in total. The stay, when granted upon request, prevents all parties from claiming or taking recourse against the debtor's assets, unless they have court consent.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

An arbitral award issued in a dispute with respect to which the relevant parties have validly agreed in writing that it shall be settled by arbitration will be recognised and enforced by the Dutch courts without examination of the merits of the case, pursuant to and subject to the conditions of and limitations of the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958 and/or Book IV of the Dutch Civil Procedures Code (*Wetboek van Burgerlijke Rechtsvordering*).

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

During bankruptcy, there is a general moratorium and ordinary and preferential creditors may no longer enforce their claims against the debtor's assets. However, secured creditors are not affected by the moratorium, unless a cooling-off period applies. Please also refer to question 7.6.

The rights of the holder of financial collateral are not affected by insolvency proceedings and it can act as if there were no insolvency proceedings, allowing the security holder to liquidate the assets over which it has security or, if agreed as part of the conditions of the security arrangement, retain ownership of the assets provided as security. Any cooling-off period ordered does not apply to assets subject to a financial collateral arrangement (*financiëlezekerheidsovereenkomst*).

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

In bankruptcy, the bankruptcy trustee may challenge voluntary legal acts (i.e., acts where there was no prior legal obligation to perform them) for consideration, and legal acts without consideration that were performed by the debtor. In addition, set-off rights and general preference claims may apply, including from the Dutch tax authorities and from employees (both pre- and post-insolvency), subject to certain conditions.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Although the Dutch Bankruptcy Act does not contain exceptions, it is unlikely that insolvency proceedings could be opened against the Dutch state and local authorities, such as municipalities and provinces. Also, Dutch courts cannot open insolvency proceedings against a foreign state.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Unsecured creditors may levy an attachment (*beslag*) on assets of the debtor to ensure that the creditor can take recourse on assets of the debtor if a successful order is awarded. To levy such attachment, the creditor needs prior court approval, which can in general be obtained quite easily, and the attachment is levied by a bailiff, being a government-appointed person.

Also, suppliers may have a retention of title (*eigendomsvoorbehoud*) on assets supplied to a debtor. However, the supplier cannot reclaim the goods when these have been used in a manufacturing process resulting in accession of the goods, in which case the supplier does not have a right to the newly created goods. In addition, Dutch law provides for a statutory reclaim right for the supplier of a movable asset, which it can invoke until both (i) six weeks have passed after payment was due, and (ii) 60 days have passed since delivery has taken place. During a cooling-off period, a supplier cannot retake possession of the goods without court permission.

Finally, the beneficiary of a non-possessory pledge over movable assets can see its rights frustrated by means of a seizure by the tax authorities of pledged assets located on the premises of the debtor (*bodemzaken*).

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Under Dutch law, the submission by a party to a foreign jurisdiction is binding upon such party. This submission does not preclude that claims for provisional measures in summary proceedings may be brought before a competent court in the Netherlands. Also, we note that certain proceedings are subject to an exclusive jurisdiction (e.g. as regards real estate or consumer contracts).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

From a Dutch law perspective, there is some uncertainty as to whether a party can waive its immunity, to the extent it enjoys immunity. In principle, the State has the sole authority to waive the immunity granted to its nationals.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

No licence requirements apply to foreign lenders solely as a result of offering a loan to Dutch companies (i.e., professionals). Lending to consumers is, in principle, a licensed activity. An existing (loan) agreement is not void or voidable as a result of a lender not meeting the applicable licence requirements. There are no additional licence requirements for a party acting as an agent under a loan (other than those applicable to a lender).

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

Given the lockdowns imposed during COVID-19, the Dutch market saw an increase in the number of documents signed electronically. From a legal perspective, the EU eIDAS Regulation forms a part of the regulatory landscape for electronic signing under Dutch law, and article 3:15a of the Dutch Civil Code provides that electronic signatures shall have the same legal effect as a wet-ink signature, if the method used for signing is sufficiently reliable, having regard to the purpose for which the electronic signature is used and to all other circumstances of the case. This is an open norm and hence the use of electronic signatures should be considered on a case-by-case basis.

Any deeds executed before the civil law notary in the Netherlands, such as notarial deeds of amendment of articles of association/incorporation/conversion or (de)merger, transfer of shares or real estate and deeds of pledge, are required to be paper-based.

We anticipate an increased use of electronic signatures that are in compliance with the applicable legal framework.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

On 1 January 2021, the long-awaited legislative proposal for the act providing for court confirmation of a private restructuring plan (*Wet homologatie onderhands akkoord* ('WHOA'), or the 'Dutch scheme') entered into force. This introduces a fast and efficient pre-insolvency procedure to restructure a company's business through a scheme between the company and its creditors and/or shareholders, with the possibility of a court-approved cram down if just one in the money class has voted in favour of the proposed plan. The new scheme procedure is meant to serve as a last-resort pre-insolvency restructuring tool, designed as a framework procedure with limited involvement of the court. It features elements of the US Chapter 11 procedure and the UK Scheme of Arrangement. More information can be found in Freshfields' WHOA briefing (http://ssl.freshfields.com/noindex/documents/WHOA-briefing-7836.pdf).

Mandeep Lotay has worked in the UK and European market for 18 years, advising on banking and structured finance transactions. He advises clients on various products across jurisdictions and the entire credit spectrum. Mandeep's unique specialism in banking and structured finance means that he is often chosen to lead projects that have both these features such as bank loan bridge financings with subsequent capital markets refinancings.

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Mandeep regularly heads up teams made up of lawyers in Amsterdam, London and other jurisdictions. As well as being technically sharp, he is commercial and focused on providing the best client service. He is an English law-qualified lawyer and registered as an overseas lawyer with the Dutch Bar.

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We advise borrowers and lenders on all aspects of their corporate financing needs and business objectives, including 're-financings' and 're-pricings'. This includes advising clients on acquisition and real estate financing needs. Our work is a mix of Dutch and international mandates, where we bring our international product knowledge and experience to the Dutch market.

We are known for our ability to deliver on the most complex and challenging mandates at the cutting edge of constantly evolving debt markets. Our breadth of experience across the credit spectrum and our ability to work seamlessly across those different markets allows us to help our clients to achieve their financing goals.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The Russian lending market has been under mounting pressure from US and EU sanctions in recent years. The major deals involving state-owned banks and companies have been non-public and denominated in Russian rubles, euros or, sometimes, in other currencies.

The prepayment finance market has further increased its share and, in terms of amount and volume of transactions, has significantly surpassed the market of "traditional" pre-export finance and other "classical" trade finance structures. There have been a number of large prepayment finance deals involving major producers of copper, coal, aluminium, oil, gas, gold, fluorspar, magnesia and other commodities which demonstrate the market trend of prepayment structures expanding well beyond the oil market. In view of the growing trade between Russia and Asia, the prepayment finance market is also expanding to Asia.

Most cross-border gold prepayments are currently structured through a direct gold supply arrangement between an international bank and a Russian producer, although traditionally, such deals have been structured through licensed Russian banks.

An increasing number of lending transactions are governed by Russian law. Federal Law No. 486-FZ, dated 31 December 2017, "On syndicate facility (loan) and on amendments to certain legislative acts of the Russian Federation" (the "Syndication Law") contains detailed regulations of syndication lending and the role of lenders, facility agents and arrangers. Many Russian state banks tend to structure Russian law syndicated lending in accordance with the Syndication Law.

In response to the global COVID-19 pandemic, Russia changed its bankruptcy laws to provide for a moratorium on bankruptcies and a freeze on certain transactions, which applied to companies in a number of listed sectors, including road transport, air transport business, etc. The moratorium entered into force on 2 April 2020 and was lifted on 7 January 2021. During the moratorium, a number of restrictions applied to the eligible companies, including:

- courts were not entitled to accept petitions (claims) filed by a creditor in respect of any eligible company;
- penalties (charges, fines) and other financial sanctions for non-performance or improper performance of monetary obligations and obligatory payments (e.g., taxes and similar payments), other than in respect of the current payments, did not accrue (the freeze on financial sanctions);
- eligible companies could not set off monetary claims if this would violate the statutory order of creditors' priority; and
- creditors could not enforce pledges and mortgages (whether through a court or without recourse to the courts) in respect of eligible companies.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Significant public finance transactions in recent years include, among others:

- a EUR 11.4 billion project financing for the construction of the Amur Gas Processing Plant by 22 banks from Europe, Asia and Russia, including the China Development Bank, Gazprombank, Sberbank of Russia and VEB.RF;
- a USD 7 billion loan by Credit Bank of Moscow PJSC to Trafigura for purchase of a stake in Rosneft PJSC's flagship Arctic oil project;
- a USD 2 billion syndicated financing of Baikal Mining Company by Sberbank of Russia, Gazprombank and VEB.RF;
- a syndicated facility of up to USD 1.5 billion for Amur Gas Processing Plant with Gazprombank (Joint Stock Company) acting as the lead arranger and lender, and Otkritie Bank and Sberbank of Russia acting as arrangers and lenders;
- a USD 665 million five-year pre-export facility for Uralkali with Crédit Agricole as a facility agent;
- a USD 1 billion sustainability-linked pre-export facility agreement with ING Bank and Natixis as Coordinating Bookrunning Mandated Lead Arrangers;
- a USD 750 million syndicated facility arranged by UniCredit for EVRAZ;
- a EUR 600 million syndicated facility for Novolipetsk Steel by Crédit Agricole Corporate and Investment Bank, NATIXIS, Intesa Sanpaolo Bank Ireland Plc, SGBTCI, AO Raiffeisenbank, Bank of America Merrill Lynch International DAC, Mizuho Bank, Ltd., Deutsche Bank AG, London Branch, ICBC Bank (JSC), ING Bank N. V. and UniCredit S.p.A.; and
- a USD 300 million syndicated facility for Aktyubinsk Copper Company organised by Natixis.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Generally, there are no restrictions on provision of guarantees or sureties by a Russian company in favour of members of its

group. If a guarantee or surety constitutes a "major" (i.e., a transaction amounting to 25% or more of the company's assets) or an "interested party" transaction, it may be subject to certain corporate consents, approvals or notification requirements.

Pursuant to the recent position of the Russian Supreme Court, unless proved otherwise, if sureties are provided by several members of the group, such sureties are considered to be given "jointly", in which case the relevant sureties will be jointly and severally liable.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Any transaction, including a guarantee or surety, may be challenged by a company and, in certain cases, by its shareholders or members of the board if such transaction is entered into to the detriment of the company, and the counterparty was aware of such circumstances. In the meantime, consideration is not required for a guarantee or surety to be valid.

Also, a director of a Russian company shall generally act reasonably and in good faith and in the best interest of the company. If such obligations are breached, the directors may be sued for losses caused to the company.

In case of insolvency of a company, if a guarantee or surety has been issued in anticipation of insolvency, it may be challenged if such transaction is aimed at a violation of creditors' rights or constitutes a preferential transaction. Directors and controlling persons of a company may be subject to "subsidiary (secondary) liability" if the insolvency occurred as a result of their actions.

2.3 Is lack of corporate power an issue?

Subject to certain exceptions, Russian companies can enter into any lawful transaction. However, the powers of a CEO may be limited by the company's articles of association. The articles of association may also contemplate that two CEOs shall act jointly or severally (in the latter case, the powers may be divided between them). In certain cases, a guarantee or surety may require consent of (notification to) the shareholders (participants) or the board of directors if it constitutes a "major" or "interested party" transaction for the company or, in other cases, is stipulated by the company's articles of association.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Generally, no governmental consents or filings are required in respect of guarantees or sureties. A company issuing a guarantee has an obligation to publish this fact and the material terms of a guarantee in the Uniform State Register of Information on the Activity of Legal Entities (*Fedresurs*) (for more information, please refer to question 3.9).

As described in question 2.3, a guarantee or surety may require consent of the shareholders (participants) or the board of directors if it constitutes a "major" or "interested party" transaction for the company or, in other cases, is stipulated by the company's articles of association.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Generally, there are no such limitations. However, if the value of the transaction exceeds certain thresholds (such as 25% of the company's assets), this may be taken into consideration if the company's transaction is contested in the course of the company's insolvency.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are generally no such obstacles other than insolvency of a company. In order for a company to make certain payments to a foreign lender in a foreign currency under a guarantee or surety, the company may be required to file with a Russian-authorised bank certain documents (including the relevant guarantee or surety) in order to record the agreement for currency control purposes. Such filing is required to be made as a condition to a payment transfer rather than to the entry into the underlying transaction, and such requirement is of an administrative nature and does not restrict or affect the company's obligation to make payments under the guarantee or surety.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Russian law allows using various types of collateral, including a pledge of immovable property (mortgage), pledge of equipment (or other movable property), pledge of rights under bank accounts, pledge of goods in turnover, pledge over shares and participatory interest, and pledge over receivables.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Russian law generally allows extending a pledge to "all assets" of a company. The respective pledge agreement shall be made in written form. However, it is unlikely that a pledge created by such a pledge agreement would automatically extend to certain types of assets, such as rights under bank accounts, immovable assets (mortgage), participatory interests in limited liability companies or shares in joint stock companies, since pledges over such assets are subject to registration/notarisation or other specific formalities.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over immovable property (land, buildings, etc.) can be taken by way of mortgage. The mortgage agreement shall be made in written form. The mortgage shall be registered with the Unified State Register of Immovable Property ("*Единый государственный реестр недвижимости*"). Security over machinery and equipment is usually taken by entering into a pledge of movables. The pledge of machinery and equipment can be recorded with the register of notices on pledges maintained by the notaries (for more information, please refer to question 3.9).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, security over receivables is usually taken by way of a pledge. The debtor shall be notified about the pledge of receivables.

The consent of the debtor is generally not required unless otherwise provided by the underlying contract. If the consent of the debtor is not obtained in breach of the underlying contract, the pledge will be valid but the pledgee and pledgor may be sued for losses caused to the debtor.

The pledge over receivables can be recorded with the register of notices on pledges maintained by the notaries (for more information, please refer to question 3.9).

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Security over cash deposited in bank accounts is usually taken by way of a pledge of rights under bank accounts. The Russian Supreme Court has supported a view that a pledge of rights under a bank account is possible only in respect of specific pledge accounts ("*залоговые счета*"), which means that there is a substantial risk that a pledge of rights in respect of an ordinary bank account may be unenforceable. It is impossible to bypass this rule by changing the status of an ordinary bank account to a specific pledge account. A new pledge account must be opened for this purpose. A pledge of rights under a bank account is created from the moment the respective account bank is notified about the pledge. However, if the account bank is the pledgee, the pledge will be created from the date of the pledge agreement.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Russian law makes a distinction between shares in joint stock companies and participatory interests in limited liability companies. Both can serve as collateral and both are in a non-documentary form.

In respect of the participatory interests, a pledgor must obtain the prior consent of other participants in the limited liability company in a form of a participants' resolution if the pledge is made in favour of a third party. A participatory interest pledge agreement must be made in written form and notarised. A pledge of participatory interest is deemed to be created from the moment of its registration in the Unified State Register of Legal Entities.

In contrast with a participation interest pledge, notarisation of a share pledge is possible but not mandatory. No consent of other shareholders is required. A share pledge must be registered with the shareholders' register or a depositary.

Pledges of participatory interests and shares are usually governed by Russian law. New York and English law may also be used to govern local pledges, but these are rarely seen because enforcement of such pledges may be more complicated in practice.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Russian law recognises the pledge of inventory (pledge of goods in turnover). The subject matter of a pledge of goods in turnover can be determined by specifying the generic features of the goods and their location (e.g., goods in certain premises). The pledge over inventory can be recorded with the register of notices on pledges maintained by the notaries (for more information, please refer to question 3.9).

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, both options are possible as long as the required corporate consents (if any) are obtained.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Any pledge agreement shall be made in written form. Notarisation of a pledge of participatory interests is mandatory, while notarisation of pledges of other types of assets is possible but, as a rule, not mandatory. However, out-of-court enforcement of the pledged assets by way of notarial endorsement is only possible if the agreement is notarised.

A mortgage shall be registered with the Unified State Register of Immovable Property and takes effect from the date of such registration. A pledge over participatory interest shall be registered with the Unified State Register of Legal Entities and takes effect from the date of such registration. Similarly, a pledge over shares shall be recorded by a book entry made in the relevant account of the pledgor held with the register or custodian. There are also specific requirements for registration of a mortgage in respect of certain assets (i.e., airplanes, ships, etc.).

The amount of notary fees depends on the amount of the secured liabilities and whether the notarisation is mandatory. If the notarisation is mandatory, the amount of the notary fee cannot exceed RUB 150,000. If the notarisation is not mandatory, this amount cannot exceed RUB 500,000.

Pledges of most assets (other than immovable property, participatory interests, trade marks, patents, rights under bank accounts and pledges of other assets, transfers of rights in respect of which are subject to mandatory registration) can be recorded with the register of notices on pledges maintained by the notaries. Such notification is not mandatory and is not required for the validity of a pledge. However, the notification makes the pledge public and third persons are deemed notified about such pledge. This is particularly important in case of a dispute in respect of the priority of pledges. The fees in connection with the registration of such notices are nominal (RUB 600 per notice).

The fees for the registration of a mortgage by legal entities in the Unified State Register of Immovable Property are RUB 4,000 (shared by a pledgor and a pledgee).

A company issuing a guarantee or proving pledge over its movable assets must record this fact and the material terms of a guarantee (pledge agreement) in the Uniform State Register of Information on the Activity of Legal Entities (*Fedresurs*). Failure to publish such information does not affect the validity of a guarantee but constitutes an administrative offence. From 1 April 2020, the creditors are entitled (but not obliged) to publish the same information about sureties provided to them.

No stamp duties are payable as a matter of Russian law.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The statutory term for registration of a mortgage is up to five business days, but in practice it sometimes takes longer.

Notarisation of a participatory interest pledge and registration of the respective pledge in the Unified State Register of Legal Entities usually takes five to 10 days. Foreign pledgors and pledgees must collect and submit to the notary a set of notarised and apostilled corporate and other documents, which often takes some additional time.

Notices regarding pledges of movable property are submitted by the notaries, and the entire process may be completed within one or two hours.

Registration and notary fees are described in more detail in question 3.9.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Regulatory or similar consents are generally not required with respect to the creation of security. A conservative interpretation of antimonopoly and foreign investment laws may purport to treat a security arrangement itself or certain covenants within it as the creditor obtaining "control" over the relevant debtor. However, as a matter of market practice, no consents of antimonopoly or other authorities are usually obtained with respect to the creation of security; depending on the situation, the creditors may consider applying for an antimonopoly clearance or at least for official guidelines at the enforcement stage.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Russian law previously required having a detailed description of the secured obligations, which created complications in instances when collateral secured the revolving facilities. At the moment, Russian law is far more flexible in respect of the requirement to describe the secured obligations, and expressly provides that a pledge or a surety/guarantee may secure future obligations, so in our view the previous priority concerns in respect of a security relating to revolving facilities is less likely to be an issue.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Please refer to question 3.9 in respect of the pledge agreements/mortgage agreements. Execution of contracts by means of electronic communication is allowed as long as such execution makes it possible to determine that the document has been signed by the relevant party.

Russian law does not set out any specific requirements in respect of execution of deeds.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Financial assistance restrictions (including restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of shares of the company, shares of any company that directly or indirectly owns shares in the company or shares in a sister subsidiary) such as those that exist in Germany and certain other jurisdictions do not exist in Russia. However, such guarantee or security may in certain cases require corporate consent. Please refer to question 2.4 for further details.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Russian law does not currently recognise the trustee relationship, which is common in English law. The Russian Civil Code contains provisions allowing creditors to enter into a pledge management agreement and appoint a "pledge manager" to act on behalf of several creditors in connection with the pledge. The pledge management agreement may contemplate payment of a fee to the pledge manager. The pledge manager shall act in the best interest of the creditors. The proceeds received by the pledge manager in connection with the pledge become the common property of the creditors unless the pledge management agreement provides otherwise.

The Syndication Law introduced the role of a facility agent referred to as the "facility manager". The functions of the facility manager can be carried out by a credit organisation, VEB.RF, a foreign bank or an international finance organisation.

Facility managers shall run the register of the syndicate participants and record all amounts granted to the borrower. Facility managers shall act on behalf of lenders in their relationship with the borrower, including in actions such as collecting funds under the facility, including interest amounts and other payments, and providing relevant documents and information to lenders and security arrangers. In December 2020, further changes to the Syndication Law were introduced. The changes, among other things, include:

- the regulation of the filing of claims by the facility manager and, in certain cases, the lenders in the case of an insolvency of the debtor; and
- the introduction of the regulation of "sub-participation agreements" under Russian law.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Please refer to the answer to question 5.1.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Rights under loan agreements and guarantees governed by Russian law are usually transferred by way of assignment. The

consent of the debtor is not required unless otherwise provided by the loan agreement or guarantee. If consent is required by the loan agreement or guarantee but is not obtained, the assignment would still be valid, but the initial creditor would be liable for breach of contract.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interest payable on loans made by Russian lenders (lenders incorporated in Russia and foreign lenders that have a permanent establishment in Russia) is generally subject to Russian income tax at a rate of 20%. The same rate applies to a foreign lender receiving its income from interest on loans at a source in Russia. In this case, taxable income is withheld by the borrower.

Proceeds under a guarantee are subject to the same rules as taxable income under loan agreements.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

The general approach under Russian law is that foreign lenders are subject to the same rules as Russian lenders. However, international tax treaties provide certain specific tax exemptions or reductions. In order to enjoy such exemptions or reductions, the foreign lender must provide the borrower with: (i) the tax residence certificate issued by the relevant competent tax authority in that lender's jurisdiction of residence, confirming that the lender is a tax resident in such tax jurisdiction for the purposes of the relevant tax treaty; and (ii) a certificate confirming the beneficial ownership of income. Such certificates are usually provided before the first payment of interest under the loan and thereafter annually until the full repayment of the loan.

In accordance with recent changes to the Tax Code, a borrower is not required to obtain a tax certificate from a foreign lender in order to apply the relevant international tax treaty if the tax residency of such lender can be verified via reliable public sources (e.g., the lender is included in the Banker's Almanac or the International Bank Identifier Code Directory).

In 2020, Russia agreed to amend international double tax treaties with such countries as Cyprus, Malta and Luxembourg in order to raise the withholding taxes to 15% and to exclude the overly friendly tax advantages for Russian nationals to move money to those countries.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Please refer to questions 6.1 and 6.2.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Notarisation of loan agreements and guarantees is not mandatory in Russia. No registration of loan agreements or guarantees is required in Russia. Notarial and other fees applicable on security are described in question 3.9.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

A loan from a foreign entity can be considered as "controlled indebtedness" if such loan is provided or secured by a foreign entity (or a Russian entity controlled by such foreign entity).

If the amount of such "controlled indebtedness" exceeds the amount of a borrower's own equity by more than three times (for banks and leasing companies, by more than 12.5 times), the interest paid on such loan can only be considered as a deductible expense subject to certain limits. The remaining interest is considered as a dividend paid to a foreign entity and is subject to 15% taxation (unless an international treaty allows specific tax exemptions or reductions).

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Russian courts should generally recognise (and enforce) foreign governing law, provided that: (i) there is a "foreign element" in the transaction (e.g., one of the parties is a foreign entity or the subject matter of the contract relates to foreign assets); and (ii) such laws do not conflict with Russian public policy or specific mandatory rules ("*нормы непосредственного применения*") of the laws of the Russian Federation. The concepts of public policy and specific mandatory rules are not defined in the laws of the Russian Federation and, therefore, are open to interpretation by Russian courts.

If there is no "foreign element" in the transaction, the parties can still choose foreign governing law, but the Russian courts would then not apply such foreign law to the extent that it contradicts mandatory provisions of Russian law (which are rather extensive).

Furthermore, a Russian court will apply foreign law as the law of the contract only, provided that such Russian court has properly established the content of the relevant foreign law in relation to the issues considered by it. If a Russian court is not in a position to establish the content of foreign law within a reasonable period, it is entitled to apply the laws of the Russian Federation. In any event, the laws of the Russian Federation will apply as to the matters of evidence and procedure.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Judgments of foreign courts may be enforced in the Russian Federation only if there is a treaty between the Russian Federation and the relevant foreign jurisdiction on the mutual recognition and enforcement of court judgments or, in the absence of such a treaty, on the basis of reciprocity. As of today, no such treaty is currently in force and no formal legal procedures for

reciprocal enforcement of court judgments exist between the Russian Federation and England or the Russian Federation and the United States, which means that the risk that a judgment of an English or a New York court would not be recognised and enforced in Russia is substantial.

We are aware of some cases in which judgments of foreign courts were successfully recognised and enforced in Russia (the claimant usually provided evidence, including an expert opinion, that, under similar circumstances, a judgment of a Russian court would be enforceable in the respective foreign jurisdiction), but we are also aware of a number of cases in which enforcement of foreign court judgments was denied by Russian courts.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In general, a claim under a loan would normally be enforced in Russia upon a court judgment.

(a) Obtaining a final and binding judgment of the arbitrazh (commercial) court of first instance usually takes three to four months. The proceeding at the court of appeal usually takes from two to three months. Enforcement of a Russian court judgment should normally be completed within two months from the day of the commencement of the enforcement proceedings, although sometimes it takes much longer due to various delays.

(b) Enforcement of a foreign judgment should technically be completed within one month, but may in practice take several months.

A bad-faith debtor may substantially delay the court or enforcement proceedings by means of raising various objections in respect of the substance of the foreign law as well as various procedural objections.

Under Russian law, it is also possible to collect debt through an out-of-court procedure under a notary's executory endorsement made on a copy of the loan agreement. An out-of-court order of debt collection may be exercised when a loan agreement specifically provides for such enforcement option. The lender must notify the borrower at least 14 days prior to the intended collection of debt. In the absence of the established court practice, it is unclear whether the out-of-court procedure can also be used by foreign banks.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

The enforcement in respect of most types of pledged assets is possible both in court and out of court. In most cases, out-of-court enforcement of the pledged assets requires notarial endorsement and such endorsement is only allowed if the pledge agreement is notarised. The creditor would also be able to select an out-of-court enforcement when it has the actual possession over the pledged assets (e.g., the lender also acts as a depositary for the shares pledged to it or as the account bank where the rights under such bank account are pledged to it).

The out-of-court enforcement may be exercised by the following methods: a private auction; an appropriation; and a private sale without an auction. The out-of-court enforcement and the particular method of enforcement shall be provided by the pledge agreement. The methods of the court enforcement are: a public auction; an appropriation; and a private sale without an auction. Acquisition of assets of and shares and participatory interests in certain companies through an enforcement procedure may require certain antimonopoly and similar consents.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Foreign creditors should generally be treated in the same way as Russian creditors in terms of filings of suits and enforcement of the collateral security. All documents filed to the Russian arbitrazh (commercial) courts must be in Russian; any documentation in any other language must be translated into Russian, notarised and apostilled, unless originally written in Russian.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

There is a general moratorium on enforcement of lender monetary claims since the introduction of the supervision procedure (the first insolvency stage). Creditors are not entitled to enforce collateral security during the supervision procedure. During the financial rehabilitation and external management procedures (further insolvency stages), secured creditors are generally entitled to enforce their security.

If a secured creditor opts for the enforcement of security during the financial rehabilitation or external management procedure, it must file an application to the court. The enforcement is possible only if there is a risk of loss or substantial devaluation of the security. If the debtor proves that the enforcement of the security will make restoration of the debtor's solvency impossible, the court can reject the creditor's enforcement application. In such case, a secured creditor obtains full voting rights at the creditors' meetings during that bankruptcy stage. Unless enforced during the previous stages, the collateral security should generally be sold during the final bankruptcy stage (liquidation).

During the bankruptcy proceedings, the company's pledged property can only be sold at an auction, and any provisions in the security documents concerning the out-of-court enforcement of a pledge do not apply.

Please also refer to question 1.1 in respect of the moratorium that applied until 7 January 2021.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

A foreign arbitral award needs to be recognised and enforced in Russia, and the creditor must obtain an executory writ for the execution of an arbitral award. The decisions of international arbitration tribunals are generally enforceable in Russia subject to compliance with the provisions of the 1958 New York Convention and the requirements of Russian procedural legislation. The process of recognising and enforcing a foreign arbitral award must be made without re-examining in substance or re-litigating the underlying dispute. In practice, however, due

to the absence of clearly established practice in this regard, Russian courts sometimes refuse to enforce foreign arbitral awards without substantiating such a decision with a sufficient legal explanation.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Please refer to question 7.6.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The proceeds obtained from the sale of pledged property are applied as follows:

(a) 80% (in the event of the pledge securing a facility agreement) or 70% (in all other cases) of the proceeds (in an amount not exceeding the aggregate amount of principal and interest) is allocated to satisfy the claim of the relevant secured creditor;

(b) 15% (in the event of the pledge securing a loan agreement) or 20% (in all other cases) is allocated to satisfy the "first priority" and the "second priority" claims if the unencumbered property of the company is insufficient to satisfy these claims; and

(c) the remaining amounts are allocated to the cost of the court and bankruptcy proceedings.

Russian insolvency laws provide that certain transactions qualifying as "suspicious" or "preferential" may be contested in the course of insolvency.

"Suspicious" transactions are those entered into (1) with the intention to infringe creditors' rights within the three-year period preceding the commencement of the insolvency proceedings, or (2) at an undervalue within one year preceding the commencement of the insolvency proceedings.

A so-called "preferential transaction" is a transaction entered into with a creditor or another person that results or may result in the preferential satisfaction of a claim of one of the creditors in comparison to claims of other creditors.

Preferential transactions may be challenged if they are entered into within the one-month period preceding the initiation of insolvency proceedings. However, the hardening period is extended to six months if a preferential transaction is entered into with a person who was aware of the debtor's inability to meet its obligations or in which the amount of the debtor's obligations exceeded the value of the debtor's assets. A related party is automatically deemed to have such knowledge.

The concept of preferential transactions captures prepayment under the existing agreements, set-offs, transfer of the debtors' property, granting security for an existing debt and other arrangements which can be frequently seen in the course of a debt restructuring. Therefore, the risk of challenge in insolvency should be carefully considered by the creditors prior to agreeing to any restructuring arrangement with a company.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

According to the Russian Civil Code, certain entities such as political parties, religious organisations, public enterprises and most state corporations are excluded from bankruptcy proceedings. Liquidation of such entities is usually subject to the Civil Code and special laws. Please also refer to question 1.1 in respect of the moratorium that applied until 7 January 2021.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

During bankruptcy proceedings, the assets of the company can be enforced only within the insolvency proceedings. Any provisions in the security documents concerning the out-of-court enforcement of a pledge do not apply.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Submission by parties to a contract to the jurisdiction of a foreign court should generally be binding and enforceable if at least one party is a foreign entity and the subject matter of the contract is not subject to the exclusive jurisdiction of Russian courts.

Pursuant to recent changes to the Russian procedural legislation, notwithstanding any provision of a contract to the contrary, if: (i) any dispute is initiated or threatened against a Russian party in a foreign court or arbitral tribunal due to the Russian party becoming subject to any foreign sanctions aimed at Russia; or (ii) any other dispute arises between the parties to the contract relating to the application of any such sanctions, the Russian party may be entitled to (a) refer any such dispute to be finally resolved by a Russian arbitrazh (commercial) court, or (b) request a Russian arbitrazh (commercial) court to issue an injunction prohibiting the initiation or continuation of the dispute proceedings in a foreign court or arbitral tribunal. If such injunction is not complied with by the foreign party, the Russian court may award damages to the Russian party in an amount up to the amount claimed by the foreign party from the Russian party plus the Russian party's litigation costs. As the exact scope and effect of these rules is uncertain, they may potentially apply to any dispute with the Russian party, as long as it continues to be subject to any foreign sanctions.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

The judicial immunity of a state or another sovereign entity consists of three elements: (a) immunity from legal proceedings (i.e., immunity from being subject to the jurisdiction of courts and arbitral tribunals); (b) immunity from interim measures; and (c) immunity from enforcement. A sovereign entity can waive the immunity under an international treaty by giving a written consent or by application to the court. The waiver of immunity is binding and enforceable in Russia.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In

connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Russian law provides different legal regimes with respect to loan agreements and facility agreements. Only banks (including foreign ones) may enter into a facility agreement, while loan agreements may be entered into by any legal entity.

In order to carry on business, all banks incorporated in Russia must receive the Central Bank of Russia's licence. No licence is required to be obtained by a foreign bank to make a loan to a Russian company.

In terms of a cross-border transaction, it should be noted that:

(a) the borrowings under a foreign currency loan can be credited to a Russian borrower's foreign account with a bank located in: (1) the Eurasian Economic Union; or (2) a foreign state which automatically exchanges financial information with the Russian Federation, provided that: (i) a lender is (a) an agent of a foreign government, (b) located in the Eurasian Economic Union, or (c) located in a foreign state which automatically exchanges financial information with the Russian Federation; and (ii) the maturity of a loan exceeds two years; and

(b) a Russian company, for the purposes of effecting certain payments to a non-resident, shall have an individual contract number assigned to the respective contract by an authorised bank.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

The possibility to execute contracts electronically existed prior to the COVID-19 pandemic; however, the COVID-19 restrictions contributed to a widespread use of electronic signatures. Under Russian law, in the case of electronic signing of a document, the parties to such document should be "reliably ascertainable", meaning that if a party later raises an objection that it had not signed the document in question, the other party should be able to prove conclusively to the court that the copy of the signed counterpart had been received from an email address associated with the counterparty. In the absence of a clearly established practice, it is considered that such means of execution is safely available only if the parties already have a document with "wet ink" signatures specifying authorised email addresses/fax numbers of each party. Electronic execution is not possible in cases where Russian law requires the notarisation of certain documents or the provision of an original of the contract for the registration. While the COVID-19 restrictions did not lead to the adoption of new laws in relation to the use of electronic signatures, in view of the global trend in online communication we expect that more detailed guidance on electronic signatures would be adopted.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

One of the most important considerations which should be addressed at the financing stage is the need to obtain a pledge or mortgage from a Russian company as collateral, which is beneficial not only because it entitles a creditor to receive satisfaction of its claim from the proceeds of the sale of the pledged or mortgaged property, but also because the status of a secured creditor gives a creditor substantial comfort during insolvency proceedings.

Further considerations that must be taken into account are the requirement to obtain corporate consents and, in respect of state-owned companies, the procurement regulations.

Given the unpredictability of potential new sanctions, foreign lenders must be particularly cautious when entering into contracts with Russian counterparties. In particular, it is recommended to make sure that a lender will be able to terminate the contracts unilaterally without excessive losses if new sanctions make it illegal for the lender to perform the contract.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The banking system has remained buoyant in the face of dampened growth prospects, disruptions to supply chains and lower overall consumption caused by the COVID-19 pandemic. The sector has largely maintained its productivity by ensuring the enduring functionality of all financial services. Investments in the digital transformation of Singapore's banking sector and related moves of activities to virtual platforms have put the industry in a resilient position notwithstanding the "circuit breaker" measures imposed by the Government during April to June 2020, and continuing restrictions to tackle the pandemic. Financial institutions are still observing incoming hires in anticipation of a projected expansion of the sector.

However, weaker base economic activity has nonetheless led to a slowing down of the robust growth observed in Q1 of 2020. In response to this slowdown in growth, the Monetary Authority of Singapore (***MAS***) announced a S$125 million support package catered to FinTech firms and smaller financial institutions. This includes a training allowance grant and a digital acceleration grant to help these firms upgrade their efficiency process, risk management and services. The MAS, in collaboration with Enterprise Singapore, also launched the MAS SGD Facility for ESG Loans. This aims to lower the cost of borrowing by lending Singapore Dollars at an interest rate of 0.1% per annum to eligible financial institutions, such as SMEs.

On the regulatory front, the Singapore Overnight Rate Average (***SORA***) has replaced the Singapore Swap Offer Rate as the effective interest rate benchmark. This is in preparation of the anticipated discontinuation of the London Interbank Offered Rate in 2021. The SORA was the preferred benchmark for several reasons, including that: (1) it is based entirely on market transactions, underpinned by a deep and liquid overnight interbank funding market; (2) market participants have performed technical analyses and model trends based on it since the MAS started publishing it in 2005; and (3) the transition is in line with the shift towards overnight benchmark rates across global financial markets. Broadly, this transition promotes global participation in the Singapore financial markets.

Additionally, the omnibus Insolvency, Restructuring and Dissolution Act 2018 (No. 40 of 2018) (***IRDA***) entered into force on 30 July 2020. Notable provisions include s440 of the IRDA, which restricts the enforcement of *ipso facto* clauses subject to certain exceptions. This restriction prevents parties from terminating a contract or taking similar actions by reason only that the other party has commenced insolvency-related proceedings.

In terms of future outlook, S&P Global Ratings has reported that Singapore's banking system, as an "early-exiter" jurisdiction with low negative impact, is expected to recover from the effects of the pandemic by the end of 2022. CGS-CIMB has also reported an expected uptick in credit growth which will reverse the slowdown in growth of borrowing activity, driven by the easing of social distancing policies in phase three and the ongoing vaccination programme.

There have been a few discernible trends in the financial sector. First, the accelerated move to widespread and deeper end-to-end digitalisation is expected to continue for institutions seeking a competitive advantage. Second, pandemic-related trends including safe management, pandemic risk insurance and impact investing in healthcare and supply-chain resilience are likely to be of heightened interest.

As part of the MAS' green finance action plan unveiled in 2019, the industry's annual stress test will include an additional assessment of financial institutions' methods of integrating environmental risk management with business operations. This is motivated in part by the risks posed to financial institutions by climate change, including hefty insurance claims and decreased collateral values for loans. 2020 has also seen the MAS launch the Green and Sustainability-Linked Loan Grant Scheme, which seeks to increase the accessibility of corporates to and defray costs of involving independent service providers to validate credentials of green loans.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

2020 has seen an unprecedented challenge in the form of the COVID-19 outbreak, leading to a slump across global markets and general lending activity. However, the year still saw landmark loan agreements as banks began to reference the SORA as their interest rate benchmark, following the transition mentioned in question 1.1. CapitaLand and UOB have signed a two-year S$200 million term loan pegged to the SORA, in a first-of-its-kind loan agreement. CapitaLand had also signed another agreement referencing the SORA, for a S$150 million three-year corporate loan as part of the original S$300 million sustainability-linked loan extended by OCBC Bank. These transactions are milestones in the industry's transition towards adopting the SORA as the new interest rate benchmark in Singapore's financial markets.

Prior to the COVID-19 outbreak, Singapore's increasing support of sustainable financing in 2019 had translated into a number of significant green loan transactions. This includes a S$670 million club loan to Mapletree Commercial Trust, a Singapore-focused real estate investment trust which is listed on

the Singapore Exchange Securities Trading Limited, to partially finance its acquisition of "Mapletree Business City Phase 2", a certified BCA Green Mark Platinum property designed with environmentally friendly features. The team of lenders consisted of DBS Bank and OCBC Bank (acting also as green loan coordinators) as well as the Singapore branches of the Bank of China, Citibank and Sumitomo Mitsui Banking Corporation. In its bid to promote sustainability as a core value of its business, the Mapletree Commercial Trust has established a green loan framework, guided by the Green Loan Principles from the Loan Market Association and the Asia Pacific Loan Market Association, to outline criteria for using the green loan proceeds.

Another green finance deal that took place in 2019 is the S$332.5 million club loan to Ophir-Rochor Hotel Pte Ltd, a subsidiary of Singapore property developer Hoi Hup Realty Pte Ltd, marking the Hoi Hup group's maiden green loan. The green loan proceeds are to partially finance the acquisition of Andaz Hotel in Singapore, which has been certified and awarded for having environmentally friendly features such as efficient energy and water usage. The loan, which according to a joint statement from the Hoi Hup group and OCBC Bank is the first green loan for Southeast Asia's hospitality industry, was provided by OCBC Bank (acting also as the green loan adviser) as well as Maybank Singapore and United Overseas Bank.

Some further sustainability-linked loans that OCBC Bank had participated in include large syndicated loans such as COFCO International's US$2.3 billion senior unsecured facilities, as well as Louis Dreyfus Company Asia's US$650 million revolving credit facility.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, subject to there being sufficient corporate benefit and no contravention of specific rules under the Companies Act (Cap. 50) (***CA***); for example, relating to guarantee of loans to companies related to directors and provision of financial assistance.

S157 of the CA provides that a director of a company "shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office". This statutory statement is in addition to the directors' duty under general law to exercise their discretion *bona fide* in what they consider is in the best interest of the company. The directors of a company have to ensure there is sufficient corporate benefit in giving any guarantee, including a guarantee for the borrowings of one or more members of its group.

A commonly asked question is whether directors can, in giving a guarantee, consider the interests of the corporate group as a whole. The theoretical rule is that companies within a group are separate legal entities. However, in practice, companies are often part of larger groups and it is generally accepted that there is corporate benefit on the face of a transaction involving a holding company guaranteeing the obligations of its subsidiary. It would be harder, however, to show corporate benefit in a subsidiary guaranteeing the debts of its holding or sister companies and in such situations it would therefore be prudent to have the shareholders of the company sanction the giving of the guarantee.

In addition, companies have to be mindful of the prohibition under s163 of the CA relating to the guarantee of loans, quasi-loans or credit transactions to companies related to directors. There are exceptions to this prohibition, including where the companies involved are in a subsidiary/holding company relationship or are subsidiaries of the same holding company in the legal sense. Members of a corporate group in the legal sense are therefore generally exempted from such prohibition. They are, however, not exempted if they are non-subsidiary affiliates and directors have to be careful then to conduct the necessary enquiry to ensure there is no contravention of the section. With effect from 3 January 2016, a new exception was introduced to allow for prior approval by the company in a general meeting to permit such transactions. Where practicable (for example, when dealing with private companies), lenders are likely to require such prior approval by shareholders to be obtained to do away with the risk of triggering this prohibition.

Regard also has to be given to the prohibition against giving of financial assistance and other considerations where a company is insolvent, as set out in sections 4 and 8 below.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

See question 2.1 above. In giving a guarantee, the directors of the company have to ensure there is sufficient corporate benefit. If the corporate benefit to the guaranteeing company is disproportionately small or there is no corporate benefit, then there may be an issue as to whether the directors in giving the guarantee are in breach of their fiduciary duties.

Where directors have given a guarantee in breach of their fiduciary duties, the guarantee may be set aside if the lender had knowledge of the impropriety and the offending directors may be both civilly and criminally liable for their breach.

Other considerations where a company is insolvent are set out in section 8 below.

2.3 Is lack of corporate power an issue?

Unless otherwise limited or restricted by the provisions of its own constitutive documents, a company has full capacity to perform any act, including entering into guarantees. Caution should be taken as there are, however, companies with old forms of constitutive documents that still contain restrictions and limits on the grant of guarantees and if so, such restrictions will continue to apply.

The effect of the lack of corporate power in the grant of a guarantee, whilst it does not invalidate the guarantee *per se*, may be asserted or relied upon in, amongst others, proceedings against the company by any member of the company or, where the company has issued debentures secured by a floating charge over all or any of the company's property, by the holder of any of those debentures to restrain the doing of any act or transfer of any property by the company. The court may, in such a situation, exercise discretion to set aside and restrain the performance of the guarantee but allow for compensation for loss or damage sustained.

S25B of the CA deems the power of the directors to bind the company, or authorise others to do so, to be free of any limitation under the company's constitution, in favour of persons dealing with the company in good faith. It remains to be seen whether the Singapore courts will find that knowledge of an act being beyond the powers of the directors under the constitutive documents of the company will, by itself, be sufficient to establish a lack of good faith for purposes of this new provision.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental consents or filings are generally required.

A guarantee will be required to be lodged with the companies' registry in Singapore, the Accounting and Corporate Regulatory Authority (***ACRA***), only if by its terms it also seeks to create a charge or agreement to charge within the meaning of s131 of the CA.

In terms of formalities, a contract of guarantee has to be in writing and signed by the person sought to be rendered liable under the guarantee. Board resolutions approving the terms, execution and performance of the guarantee should be passed. Shareholders' approval should also be obtained if there is any potential issue of lack of corporate benefit and breach of directors' duties, or triggering of s163 of the CA, or where it is otherwise required by statute (for example, to whitewash the transaction) or the constitutive documents of the company.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, unless otherwise restricted by the constitutive documents of the company.

If, however, the amount guaranteed is clearly disproportionate to the corporate benefit received, the issues discussed in question 2.2 above would arise.

Other considerations where a company is insolvent are set out in section 8 below.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange controls in Singapore that would act as an obstacle to the enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Under Singapore law, all types of collateral may potentially be available to secure lending obligations, provided the grant thereof is not against public policy.

Common types of collateral that can be used include real property (land and buildings), personal chattels, debts and other receivables, stocks and shares and other choses in action.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is possible to give asset security by means of a general security agreement; for example, by way of a debenture seeking to take security over different classes of assets, save to the extent that a statutorily prescribed form is required (e.g. to effect a legal mortgage over land under the Land Titles Act (Cap. 157) (***LTA***) or take a legal assignment over book-entry securities under the Securities and Futures Act (Cap. 289).

The main types of security interests that can be created under Singapore law are mortgages, charges, liens and possessory pledges, and the appropriate method of taking security would depend on the nature of the asset over which the security is to be taken and the extent of security required.

Different classes of assets will also be subject to different procedures and perfection requirements.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Land

Yes, a legal or equitable mortgage/charge or assignment of sale and purchase/lease/building agreement with mortgage-in-escrow is commonly granted over real property (land and to the extent immovable, plant and buildings thereon). The type of security will depend on, amongst other factors, whether title over the land has been issued, the land type and the type of holding.

There are two types of land in Singapore – common law titled land and land under the LTA. Virtually all land in Singapore has been brought under the LTA. A legal mortgage for land under the LTA has to be in a statutorily prescribed form and registered with the Singapore Land Authority (***SLA***). Where title has not been issued for land under the LTA, a lender would take an equitable mortgage over the sale and purchase agreement, lease or building agreement in relation to the land, with an accompanying mortgage-in-escrow for perfection upon issue of title.

Commonly, an appropriate caveat may also be lodged with the SLA against the land to protect the lender's interest during the time between the acceptance of the facility and the registration and perfection of the security.

Related security like an assignment over insurances, rental and sale proceeds and agreements and in the case of land under construction, assignment over construction contracts and performance bonds are usually also taken.

Procedure and perfection steps briefly include taking of relevant title documents, registration with the SLA (or Registry of Deeds, if applicable), registration of the charge with ACRA under s131 of the CA, stamping, consents from lessor of the land or other third parties (if applicable), corporate authorisations, whitewash/shareholders' approval (if applicable), etc. In practice, some banks require shareholders' approval where the assets to be mortgaged/charged constitute the whole or substantially the whole of the company's undertaking or property.

Machinery and equipment

A fixed charge granted by way of a debenture or charge is commonly taken over machinery and equipment.

Registration with ACRA will be required under s131 of the CA. Other perfection steps are (to the extent applicable) discussed above.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, security over receivables (being choses in action) can be taken by way of an assignment or charge (fixed or floating) through a deed of assignment/charge or a debenture, depending on the entire security package to be taken. Generally, lenders may also, for control purposes, obtain a charge (fixed or floating) over the accounts into which the receivables are paid (see question 3.5 below).

In order to take a legal assignment over receivables, it has to be in writing with express notice in writing given to the debtor of the receivables. The giving of notice also enables the lender to secure priority.

A charge to be taken over receivables can be fixed or floating. Where the lender is able to control the receivables and they are not subject to withdrawals without consent, a legal assignment or fixed charge may be created over the subject receivables. Often, however, the receivables are part of the ongoing business of the security provider and the lender does not seek to take control over the same. In such a situation, only a floating charge may be created in substance, regardless of how the charge is termed or labelled in the documentation.

Registration with ACRA will be required if the charge is floating or the receivables fall under one of the prescribed categories of s131 of the CA. Other perfection steps are, to the extent applicable, discussed in question 3.3 above.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, security over cash deposited in bank accounts (being choses in action) can be taken in the same way as receivables and the principles and requirements in question 3.4 apply.

In practice, it may be difficult to obtain a legal assignment or fixed charge over cash deposited in a bank account unless the bank account is opened with and controlled by the lender. Where that is not practicable and/or it is necessary to enable the chargor to make withdrawals from the bank account freely, the lender may be left with taking only a floating charge over the account.

Registration with ACRA will be required if the charge is floating or if it falls under one of the prescribed categories of s131 of the CA. An express written notice of assignment must also be given to the account bank to perfect the security and preserve priority. Other perfection steps are, to the extent applicable, as discussed in question 3.3 above.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Shares in Singapore may be in certificated/scrip or scripless form.

Where shares are certificated, a legal or equitable mortgage may be taken over the shares. A legal mortgage may be granted by way of a share mortgage, accompanied by a transfer and registration of the shares and delivery of share certificates in the mortgagee's name. The procedures and restrictions for the transfer will be set out in the company's constitutive documents and the CA. An equitable mortgage/charge may be granted by way of a share mortgage/charge and deposit of share certificates together with a blank transfer executed by the mortgagor/chargor on the agreement that the mortgagee/chargee may complete the transfer forms upon occurrence of a default event under the facility or by notice.

Where shares are in scripless form (i.e. book-entry securities, being essentially listed shares of companies on the Singapore stock exchange – Singapore Exchange Securities Trading Limited), by statute, a different regime will apply. Security may be taken over such shares by way of a statutory assignment or statutory charge in prescribed form registered with the Central Depository (Pte) Limited in Singapore or by common law subject to certain prescribed requirements.

There is no specific restriction to prohibit the general terms of security over shares to be governed by New York or English law, but the creation and grant of security over shares should be governed by Singapore law as the shares of Singapore companies (and exercise of certain enforcement rights) are regulated by the CA and local property rules.

Registration with ACRA will be required if the charge is floating or if it falls under one of the prescribed categories of s131 of the CA. In the case of a statutory charge over shares in scripless form, an express written notice of assignment must also be given to the depository agent to perfect the security and preserve priority. Other perfection steps, to the extent applicable, are as discussed in question 3.3 above.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, a floating charge is most commonly created over inventory. The chargor in this instance will generally be permitted to deal with the inventory in the ordinary course of its business until the occurrence of a default event under the facility or notice from the lender.

Registration with ACRA is required under s131 of the CA. Other perfection steps, to the extent applicable, are as discussed in question 3.3 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes for both cases, subject to considerations such as the existence of corporate power and corporate benefit, s162/s163 of the CA (prohibition on loans, quasi-loans and credit transactions to directors and related companies) and financial assistance, etc., as set out in this chapter.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The fee for the registration of a charge/security instrument with ACRA in accordance with s131 of the CA is currently S$60 per charge.

In addition, security interest over certain assets (e.g. aircraft, ships, intellectual property rights and land) will need to be registered at specialist registries and additional fees will be payable. For example, the fee payable for the registration of a mortgage over land with the SLA is currently S$68.30 per mortgage.

Stamp duty is payable on a mortgage, equitable mortgage or debenture of any immovable property and stocks or shares. A legal mortgage is subject to *ad valorem* duty at the rate of 0.4% of the amount of facilities granted on the mortgage of immovable property or stocks and shares, subject to a maximum of S$500. An equitable mortgage is subject to *ad valorem* duty at the rate of 0.2% of the amount of facilities granted on the mortgage of immovable property, subject to a maximum of S$500.

Notarisation is not required for security documents which are executed and to be used in Singapore.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The charge/security instrument to be lodged with ACRA under s131 of the CA must be lodged within 30 calendar days after the

creation of the charge where the document creating the charge is executed in Singapore (or within 37 calendar days if executed outside Singapore). The filing (once filing forms are completed) is instantaneous and confirmation of registration from ACRA will normally take up to three business days.

The timeframe for registration at specialist registries differs according to each registry. For example, the registration of a mortgage with the SLA may take several weeks or even several months if complex and involving multiple units. In the interim, a lender may protect its interest by the lodgement of a caveat with the SLA.

Fees payable for such registrations are as discussed in question 3.9 above.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Regulatory consents may be required in certain circumstances; for example, where the subject land is state land leased from the Government or Government statutory boards like the SLA and Urban Redevelopment Authority.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Under Clayton's rule, security taken over a revolving loan may be "reducing" as the loan "revolves" as a result of the "first in first out" rule. In the absence of contrary indication, a secured revolving facility may technically lose the security once an amount equal to the original loan and any associated charges and interest has been paid into the account, even though sums have been paid out in the meantime. This is rarely an issue in practice, however, as finance documents will be drafted to provide for inverse order of payment and/or for security to be continuing notwithstanding any intermediate payments made as long as there is anything outstanding under the loan.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Execution requirements are predominantly set out in the company's constitutive documents and the CA. In addition, certain instruments are also statutorily required to be in writing or executed by deed. For example, a legal mortgage over land must be by deed. Certain statutory remedies (e.g. power to sell the mortgaged property, to insure the property, to appoint a receiver, etc.) given to mortgagees will also not be available unless the mortgage is by deed. Commonly, it is prudent in any event for securities to be executed by deed so that there is no issue of past consideration. It is worth noting that amendments to the CA in 2015 introduced provisions allowing for the execution of deeds without the use of a common seal, thereby making the execution of deeds less administratively burdensome for local companies.

Where it is envisaged that the execution of the security instrument be completed by virtual means, it is also good practice for it to be done in line with the principles set out in the English case R *(on the application of Mercury Tax Group and another) v HMRC.*

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

S76 of the CA provides, *inter alia*, that a public company or a company whose holding company or ultimate holding company is a public company, shall not, whether directly or indirectly, give any financial assistance for the purpose of, or in connection with, the acquisition by any person (whether before or at the same time as the giving of financial assistance) or proposed acquisition by any person of shares in the company or in a holding company or ultimate holding company (as the case may be) of the company. The prohibition does not extend to sister subsidiary companies. The CA further provides that financial assistance for the acquisition of shares may be provided by means of a loan, the giving of a guarantee, the provision of security, the release of an obligation or the release of a debt or otherwise.

These provisions may therefore be triggered in the event of the giving of guarantees/securities or other accommodation which may directly or indirectly provide "financial assistance" within the meaning of the CA. There are, however, whitewash provisions available under our laws, including short-form whitewash procedures that would enable the company to effect a whitewash through, *inter alia*, board approval if doing so does not materially prejudice the interests of the company or its shareholders or the company's ability to pay its creditors, or the passing of shareholders' and directors' resolutions and lodgement of solvency statements and papers with ACRA without the need for public notification and objection period or court order. Where the company is unable to effect a short-form whitewash, parties have to bear in mind that the need for public notification and objection period for a long-form whitewash will mean that a timeframe of six to eight weeks (assuming no objections) may be required.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes, Singapore recognises the role of an agent and trustee and these roles are normally taken up by the lead bank to whom the borrower has granted the mandate to arrange the syndicated loan. An express trust will be created to ensure the desired consequences.

The creation of the trust must comply with the relevant formalities. For example, s7 of the Singapore Civil Law Act (Cap. 43) requires a trust in respect of immovable property to be manifested and proved in writing signed by the person who is able to declare such trust. In addition, a validly constituted express trust has to be certain as to the intention of the settlor to create the trust, the identity of the subject matter and the identity of the beneficiaries. Provided the relevant mechanics are set out in the finance documents and the trust is properly

constituted, the security trustee will be able to hold the security on trust for the syndicated lenders and will have the right to enforce the finance documents and collateral security, including applying the proceeds from the collateral to the claims of the syndicated lenders in accordance with the finance documents.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable. Please refer to question 5.1 above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The right of Lender B to enforce the loan and guarantee exists provided the procedure for assignment or novation of Lender A's rights and obligations, as set out in the finance documents, are complied with (e.g. consent of borrower and guarantor if required) and the continuity of the guarantee is provided for expressly and preserved under the documents.

Where there are no proper procedures or transfer/preservation provisions within the finance documents or the security agency/trust is not properly constituted, an assignment or novation of the underlying loan may result in an assigned or new debt that is not covered by the guarantee. A transfer in such a situation may fail and the guarantee rendered unenforceable over the assigned or new debt. In such an instance, a fresh guarantee will be required for Lender B to be guaranteed. In practice, confirmation by the guarantor is often sought even if the documents provide expressly for preservation without consent.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Withholding tax is applicable by virtue of s12(6) read with s45 or s45A of the Singapore Income Tax Act (Cap. 134) (***ITA***), where a person is liable to pay another person not known to him to be tax resident in Singapore any interest, commission, fee or any other payment in connection with any loan or indebtedness or with any arrangement, management, guarantee, or service relating to any loan or indebtedness if such payments are either (i) borne, directly or indirectly, by a person resident in Singapore or a permanent establishment in Singapore (except in respect of any business carried on outside Singapore through a permanent establishment outside Singapore or any immovable property situated outside Singapore), or (ii) deductible against any income accruing in or derived from Singapore. Interest and payments in connection with any guarantee or indebtedness that are made to foreign lenders would generally be subject to this withholding tax unless otherwise exempted. The current withholding tax rate on such s12(6) payments is 15% of the gross amount (assuming the payment is not derived by the non-resident from any trade, business, profession or vocation carried on or exercised by him in Singapore and is not effectively connected with any permanent establishment in Singapore of the non-resident).

There are, however, various exceptions to this. S12(6A) of the ITA excludes from the scope of s12(6) the following payments:

(i) any payment made to a non-resident person for any arrangement, management or service relating to any loan or indebtedness where the arrangement, management or service is performed outside of Singapore for or on behalf of a person resident in Singapore or a permanent establishment in Singapore; and

(ii) any payment made to a guarantor who is a non-resident person for any guarantee relating to any loan or indebtedness, where the guarantee is provided for or on behalf of a person resident in Singapore or a permanent establishment in Singapore.

For the purposes of s12(6A), a qualifying "non-resident" is a person who is not incorporated, formed or registered in Singapore and who does not, by himself or in association with others, carry on a business in Singapore and does not have a permanent establishment in Singapore; or if he does carry on a business in Singapore (by himself or in association with others) or has a permanent establishment in Singapore, the arrangement, management, service or giving of guarantee was not performed through, or effectively connected with, that business carried on in Singapore or that permanent establishment.

Since payments covered under s12(6A) are excluded from the scope of s12(6), the obligation to withhold tax does not arise for s12(6A) payments even though they are made to a non-resident person. In addition, s45(9)(c) of the ITA exempts from withholding tax interest that is paid to Singapore branches of non-resident foreign companies (e.g. non-resident foreign banks). If the non-resident bank is a resident of a country with which Singapore has an applicable tax treaty, the treaty may provide for a reduced withholding tax rate.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Singapore has various governmental agencies to assist foreign investors and creditors. The Economic Development Board is the lead governmental agency responsible for planning and executing strategies to attract foreign businesses and investments. Enterprise Singapore works to position Singapore as a base for foreign businesses to expand into the region, in partnership with Singapore-based companies.

Although incentives are generally industry-specific, and are not affected by the residency of the investors or creditors, there are selected schemes directed at attracting foreign investors and creditors. For example, interest payments on approved loans taken to purchase productive equipment for the purposes of trade or business may enjoy an exemption from withholding tax or a reduced withholding tax rate.

Save for withholding taxes as discussed in question 6.1, no taxes specific to loans, mortgages or other security documents, either for the purposes of effectiveness or registration, are applicable. Stamp duty as discussed in question 3.9 will be applicable.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Where the bank is not a tax resident in Singapore, withholding tax as discussed in question 6.1 may apply.

Where the bank is a tax resident in Singapore or has a branch in Singapore, any interest, commission, fee or any other payment in connection with any loan or indebtedness or with any arrangement, management, guarantee, or service relating to any loan or indebtedness that is either (i) borne, directly or indirectly, by a person resident in Singapore or a permanent establishment in Singapore (except in respect of any business carried on outside Singapore through a permanent establishment outside Singapore or any immovable property situated outside Singapore), or (ii) deductible against any income accruing in or derived from Singapore, that accrues to or is derived by the bank or its Singapore branch will be deemed to be sourced in Singapore and subject to income tax in Singapore by virtue of s12(6) read with s10(1) of the ITA.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Apart from fees and tax payable as discussed above (i.e. questions 3.9 and 6.1), the provision of certain services, for example the provision of guarantee services, may be subject to Goods and Services Tax (***GST***) in Singapore if the provider of the service is registered for GST purposes pursuant to the Singapore Goods and Services Tax Act (Cap. 117A) unless the service qualifies as an international service or is an exempt supply on which no GST is chargeable. The rate at which GST is chargeable on standard-rated supplies of goods and services is presently 7% (and will be raised to 9% by 2025).

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Singapore tax laws do not contain thin capitalisation rules. However, should the banks be organised under the laws of a foreign jurisdiction, and no express choice of law is made in the finance documents, the applicable law governing the finance documents may be that of the foreign jurisdiction. In such a situation, the borrower may not be able to enjoy any rights and remedies that are available to a borrower in Singapore, but not in that foreign jurisdiction.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Provided that it is *bona fide* and legal and there is no reason for avoiding the choice on the grounds of illegality or public policy, the express choice of the laws made by the parties to a contract will be upheld as valid and binding in any action in the courts of Singapore and the courts will enforce a contract that has a foreign governing law.

In January 2015, the Singapore International Commercial Court (***SICC***) was established to hear international commercial disputes, including those governed by foreign laws.

The key features of the SICC are: (i) it is a division of the Singapore High Court, which means that SICC judgments can be enforced as judgments of the Supreme Court of Singapore; (ii) it has a diverse panel of judges that include eminent international jurists and existing Supreme Court Judges; (iii) its proceedings are open court proceedings although parties may apply for the proceedings to be confidential; and (iv) there is flexibility for parties to seek leave of court to apply alternative rules of evidence (i.e. rules that differ from the existing Singapore rules of evidence) that they may be more familiar with; and to appoint foreign-qualified lawyers to represent them in court where the cases have no substantial connection to Singapore or to address the court on matters of foreign law.

The SICC has heard a number of cases on a range of subjects and involving parties from various jurisdictions. Additionally, the Supreme Court of Judicature (Amendment) Act 2018 clarified that the SICC has jurisdiction to hear cases relating to international commercial arbitration.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

At present, certain judgments from English courts may be recognised and enforced in Singapore without a re-examination of the merits of the case under the Reciprocal Enforcement of Commonwealth Judgments Act (Cap. 264) (***RECJA***) or the Choice of Court Agreements Act 2016 (No. 14 of 2016) (***CCAA***).

Under the RECJA, a final judgment for a sum of money obtained against a company in Singapore (which is not a judgment for the payment of a fine, penalty or tax, or anything of that nature) in a superior court in England may be enforceable against the company in Singapore. However, legislative reform is under way and soon, a wider scope of English judgments, such as non-money judgments (e.g. freezing orders, injunctions) or judgments of lower courts, among others, may be registered and enforced in Singapore under new legislation relating to registration of English judgments.

English judgments may also be recognised under the CCAA, which implements the regime created by the 2005 Hague Convention on Choice of Court Agreements (***Hague Convention***). Under the CCAA, English judgments may be recognised and enforced if parties had entered into an agreement designating the English courts as having exclusive jurisdiction in respect of a particular matter. In instances of overlap (i.e. where the English judgment is a final judgment for a sum of money obtained against a company in Singapore (which is not a judgment for the payment of a fine, penalty or tax, or anything of that nature) from a superior court in England and there exists an agreement designating English courts as having exclusive jurisdiction over the subject matter in dispute), enforcement of the English judgment will be governed by the CCAA and not the RECJA.

Like the RECJA, recognition and enforcement of English judgments under the CCAA will not entail a re-examination of the merits. However, there are exceptions to the scope of the CCAA. For example, insolvency matters and matters involving consumers are excluded from the scope of the CCAA. Further, recognition and enforcement may be refused if, for example, the English judgment is inconsistent with a Singapore judgment given in a dispute between the same parties. There are also several grounds on which recognition and enforcement must be refused if, for instance, the foreign judgment was obtained by fraud in connection with a matter of procedure, or where it would be manifestly incompatible with the public policy of Singapore.

As to judgments by New York courts, only certain judgments issued by New York courts will be enforced in Singapore in accordance with the common law. There is no reciprocal agreement or convention between Singapore and the United States of America in respect of the enforcement of court judgments. There is also no Singapore legislation in place to facilitate the enforcement of New York court judgments. Under the common law, a money judgment may be enforced, provided it is final and conclusive, and the foreign court had jurisdiction over the defendant in accordance with conflict principles recognised by the Singapore courts. It will then be for the party resisting enforcement to prove that the New York courts had no jurisdiction over the matter, or that the judgment was obtained by fraud, or that there were any major procedural irregularities in arriving at the judgment, or that enforcement would be a direct or indirect enforcement of foreign penal, revenue or other public law, or that enforcement would be contrary to the public policy of Singapore. The Singapore court will not re-examine the merits of the case.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The timeline for each case would depend on its own facts. Generally, if the claim is against a defendant in Singapore and based on a straightforward loan agreement or guarantee, it is possible to obtain default or summary judgment within three to six months of filing the claim (assuming there is no appeal).

There are generally four main methods of enforcement, namely, a writ of seizure and sale, garnishee proceedings, examination of judgment debtor, and liquidation proceedings. Depending on which method of enforcement is selected and whether any challenge is mounted by the debtor, the process could take two to six months or longer (again, assuming there is no appeal).

In May 2017, the Companies (Amendment) Act 2017 (No. 15 of 2017) (***Amendments***) came into effect. Modelled on chapter 15 of the U.S. Bankruptcy Code and the UK Cross-Border Insolvency Regulations, the Amendments adopted the UNCITRAL Model Law on Cross-Border Insolvency to facilitate the recognition of foreign corporate insolvencies and rehabilitative proceedings in Singapore. The Amendments are now found in the IRDA. The IRDA came into effect on 30 July 2020 and consolidated the provisions governing personal bankruptcy, liquidation as well as debt restructuring.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

There is no specific requirement for a public auction, although sale by public auction is commonly carried out as a matter of practice. Secured creditors typically have wide powers under the terms of the security document to take possession, dispose or otherwise deal with the secured assets, or appoint a receiver in respect of the secured assets, to satisfy the secured debts. There may be requirements for regulatory consent in respect of certain types of borrowers (for example, regulated entities).

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

There are no specific restrictions on foreign lenders filing a suit or foreclosing on collateral security so long as the Singapore courts have jurisdiction over the matter.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The IRDA provides for an automatic moratorium where a provisional liquidation or liquidation order is made. Notwithstanding the moratorium, secured creditors may enforce their security in a provisional liquidation or liquidation.

The IRDA also provides for an automatic moratorium upon the making of an application for a judicial management order or the lodgement of a written notice of appointment of an interim judicial manager (i.e. where creditors have resolved to place the company under judicial management, a process that does not involve the Singapore court). However, if within the period of 12 months immediately before the date on which such an application or lodgement the company already enjoyed such an automatic moratorium by virtue of a prior application for a judicial management order or lodgement, no second automatic moratorium will apply. An automatic moratorium also applies upon the making of a judicial management order. If such an automatic moratorium applies, generally a creditor may not enforce any security over the company's assets without permission from the court or the judicial manager.

Under the IRDA and the CA, the court may grant a moratorium order if requested by an applicant proposing or intending to propose a scheme of arrangement (***Scheme Moratorium***). Most companies would be able to avail themselves of the IRDA regime, under which an automatic 30-day stay comes into effect on the filing of a moratorium application. Under the IRDA regime, related companies (i.e. the applicant company's subsidiaries, holding company or ultimate holding company) may apply to extend the Scheme Moratorium to the related companies. If the IRDA regime is unavailable, a company may seek a Scheme Moratorium under the CA but as a prerequisite the applicant company will need to put forth a sufficiently detailed scheme proposal first. Generally, a Scheme Moratorium does not restrict the enforcement of collateral security. However, the IRDA gives the court express power to restrain the enforcement of security over the assets of the applicant company or any of its related companies. Further, the IRDA also allows a Scheme Moratorium to have worldwide or extraterritorial effect, if creditors are subject to the jurisdiction of the Singapore court, although such orders are rarely made. For the Scheme Moratorium to have extraterritorial effect, the applicant company must seek to restrain a specific act or acts of a specific party that is in Singapore or within the jurisdiction of the Singapore court. The Singapore court will not grant a general worldwide or extraterritorial Scheme Moratorium over unspecified acts or parties that are not subject to its jurisdiction.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Arbitral awards may be recognised and enforced in Singapore in accordance with the New York Convention in conjunction

with the International Arbitration Act (Cap. 143A) or under the Arbitration Act (Cap. 10) without having its merits re-examined. However, the courts may refuse to enforce such awards on the following grounds: incapacity of a party; failure to give proper notice to a party or the inability of a party to present his/her case; issues with the selection of the arbitrators; the award falling outside of the scope of the arbitration agreement; invalidity of the arbitration agreement; the subject matter of the difference between the parties to the award not being capable of settlement by arbitration under the law of Singapore; the award having been set aside; and/or the enforcement of the award being contrary to the public policy of Singapore.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy proceedings in respect of a company include receivership, liquidation, schemes of arrangement and judicial management. The right to appoint a receiver over a company can arise statutorily, contractually in accordance with the terms of the security document such as a debenture or by an exercise by the court of its power to appoint a receiver on the application of the secured creditor. In such a case, the receiver would act in furtherance of the interests of the secured creditor that appointed the receiver to realise the collateral security. For restrictions on enforcing security in the context of liquidation, schemes of arrangement and judicial management, see question 7.6 above.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Yes. Liquidators and judicial managers, but not receivers, can apply to set aside transactions entered into or claw back certain assets transferred before the commencement of liquidation. Such transactions include transactions at an undervalue, unfair preferences, extortionate credit transactions, avoidance of floating charges and unregistered charges, and transactions defrauding creditors. The clawback period ranges from three years (transactions at an undervalue and extortionate credit transactions) to two years (unfair preferences, if given to a person connected with the company; if not, one year) from the commencement of liquidation or judicial management. Generally, floating charges created within one year (two years if given to a person connected with the company) from the commencement of liquidation or judicial management are invalid except to the amount of any cash paid to the company in consideration of the charge together with interest, unless there is proof that the company was solvent at the time the floating charge was created.

The IRDA also contains provisions against fraudulent trading (i.e. where the business of a company has been carried on with the intent to defraud creditors or for any fraudulent purpose) as well as wrongful trading (i.e. where the business of a company has been carried on wrongfully). A liquidator, judicial manager or creditor can in such instances apply for a declaration for the parties to the wrongful trading to be personally responsible for the debts/liabilities of the company.

The tax authorities and employees who are owed wages (up to a certain limit) are preferential creditors and are paid ahead of unsecured creditors but behind secured creditors.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Entities incorporated in Singapore are generally not excluded from bankruptcy proceedings in Singapore.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

See question 8.1 above. In addition, creditors may apply for a writ of seizure or to garnish the assets of the debtor.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, a party's submission to a foreign jurisdiction will generally be upheld as valid and binding in any action in the courts of Singapore provided that it is *bona fide* and there is no reason for avoiding such submission on the grounds of illegality or public policy.

In particular, where a party has submitted exclusively to the jurisdiction of a state that is party to the Hague Convention (see question 7.2 above), the CCAA would apply and a Singapore court must stay or dismiss proceedings in the Singapore court in favour of proceedings in the foreign court. This is subject to certain exceptions. For example, the CCAA does not apply to certain types of matters, such as insolvency matters and matters involving consumers. The Singapore court can also refuse to stay or dismiss proceedings in its courts if, for example, the agreement to submit to the foreign jurisdiction is null and void under the law of the foreign jurisdiction, or if giving effect to the agreement would lead to manifest injustice or would be manifestly contrary to the public policy of Singapore.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A party's waiver of sovereign immunity may be legally binding and enforceable provided it satisfies the conditions as set out in the Singapore State Immunity Act (Cap. 313).

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Under Singapore law, unless exempted or excluded, a person may not carry on the business of a moneylender without holding

the requisite moneylenders' licence. The relevant legislation, the Moneylenders Act (Cap. 188) (***MA***), provides that any person who lends a sum of money in consideration of a larger sum being repaid (i.e. charge interest) shall be presumed, until the contrary is proved, to be a moneylender. The same prohibition would apply to a "foreign" lender who carries on the business of moneylending in Singapore from a place outside Singapore.

"Any person licensed, approved, registered or otherwise regulated by the MAS under any other written law", amongst others, would fall outside the ambit of the prohibition as an "excluded moneylender". These would include banks or finance companies that are licensed and regulated under the Banking Act (Cap. 19) and Finance Companies Act (Cap. 108), respectively. The question therefore is whether "foreign" lenders or other non-bank entities that are not so licensed, approved, registered or otherwise regulated by the MAS are necessarily excluded. With effect from 1 March 2009, an amended Moneylenders Act came into force in Singapore pursuant to which, amongst others, "any person who lends money solely to corporations" or "any person who lends money solely to accredited investors within the meaning of section 4A of the Securities and Futures Act (Cap. 289)" would be an "excluded moneylender". Accordingly, a lender can be an "excluded moneylender" provided on the facts it lends (and has lent) money solely to corporations or only to accredited investors.

There has been academic debate on whether a "foreign" unlicensed lender or other non-bank entity would not be deemed to be an excluded moneylender if it had in the past lent money otherwise to individuals who were not accredited investors. The prevailing view, however, is that the Singapore courts are unlikely to allow such a defence without more to succeed in the context of legitimate financial activity of commercial entities.

For corporations convicted of unlicensed moneylending, a fine will be imposed of not less than S$50,000 and not more than S$500,000. In addition, subject to certain exceptions, the contracts for such loans, and guarantees or securities given for such loans, shall be unenforceable, and any money paid by or on behalf of the unlicensed moneylender under the contracts for the loans will not be recoverable in any court of law.

The granting of loans to corporations *per se* is not otherwise regulated in Singapore. There are no eligibility requirements in Singapore for a lender lending to a company and, subject to the above, it need not be licensed or authorised provided that no other regulated activities (e.g. banking, securities or financial advisory activities) are being conducted.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

The COVID-19 pandemic has rendered it complex and unsuitable for some individuals and businesses to obtain traditional "wet-ink" signatures. As a result, COVID-19 has compelled more businesses to recognise the efficiency of using electronic signatures (***e-signatures***) and this is expected to influence the operation of business moving forward.

E-signatures are generally valid in Singapore, as provided for in the Electronic Transactions Act (Cap. 88) (***ETA***). However, the ETA also sets out a list of excluded matters in which an e-signature should be avoided. These matters include, amongst others, the creation or execution of a will and the conveyance of interests in immovable property. Although case-law on these matters has been permissive, it remains prudent to avoid using e-signatures when executing documents dealing with excluded matters where possible. Specifically, and in the absence of express legislation or guidance, it remains prudent to use "wet-ink" signatures in security and other financing documents.

With regard to notary requirements, individuals and businesses facing difficulties in arranging for the physical administration of statutory declarations have resorted to executing such documents by way of video conference. Such arrangements are not expressly provided for under the Oaths and Declarations Act (Cap. 211) but are practised and accepted in Singapore.

Given the widespread recognition of more efficient alternative methods of execution, and with most of the global population still telecommuting amidst ongoing social distancing measures, businesses and individuals are likely to continue to assess the efficacy of traditional methods into 2021 and beyond.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The principal Singapore law considerations for lenders when participating in financings in Singapore have generally been covered by the above questions and answers.

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South Africa

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Lionel Shawe

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Debt restructurings and unsecured lending continue to rise as a result of continued economic pressures and amidst the COVID-19 global pandemic. Policy proposals to permit expropriation of land without compensation and draft legislation which has now been published in this regard, together with otherwise policy inertia and uncertainty, continue to constrain investment and confidence in the South African economy.

The stabilisation and reform of state-owned entities continues to be critical and will likely lead the South African Government's agenda and efforts over the next few years. A number of state-owned entities mired in financial and governance crises have commenced restructuring processes in an attempt to restore financial and operational sustainability.

These trends are driving financial institutions to look for opportunities with clients elsewhere in Africa, with a focus on jurisdictions targeting high growth.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Arguably the most high-profile restructuring over the last few years is that of South Africa's national carrier, South African Airways (**SAA**). SAA was placed in business rescue in December 2019 and was provided ZAR5.5 billion in post-commencement financing by local commercial banks and other financial institutions. The Government of South Africa has also allocated ZAR10.5 billion to the restructuring, of which ZAR3.5 billion has already been made available to SAA.

PepsiCo, Inc acquired South Africa's Pioneer Foods through PepsiCo's existing South African subsidiary, Simba for approximately ZAR24.4 billion. The acquisition price was partly funded by The Standard Bank of South Africa which is understood to be the largest ever cheque to be written by a South African bank at one time.

The Ascendis group of companies underwent a restructuring and refinancing and obtained approximately ZAR6 billion from various financial institutions. The transaction was complex, involving asset disposals, various vendors and businesses across several jurisdictions, including South Africa, Cyprus, Spain, Luxembourg, Malta, Romania and Hungary.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Generally yes, provided the company satisfies the requirements for the granting of financial assistance and (to the extent applicable) the making of a distribution under the relevant provisions of the South African Companies Act, 2008 (the **SA Companies Act**) prior to its obligations under the guarantee coming into force.

See question 4.1 below for the requirements for financial assistance under the SA Companies Act.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

There is no requirement under South African law for there to be corporate benefit to the guaranteeing/securing company. Directors have a fiduciary duty both in terms of the SA Companies Act and South African common law to act in good faith and for a proper purpose and in the best interests of a company. A breach of fiduciary duty may attract personal liability for that director.

2.3 Is lack of corporate power an issue?

Under South African law, a company has all the legal powers and capacity of a natural person except to the extent (1) it is incapable of exercising such power or of having such capacity, or (2) its memorandum of incorporation provides otherwise. However, where capacity of a company is limited in terms of its memorandum of incorporation, all third-party effects of the limitation are voided. A transaction outside the "limited" capacity of a company only gives rise to internal remedies. Shareholders, directors or prescribed officers of a company may apply to court to restrain a company from acting contrary to a limitation on its capacity, but any such action is without prejudice to the rights of a third party who obtained such rights in good faith and who did not have actual knowledge of the limitation of capacity. In addition, any action outside the "limited" capacity of a company is capable of ratification by special resolution of the shareholders. To the extent, however, any limitation applies to a company's ability to grant financial assistance, any provision

of financial assistance in contravention of that limitation (or the SA Companies Act) is not capable of ratification.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Under the SA Companies Act, the provision of financial assistance (which includes the granting of a guarantee) requires shareholder approval by way of special resolution (unless such financial assistance is pursuant to an employee share scheme that satisfies the requirements of section 97 of the SA Companies Act) and board approval. The shareholder approval can be generic (i.e. approval for a category of recipients and the recipient falls within that category) or transaction-specific and it must have been adopted within the past two years of the board resolution. Prior to authorising the provision of financial assistance at board level, the board must be satisfied that: (1) the company would satisfy the solvency and liquidity test immediately after providing the financial assistance in question; (2) the terms under which the financial assistance is given are fair and reasonable to the company; and (3) any conditions for financial assistance contained in the company's memorandum of incorporation have been satisfied.

To the extent the financial assistance (i.e. the guarantee) is granted for the benefit of a director or officer of the company or a related or inter-related company and the total value of the financial assistance granted exceeds 1/10th of 1% of the guaranteeing company's net worth at the time the board resolution authorising the financial assistance is taken (together with any such previous resolution during the financial year), the board of the guaranteeing company must give notice of the financial assistance to all shareholders of the company and any trade unions representing employees of the company. In all other circumstances, notice of the financial assistance must be given to all shareholders and any trade union within 30 business days after the end of the financial year. This is an administrative step and not a requirement for financial assistance under the SA Companies Act.

As at the date of publication of this guide, there are proposed amendments to the SA Companies Act which include exempting downstream financial assistance (i.e. financial assistance from a holding company to a subsidiary) from the requirements under section 45 of the SA Companies Act. These amendments are expected to be clarified and finalised during the course of 2021.

In addition to financial assistance, a guarantee for the benefit of one or more holders of any shares of the guaranteeing company (i.e. an upstream guarantee) or one or more holders of any shares of another company within the same corporate group constitutes a "distribution" as defined in section 1 of the SA Companies Act and requires board approval under section 46 of the SA Companies Act. This approval must include an acknowledgment that the board has applied the solvency and liquidity test and has reasonably concluded that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution.

See question 2.5 below for an explanation on the solvency and liquidity test under the SA Companies Act.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Not strictly, although the board of the guaranteeing company is required to confirm that the company will satisfy the solvency and liquidity test as provided for in the SA Companies Act immediately after providing the financial assistance, and to the extent applicable, immediately after completing the distribution.

The solvency and liquidity test is satisfied if, considering all reasonable and foreseeable financial circumstances of the company at that time the test is applied: (1) the assets of the company (fairly valued) equal or exceed the liabilities of the company (fairly valued); and (2) the company will be able to pay its debts as they become due in the ordinary course of business for the 12-month period following the provision of financial assistance or completion of the distribution, as applicable.

See question 2.6 below regarding limitations that may be imposed by the South African Reserve Bank.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Funds flowing in and out of South Africa are subject to exchange control in terms of the Exchange Control Regulations, issued under the Currency and Exchanges Act, 1933 (the **Exchange Control Regulations**). Exchange control is controlled by the Financial Surveillance Department (**FinSurv**) of the South African Reserve Bank. Certain powers set out in the Currency and Exchanges Manual for Authorised Dealers (previously known as the exchange control rulings) have been delegated to authorised dealers, which are banks authorised by FinSurv to deal in foreign exchange.

The enforcement of a guarantee given by a South African resident in favour of a foreign lender is subject to the requisite exchange control approval for that guarantee being in place. The approval must be obtained from FinSurv on application by the South African resident through its authorised dealer. While there is no regulatory limitation on the amount of a guarantee under the Exchange Control Regulations or rulings, FinSurv has a general discretion to impose any conditions on the approval granted by it. FinSurv has recently tended to include in its approval a limitation that any amount recovered under the guarantee is limited to the net asset value of the guaranteeing company at the time of recovery.

The approval process generally takes between four and six weeks.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

It is possible to take security over most common assets of a South African company.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

South Africa does not have a universal corporate security interest covering all assets generically. The appropriate form of security is determined by reference to the classification of the assets concerned as immovable (land) or movable and in respect of movable assets, further sub-classification as corporeal (tangible) or incorporeal (intangible).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over immovable property (land) is created by way of registration of a mortgage bond specially mortgaging the land

in accordance with the requirements under the Deeds Registries Act, 1937. Registration at the deeds registry where the land is registered perfects the security. There is no prescribed form for mortgage bonds, although there are recommended forms for certain types of mortgage bonds. The content of a mortgage bond is determined by banking and conveyancing practice, the South African common law and statute law.

Security over plant, machinery and equipment may be caught by any mortgage bond over the land to the extent those assets are sufficiently attached to the mortgaged land and were intended to be annexed permanently to the land. In these circumstances, the plant, machinery or equipment would be classified as immovable property.

Security over plant, machinery or equipment not constituting immovable property under South African property law is usually taken by way of mortgage in the form of either a special notarial bond or a general notarial bond. A special notarial bond is a mortgage by the debtor of specifically identified tangible movable property in favour of a creditor as security for a debt or other obligation. It must comply with the requirements outlined in the Security by Means of Movable Property Act, 1993; including the requirement that the property secured must be clearly identified and described in such a manner which makes it readily recognisable. A special notarial bond must be registered at the deeds registry within three months after the date of its execution. Once registered, the creditor is a secured creditor in the estate of the debtor.

A general notarial bond is a mortgage by the debtor of all its present and future tangible movable property in favour of a creditor as security for a debt or other obligation. A general notarial bond must be registered at the deeds registry within three months of the date of its execution. A general notarial bond does not confer a real right of security in the property concerned unless the creditor obtains possession of the property prior to insolvency of the debtor by way of a perfection order obtained from a court.

Both a special and general notarial bond must be prepared by a notary public and executed by either the owner of the movable assets (the mortgagor) encumbered under the bond or the notary public under a formal power of attorney granted to him by the mortgagor.

It is also possible to grant security over plant, machinery and equipment by way of a pledge, although this form of security requires delivery of the assets concerned, in addition to the agreement to grant the security over the asset, to perfect the security over those assets.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables is taken by way of cession. There are no formalities: the security interest is created by the debtor agreeing to grant security by way of cession over the receivables in favour of the creditor.

It is not necessary to notify the underlying debtors of the cession to perfect the security created over the receivables and given the fluctuating nature of receivables, it is fairly uncommon to give notice of the cession to the underlying debtors prior to the occurrence of an event of default. In the absence of notice, however, any payment by an underlying debtor to the security provider following the occurrence of the event of default constitutes a valid discharge by the underlying debtor of its obligations in respect of such receivables and the creditor will have to recover these amounts from the security provider.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, security over cash deposited in a bank account is taken by way of cession.

As discussed above in relation to security over receivables, there are no formalities for a cession: the security interest is created by the debtor agreeing to grant security by way of cession over the cash in the bank accounts in favour of the creditor.

It is more common in the case of a cession over cash in bank accounts to notify the banks of the security interest at the time of its creation and for the banks to acknowledge the security interest created. Where a bank has restricted the creation of security interests over bank accounts (pursuant to the terms and conditions entered into between the bank and the debtor), the bank's consent will be required to create such security over the cash in bank accounts.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes, security can be taken over shares in companies incorporated in South Africa. Shares in a private company are generally in certificated form, while shares in a public company are generally in uncertificated form.

Security over shares in a South African company is taken by way of pledge and cession. Similar to security over receivables and cash in bank accounts, the security interest is created by the debtor agreeing to grant security over the shares in question. There are no other perfection requirements in respect of certificated shares, although it is fairly common (i) to have any share certificates together with undated and blank share transfer forms delivered to the secured creditor, and (ii) for any other shareholders to waive any pre-emptive rights they have in respect of the certificated shares at the time of creation of the security interest to facilitate enforcement if needed following the occurrence of an event of default. There is a statutory obligation to "effect" any security interest over shares lodged and immobilised in South Africa's central securities depository (i.e. uncertificated shares) by "flagging" the relevant securities account in accordance with the Financial Markets Act, 2012.

Under South African law, the proper law for a security document granting security over assets situated in South Africa is South African law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, security over inventory is possible and usually takes the form of a special or general notarial bond.

See question 3.3 above for the procedure for taking security by way of a special or general notarial bond.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, provided the requirements for the granting of financial assistance and the making of a distribution under the SA Companies Act are satisfied where applicable.

See question 4.1 below for the requirements for financial assistance under the SA Companies Act.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

There is no stamp duty or other documentary tax payable under South African law for the granting, or taking, of security. Nominal registration fees are payable for the registration of mortgage bonds, general and special notarial bonds, aircraft mortgages, ship mortgages, hypothecations relating to trade marks, designs and patents. A mortgage bond must be prepared by a conveyancer and a notarial bond by notary public, both of whom are entitled to charge fees on a tariff-fee basis in South Africa, calculated by reference to the principal amount of the secured debt for preparing the bonds.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The costs for the preparation and lodgement of mortgage bonds and notarial bonds can be significant. It is fairly common, however, for conveyancers and notary publics preparing and lodging these documents to offer a fairly significant discount on the tariff rates.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Exchange control approval is required for the enforcement by a foreign lender of any security granted by a South African resident but it is common practice to obtain this approval prior to the creation of the security. As discussed in question 2.6 above for exchange control for a guarantee, the approval must be obtained from FinSurv on application by the South African resident company through its authorised dealer. The approval process generally takes between four and six weeks.

There may be particular requirements for regulated entities or assets. For example, a cession over shares in a company that holds a mining licence requires the consent of the Department of Mineral Resources in South Africa.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Generally, no.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Creditors generally expect to receive board and/or shareholder resolutions approving the transaction for evidentiary purposes and to ensure any financial assistance requirements have been satisfied.

The Uniform Rules of Court (of South Africa) provide for the authentication of any document signed outside of South Africa which is to be received in the courts of South Africa. A document executed outside of South Africa that has not been authenticated in accordance with the Uniform Rules of Court (of South Africa) remains valid and is admissible in evidence in a South African court but there is an evidentiary risk in respect of due execution. This risk can be mitigated in various ways, including but not limited to resolutions passed authorising a person to execute documents, specimen signatures of signatories and copies of passports or identity documents of signatories.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Both a private and public company are restricted from providing financial assistance (including by way of guarantee or security) in connection with the acquisition of:

(a) its own shares;
(b) the shares of its holding company; and
(c) the shares in a sister company,

unless the financial assistance has been approved in accordance with the relevant provisions of the SA Companies Act.

The board of a company may not authorise the provision of any financial assistance unless that financial assistance is pursuant to an employee share scheme under section 97 of the SA Companies Act or has been approved by way of a special resolution of the shareholders of that company that provides for generic approval for a category of recipients and the recipient falls within that category or for transaction specific approval. The shareholder resolution must have been adopted within the past two years of the board resolution. Further, the board must be satisfied that: (1) the company would satisfy the solvency and liquidity test immediately after providing the financial assistance in question; (2) the terms under which the financial assistance is given are fair and reasonable to the company; and (3) any conditions for financial assistance contained in the company's memorandum of incorporation have been satisfied.

The SA Companies Act also restricts the provision of financial assistance to a director or officer of the company or a related or inter-related company of the company granting the financial assistance. The requirements discussed above apply equally in these circumstances.

See question 2.5 for an explanation on the solvency and liquidity test under the SA Companies Act.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

South African law does recognise the concept of a trust. However, the security trustee structure recognised under English and New York law is not recognised under South African law. South African law requires that the security provider owe a valid principal obligation (not an accessory obligation) to the creditor. The security trustee structure does not meet this requirement.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Where a security agent is used for the purpose of holding South African security, a parallel debt arrangement is normally used in order to ensure that the security can be validly given to the security agent. The security interest, however, vests in the estate of the security agent and as a result, lenders take insolvency risk on the security agent.

Another alternative structure commonly used in South African law-governed transactions entails the establishment of a separate special purpose vehicle (known as the security SPV) to act as a beneficiary of the security granted by the security provider. The security SPV will provide a guarantee to the creditors for all of the secured obligations of the security provider, and the security provider will provide an indemnity to the security SPV. The shares in the security SPV are held by an owner trust.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Exchange control approval is required for a loan (whether in Rand or foreign currency denominated) made to a South African resident by a foreign lender as well as the granting of security or a guarantee by the South African resident in favour of a foreign lender.

Any change in the foreign lender does not require fresh approval but must be notified to the exchange control authorities through the relevant authorised dealer.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Yes, interest payable to or for the benefit of a foreign lender is subject to withholding tax at the rate of 15% to the extent that the amount is regarded as having been received or accrued from a source within South Africa under the South African Income Tax Act, 1962 (the **SA Income Tax Act**), unless the levying of withholding tax is exempted under the applicable provisions of the SA Income Tax Act or the amount of withholding tax is reduced as a result of a double taxation treaty.

Under the SA Income Tax Act, the exemptions relevant to withholding tax on interest fall into three broad groups:

- the payor (i.e. the person paying the interest);
- the instrument (i.e. the instrument giving rise to the interest, for example the debt or the investment); and
- the foreign person (the recipient of the interest).

A foreign person is exempt from the withholding tax on interest if the debt claim for which interest is paid is effectively connected with a permanent establishment of that foreign person if that foreign person is registered as a taxpayer in South Africa.

It is not clear from the current wording of the withholding tax provisions of the SA Income Tax Act whether the proceeds of a claim under a guarantee representing any amount of interest under the loan would be subject to withholding tax. The current market view is that this is not the case.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no preferential tax incentives for foreign lenders lending into South Africa.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

A foreign lender is not liable to pay tax in South Africa by reason only of its entering into a loan or exercising its rights (including taking steps to enforce its rights) under a loan, guarantee or security agreement.

Unless an exemption under the SA Income Tax Act applies, a foreign lender may be subject to tax on income that has, or is deemed to have, its source in South Africa. Income is or will be deemed to have its source in South Africa if, for example, it relates to rental on property situated in South Africa. South African-sourced interest which is received or accrued by or to a foreign lender is exempt unless the debt from which the interest arises is effectively connected to a permanent establishment of that foreign lender in South Africa.

See question 6.1 above for the application of withholding tax on payments of interest under a loan to a foreign lender.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There is no stamp duty or other documentary tax payable under South African law on the execution of enforcement of a loan or guarantee.

See question 3.9 for fees associated with taking security in certain circumstances.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

If one of the lenders is connected to the South African borrower and a tax benefit has arisen, the South African borrower cannot claim, in terms of section 31 of the SA Income Tax Act, a deduction of interest on any portion of the financing that is not at arm's length (i.e. any excessive portion of the financing). There are essentially two requirements that must be met before section 31 can be applied: (1) the terms and conditions of the transaction must differ from what they would have been had the parties been independent persons acting at arm's length (i.e. unconnected persons); and (2) the transaction must result (currently or in the future) in a tax benefit being derived by a person that

is a party to the transaction or by the South African resident in relation to an affected transaction involving its controlled foreign company. "Tax benefit" is defined in the SA Income Tax Act to include any avoidance, postponement or reduction of any liability for tax under the SA Income Tax Act. With effect from 1 January 2022, section 31 of the SA Income Tax Act will also apply in circumstances where the parties to the transaction are associated enterprises, as contemplated in Article 9 of the OECD Model Tax Convention on Income and on Capital.

Further, the amount of interest that may be deducted by the South African borrower is limited under section 23M of the SA Income Tax Act if: (1) the lender is in a controlling relationship with the borrower or it has obtained the funding from a person that is in a controlling relationship with the borrower; and (2) the amount of interest is not subject to tax in South Africa in the hands of the foreign lender. If the interest paid to the foreign lender is subject to withholding tax, the provisions of section 23M do not apply. A "controlling relationship" is one where a person holds (directly or indirectly) 50% of the equity shares in a company or at least 50% of the voting rights in a company.

The location of any unconnected lender has no other adverse consequences for a South African borrower (disregarding withholding tax concerns).

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

South African law gives effect to the choice of law exercised by contracting parties, subject to certain exceptions. Where foreign governing law applies, the applicable legal position is often the subject of expert evidence in litigation or arbitration proceedings. There are certain aspects which cannot be governed by the law chosen by the parties, however. For example, the proper law for a security document granting security over assets situated in South Africa is South African law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A foreign judgment is not automatically enforceable in South Africa but does constitute a cause of action and would be recognised and enforced by the South African courts (on application brought under the Enforcement of Foreign Civil Judgments Act, 1988) without re-examination of the merits of the case, provided:

- the court which pronounced the judgment had jurisdiction to entertain the case according to the principles recognised by South African law with reference to the jurisdiction of foreign courts;
- the judgment is final and conclusive in its effect and has not become superannuated;
- the recognition and enforcement of the judgment would not be contrary to public policy in South Africa;
- the judgment was not obtained by fraudulent means;
- the judgment does not involve the enforcement of a penal or revenue law of the foreign state; and
- the enforcement of the judgment is not precluded by the provisions of the Protection of Businesses Act, 1978. This Act requires that the consent of the Minister of Trade and Industry be obtained before certain foreign judgments can be enforced. The South African courts have interpreted the ambit of the Act restrictively and the current market view is that the ambit of the Act would appear not to include loans from, or guarantees to, foreign lenders.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) A South African court will exercise jurisdiction in a contractual dispute notwithstanding the chosen law of the agreement being foreign, if the normal grounds for jurisdiction exist. A foreign lender, like any local lender, can initiate legal proceedings in one of two ways: by way of action for matters involving a factual dispute, or (less likely in the circumstances) by way of application for matters where no factual dispute exists but involves application of the relevant law in question.

An action is usually initiated by way of service of combined summons. After formal service of that summons by the Sheriff of the Court, the defendant must file a notice of intention to defend if he wishes to oppose the action (within 10 court days after service, subject to limited exceptions). Two scenarios arise:

- If no notice of intention to defend is filed, and the claim is a debt or liquidated demand (which is likely to be the case in the context of this query), the foreign lender can apply to the registrar of the court for default judgment without further notice to the defendant. This procedure, if successful, usually takes approximately four to six weeks from initiation of proceedings.
- If the defendant delivers a notice of intention to defend, and, 20 court days thereafter, a plea, and the claim is liquid (which is likely to be the case in the context of this query) the foreign lender can apply for summary judgment. The courts are reluctant to grant summary judgment unless the foreign lender has satisfied the court that the defendant has no *bona fide* defence and has entered a notice of intention to defend solely for the purposes of delaying the action. The summary judgment procedure, if successful, takes approximately three to six months from initiation of proceedings. If the defendant is able to demonstrate under oath that it has a *bona fide* defence, alternatively, the defendant puts up security for the sum claimed in the summons, the matter will proceed to trial. If summary judgment is refused, the costs of the application are usually costs in the cause; however, the foreign lender may be penalised with an adverse costs order if the court believes that the foreign lender knew that the defendant intends to defend the claim upon grounds which – if accepted by the trial court – would constitute a good defence, irrespective of the ultimate success in the trial.

  Initiation of proceedings refers to issuing of the summons. The above timeframes depend on the congestion of the court roll at the time the matter is

set down. A full trial procedure usually takes between one and two years from initiation of the proceedings given an unfortunate backlog in the South African courts as regards the allocation of trial dates.

(b) A foreign lender seeking to enforce a foreign judgment in South Africa must first apply to a local court for an order recognising the judgment. If the foreign judgment satisfies the requirements for its recognition as discussed in question 7.2 above and the local court grants an order recognising it, the foreign lender can enforce the judgment in the ordinary course as if it were a judgment of a South African court – i.e. the foreign lender can obtain a writ of execution and attach the defendant's assets for sale in execution in satisfaction of the judgment. Opposed motion proceedings relating to the recognition of the foreign judgment usually take approximately six to eight months from initiation of proceedings. A writ may be issued immediately after the handing down of the judgment; however, in practice the creditor will normally postpone this process until costs included in the court order have been agreed or taxed.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

In the case of foreclosing on a mortgage bond or a general notarial bond where the secured creditor is not in possession of the assets, the secured creditor would need to first obtain a court order before enforcement. This will have an impact on the cost and timing of recovery.

Regulatory consents may be required if the company is a regulated entity or the assets are regulated.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No, foreign lenders are essentially treated the same as domestic lenders. A defendant will, however, be entitled to request (on application to the registrar, or court, depending on the circumstances) that the foreign lender provide security for the defendant's legal costs.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

On liquidation, a *concursus creditorum* occurs and the estate of the insolvent is essentially frozen. The aim in liquidation is to realise the unsecured assets of the company for the benefit of creditors as a whole (save for secured creditors). All legal proceedings against the company are suspended until the appointment of a liquidator and any civil attachment of assets of the company after insolvency proceedings have been commenced is void. A secured creditor is not entitled to enforce its rights under its security agreement but must rather deliver any secured property held by it to the liquidator of the insolvent estate for realisation. There are limited circumstances in which a secured creditor may realise certain secured assets itself without the consent of the liquidator of the insolvent estate. These limited circumstances relate to where the secured property comprises marketable securities (i.e. property ordinarily sold through a stockbroker); financial instruments or bills of exchange. Any cash proceeds realised through any disposal of the secured assets would then have to be turned over to the liquidator unless an agreement is reached with the liquidator for the lender to retain the proceeds subject to paying the fees of the liquidator and Master of the High Court.

A company in "financial distress" may be placed into business rescue with the aim of rehabilitating the company by providing for the temporary supervision and management of the company's affairs and business by a business rescue practitioner. During business rescue, no creditor may institute any legal proceedings or take any enforcement action (including enforcement of any collateral security) against the company. In certain circumstances, proceedings may be brought against the company with the written consent of the business rescue practitioner or with the leave of the court.

The terms and effect of any reorganisation of a company (including whether any moratorium applies) by way of compromise with its creditors will depend on the terms agreed between the company and all its creditors.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

In terms of the International Arbitration Act, 2017 (the **International Arbitration Act**) (which came into effect on 20 December 2017), the Model Law on International Commercial Arbitration, as adopted by the United National Commission on International Trade Law, has been wholly adopted into South African law for the purposes of international arbitral awards. In effect, as regards to enforcement of arbitral awards:

- a foreign arbitral award is binding between the parties to that foreign arbitral award, and may be relied upon by those parties by way of defence, set-off or otherwise in any legal proceedings;
- a foreign arbitral award must be made an order of court on application to the court;
- a foreign arbitral award may be enforced in the same manner as any judgment or order of court, and the party seeking such order must produce: an original award and arbitration agreement (as authenticated in a manner acceptable to a South African court (i.e. by a notary public, or certified as true originals)); and, if issued in a foreign language, an authenticated sworn translation or the award and arbitration agreement;
- a court may only refuse to recognise or enforce a foreign arbitral award if:
  - the court finds that a reference to arbitration of the subject matter of the dispute is not permissible in South African law; or the recognition or enforcement of the award is contrary to public policy;
  - the party against whom the award is invoked proves to the satisfaction of the court that:
    - a party to the arbitration agreement had no capacity to contract under the law applicable to that party;
    - the arbitration agreement is invalid under the law to which the parties have subjected it, and, where no law is subjected, the law of the country in which the arbitral award was made;
    - the required notice was not given as regards to the appointment of an arbitrator, and/or the constitution of an arbitration, and that party was not able to present its case;

    - the arbitral award is beyond the arbitrator's jurisdiction – i.e. it deals with a dispute not contemplated by/falling within the terms of reference/scope of the arbitrator's appointment;
    - the constitution of the arbitration proceedings was not in accordance with or provided for in the arbitration agreement or the law of the country in which it is constituted; and
    - the award is not yet binding on the parties, has been set aside or suspended by a competent authority in the country in which, or under the law of which, the arbitral award was made;
- an arbitral award can be recognised and enforced in part, provided that the aspects which a party seeks to enforce can be separated from the rest of the award; and
- where an application for the setting aside or suspension of an award had been made to a competent authority, the court where recognition or enforcement is sought may, where appropriate, adjourn its decision and, on application by the party seeking recognition and enforcement, order the other party against whom the arbitral award is being invoked to provide suitable security.

Importantly, as regards to the applicability of the International Arbitration Act, the provisions will apply to all international commercial arbitration agreements regardless of whether they were entered into before or after the commencement of the International Arbitration Act. It will not, however, apply where:

- proceedings for the enforcement of an arbitral award under the Recognition and Enforcement of Foreign Arbitral Awards Act, 1977; or
- proceedings for the enforcement, setting aside or remittal of an arbitral award under the Arbitration Act, 1965,

were already in progress prior to 20 December 2017 – i.e. the old position will still apply to such proceedings.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

A secured creditor is not entitled to enforce its rights under its security agreement during insolvency proceedings but must rather deliver any secured property held by it to the liquidator of the insolvent estate for realisation. There are limited circumstances in which a secured creditor may realise certain secured assets itself without the consent of the liquidator. These limited circumstances relate to where the secured property comprises marketable securities (i.e. property ordinarily sold through a stockbroker), financial instruments or bills of exchange. Any cash proceeds realised through any disposal of the secured assets would then have to be turned over to the liquidator unless an agreement is reached with the liquidator for the lender to retain the proceeds subject to paying the fees of the liquidator and Master of the High Court.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Certain pre-liquidation contracts can be set aside by a liquidator exercising anti-avoidance (or clawback) powers afforded to it under the SA Insolvency Act. Clawback could be available in relation to: dispositions (commonly known as impeachable dispositions) made not for value; dispositions having the effect of preferring creditors and not made in the ordinary course of business; dispositions made with intent to prefer creditors; collusive dealings; and dispositions in fraud of creditors.

The definition of a "disposition" in terms of the SA Insolvency Act is very wide, and is designed to cover every loss of rights to property, which includes the granting of security.

A disposition will only qualify as an impeachable disposition if it was made at a time when the debtor's liabilities exceed its assets or, in the case of a disposition at no value, the debtor's estate was rendered insolvent by the disposition. For this purpose, "insolvent" means that the insolvent's liabilities must exceed the value of his assets (fairly valued) at the date of the disposition.

Where a special notarial bond or mortgage bond is passed over assets to secure a debt and such bond is not registered within two months of the debt being incurred, and the debtor is liquidated within six months of the registration of the notarial bond or mortgage bond, no preference is recognised under the notarial bond or mortgage bond and the lender effectively loses its security.

Creditors in the insolvent estate are paid according to the following order of rank:

- costs of liquidation – this includes the costs of court application; the liquidator and master's fees; and sheriff's costs;
- secured creditors – payment is made to secured creditors from the proceeds of a sale of the secured assets (after the proportionate liquidation costs have been deducted from the proceeds of the realised secured asset). Where a secured creditor's claim is not secured in full, the unpaid balance is treated as a concurrent claim. Secured claims include mortgage bonds over immovable property which are satisfied in the order in which they are registered or recorded; pledges over movable property; special notarial bonds registered over movable property are satisfied in the order in which they are registered; and cessions over intangible movable property;
- preferent creditors – these are creditors who do not hold security for their claims but rank above the claims of concurrent creditors. They are paid from the proceeds of the unencumbered assets (the free residue) in a pre-determined order as follows:
    - the salary and wages of employees (and certain other amounts payable to, or on behalf of, employees);
    - certain statutory obligations (such as amounts owing to the workmen's compensation fund; any customs or sales tax due under the Customs Excise Act, 1964; any value-added tax or penalty due under the Value-Added Tax Act, 1991; and any amounts owing to the unemployment insurance fund);
    - income tax; and
    - preferential claims arising from bonds giving preferences (i.e. general notarial bonds or special notarial bonds registered before 7 May 1993);
- concurrent creditors – these are creditors who are paid from the proceeds of the free residue that remains after preferent creditors have been paid in full in proportion to the amounts owed to them;
- subordinated creditors – if they have subordinated their claims to the claims of concurrent creditors; and
- shareholders (holders of preference shares generally take priority over holders of ordinary shares).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Special legislation and special insolvency regimes may apply to certain businesses (e.g. banks/credit institutions and investment firms).

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The lender and security provider may agree that the lender has a right (called *parate executie*) to sell the secured assets without an order of court by public auction to the highest bidder or in such manner as may be otherwise agreed between the parties.

The debtor may seek the protection of the court if, on any just ground, he can show that, in carrying out the agreement and effecting a sale, the creditor acted in a manner which prejudiced the debtor in his rights in respect of a security interest created over movable property.

An agreement in a mortgage bond entitling the mortgagee to resort to *parate executie* by taking possession of the property and selling it privately is, however, invalid.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Generally yes, submission to a foreign jurisdiction is legally binding and enforceable under South African law. However, as per the Foreign States Immunities Act, 1981, the inherent jurisdiction of the South African courts cannot be ousted and, as such, a South African court may exercise its discretion not to take cognisance of the submission to foreign jurisdiction clause in commercial transactions with a foreign state, or, where the obligations of a foreign state (in terms of a contract, whether a commercial transaction or not) falls to be performed wholly or partly in South Africa. Commercial transactions falling within the ambit of the Foreign States Immunities Act relate to: (i) any contract for the supply of services or goods; (ii) a loan or other transaction for the provision of finance, and any guarantee or indemnity in respect of any such loan or other transaction, or, of any other financial obligation; and (iii) other transactions/activities, or a commercial, industrial, financial, professional or other similar character contract into which a foreign state enters, or in which it engages other than in the exercise of sovereign authority. It does not, however, include a contract of employment between a foreign state and an individual.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, sovereign immunity may be waived as per the Foreign States Immunities Act, 1981. More particularly, a waiver of immunity may be effected after the dispute which gave rise to the proceedings has arisen, or by prior written agreement.

A provision in an agreement that it is to be governed by the law of South Africa shall not be regarded as a waiver, but, a foreign state shall be deemed to have waived its immunity: (i) if it has instituted the proceedings; or (ii) if it has intervened or taken any step in the proceedings (save for where this "step" is taken for the purpose of claiming immunity, or asserting an interest in property in circumstances such that the foreign state would have been entitled to immunity if the proceedings had been brought against it). A waiver in respect of any proceedings shall also apply to any appeal and to any counter-claim arising out of the same legal relationship or facts as the claim.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Lending activity as such is not a regulated activity in South Africa unless credit is provided to consumers (i.e. retail lending activity).

However, under the Banks Act, 1990 (the **SA Banks Act**), no person may conduct "the business of a bank" unless such person is a public company and registered as a bank under the SA Banks Act. The business of a bank is widely defined and includes accepting deposits from the general public as a regular feature of the business in question. The SA Banks Act does not define nor offer guidance as to what constitutes the "general public" but it is generally understood to refer, with reference to the SA Banks Act, to any section of the public, irrespective of any pre-selective or pre-determinative criteria applicable to a particular group of persons. It would not include any private or domestic arrangements.

The South African Reserve Bank is responsible for bank regulation and supervision in South Africa. It is not, however, necessary under the laws of South Africa that a foreign lender is licensed, qualified or otherwise entitled to carry on business in South Africa to enable it to exercise its rights (including taking steps to enforce its rights) under any lending arrangements entered into with a South African borrower, or to enter into or perform its obligations under the lending arrangements.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

Although formal "in person" signing and closing meetings had already been on a downward trend in recent years, the impact of the current COVID-19 lockdowns and the resultant restrictions on the mobility of signatories on a global scale have meant that virtual and e-signings have generally become the norm.

Where possible, parties should use a web-based e-signing platform given the enhanced security and authentication measures. The South African market, however, is still relatively green in the adoption of e-signatures and in some sectors not yet familiar (or comfortable) with a web-based platform. In these instances, parties sign the documents either by affixing a PDF or JPEG of a handwritten signature in the document or signing using a stylus or Apple pen, and following an agreed signing process similar to the English law Mercury protocol for the execution of deeds.

The Electronic Communications and Transactions Act, 2002 (**ECT Act**) gives legal recognition to transactions concluded electronically, unless expressly excluded from the application of the ECT Act. These exclusions include agreements for the sale of immovable property, long-term leases of immovable property in excess of 20 years, wills and bills of exchange. The ECT Act also expressly provides that electronic signatures are not without legal force and effect merely because they are in electronic form. The ECT Act essentially provides for two types of electronic signature: an advanced electronic signature which results from an accredited process; and an "ordinary" electronic signature. An advanced electronic signature is required where the signature of a person is required by law and such law does not specify the type of signature or where the parties specify that an advanced electronic signature is required.

It is important that the parties in a transaction agree upfront to (i) the use of electronic signatures and the type of electronic signature to be used, and (ii) a virtual closing.

Most finance documents may be electronically signed by using "ordinary" electronic signatures. However, where a law requires a signature, statement or document to be notarised, acknowledged, verified or made under oath, the advanced electronic signature of the person authorised to perform those acts is required. Accordingly, if a notary public is required to attest to any document in terms of law (including notarial bonds – refer to questions 3.3 and 3.9 above), any such attestation, if done electronically, must be by way of an advanced electronic signature.

The ECT Act does not specifically deal with documents that need to be filed and/or registered in an applicable deeds registry (which would include documents relating to mortgage and notarial bonds – refer to question 3.3 above). The Electronic Deeds Registries Systems Act, 2019 (the **EDRS Act**) aims to provide for electronic deeds registration, having regard to legislation regulating electronic communication and transactions. The EDRS Act was assented to on 19 September 2019 but only section 2 dealing with the development, establishment and maintenance of an electronic deeds registration system is currently in force and effect. No expected timing for the enactment of the balance of the provisions of the EDRS Act has been given, including section 3, which provides express recognition for e-signing of bonds, amongst others, and those related for the filing of bonds at the applicable deeds registry/ies. At the time of publication of this guide, we understand that the registrar of deeds has accepted electronically signed documents in one instance only where prior arrangements were made.

Where documents signed in wet ink are contractually required to be exchanged in a specific transaction, parties generally agree to exchange electronic copies of the documents to close the transaction, with an undertaking/conditions subsequent to deliver the original signature pages as soon as possible. In practice, the process of receiving and collating original documents now takes much longer as a result of the COVID-19 lockdowns and restrictions. Parties must be cognisant of the hardening period that applies to special notarial bonds and mortgage bonds – refer to question 8.2 above.

We anticipate that the number of transactions to be concluded virtually using a web-based e-signing platform will continue to increase going forward. Hopefully the balance of the provisions of the EDRS Act will be enacted soon to allow for the electronic filing and registration of deeds, mortgage and notarial bonds and other relevant documents in the applicable deeds registry/ies.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Under the Financial Advisory and Intermediary Services Act, 2002 (**FAIS**), no person may provide intermediary services or advice to clients in respect of financial products (including insurance products; bank deposits and securities) unless that person has been issued a licence under FAIS. Authorised financial service providers holding the requisite licence under FAIS are bound by principles and rules set out in the applicable codes of conduct created by the Financial Sector Conduct Authority, the regulatory body responsible for administering FAIS.

Foreign investors should also consider a controversial piece of legislation, the Protection of Investment Act, 2015, which came into force and effect on 13 July 2018. The stated aim of the Act is to provide for the protection of investors and their investments in South Africa in accordance with and subject to the Constitution of South Africa in a manner which balances the public interest and the rights and obligations of investors. The Act intends to eventually replace South Africa's bilateral investment treaties (**BITs**); however, South Africa is currently still a party to 12 BITs. The Act has been criticised for (amongst other things): (i) creating uncertainty as to whether expropriation without compensation is a risk for foreign investment assets, particularly as the protection of investment clause in the Act specifically notes investors' right to property in terms of section 25 of the Constitution of South Africa, which section is currently under review to determine whether it should be amended to explicitly provide for expropriation without compensation; and (ii) providing for a dispute resolution process that requires ministerial consent and facilitation and exhaustion of domestic remedies before a request for international arbitration can be made or considered. As part of the process to introduce the concept of expropriation without compensation into South Africa's legal system, the draft Expropriation Bill, 2020 has been published, which permits expropriation without compensation in certain circumstances. Given the relatively recent enactment of the Act and the consequent lack of judicial precedent, there is little guidance as to how the relevant provisions of the Act will be construed or applied.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

During the past few years, companies in Spain have been greatly benefitting from the very accommodative monetary policy of the market, and the reduced cost of borrowings has contributed to very high levels of corporate debt that, amidst a period of full or partial stoppage of economic activity, seems difficult to cope with.

Both the European authorities and the Spanish government, through the *Instituto de Crédito Oficial* ("ICO"), a state-owned bank, with the legal status of a corporate state-owned entity, attached to the Ministry of Economy and Business, launched a wide range of measures including, but not limited to, the creation of a guarantee facility of up to €100 billion for the financing of businesses and self-employed workers aimed at covering their liquidity needs arising as a consequence of the pandemic. Such aid is provided through the ICO in cooperation with financial institutions that adhere to it by entering into a framework cooperation agreement that has been negotiated among a group of financial institutions and the ICO, enhancing the release of credit and liquidity from the banks to the market and preventing companies that are facing financial difficulties due to the pandemic and the lockdown from falling into insolvency.

Aside from the disrupting impact of the COVID-19 pandemic on the Spanish economy, we must highlight that the main tendencies outlined in the financial sector last year remain unchanged. The sale and trading of non-performing assets by the largest banks in Spain has continued its steady growth and, as Europe demands a larger focus on banking activity to improve performance and liquidity ratios, it is envisioned that these transactions will keep growing in the coming months.

Due to the economic constraints, 2021 will be the year of restructuring deals in Spain. Whilst the stimulus and incentives approved by the European and Spanish authorities have mitigated the negative impact caused by the pandemic, a huge range of companies will need to enter into negotiations with their lenders to discuss the terms of their current financial indebtedness.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Corporate refinancing and debt restructuring processes

For some years now, we have been actively participating in debt refinancing and restructuring processes, involving large national and international companies, which have required forming multidisciplinary teams with a high international element. Some examples include our advice in the debt restructuring of Abengoa refinancing (€3 billion), Corte Inglés (€2 billion), Lecta Group (€700 million), Bergé (€650 million), Saba Aparcamientos (€400 million), as well as some acquisition finance deals, such as Adevinta's financing to acquire eBay's global classified-ads business through a secured bond issue and a senior financing agreement (€2,850 million).

Project and real estate finance

Our team was very active last year and was involved in several projects in Spain and abroad, particularly in Latin America.

In Latin America, we note our advice given for: the financing for the modernisation of the Salaverry port in Peru (US$132 million); the project financing for the construction of an 89.4MW solar farm in Chile (US$100 million); as well as the financing of two photovoltaic power plants (82.5MW and 34.2MW, respectively) in Mexico (Coahuila and Aguascalientes) (US$84 million).

Distressed debt

We are one of the most specialised law firms advising on distressed debt transactions, acquisition of corporate debt, loan portfolios and restructuring debt processes. We have been chosen by major international and prestigious funds and have advised either the distressed/special situations funds (as a purchaser), or the financial institution (as a seller) in many significant deals. Among others, some recent transactions include Project Louvre, Project Higgs, Project Aurora, Project Explorer, Project Kingfisher and Project Alcazar, clearly showing the Spanish banks' interest in cleaning up their balance sheets and international investors' interest in Spanish assets.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Although some financial assistance restrictions need to be taken into consideration (see question 4.1 below), there are no significant legal restrictions to corporate guarantees. Having said that, there are certain formalities that need to be conducted when granting guarantees for the benefit of other members of their group, such as the shareholder approval attesting that they are aware of the transaction and that they are confident that the transaction envisioned is sound from a general corporate perspective and will benefit the group as a whole. Unlike other

EU jurisdictions, there is no specific obligation for Spanish companies to justify that they are acting for corporate benefit reasons when granting a guarantee or security, although it is advisable to do so based on the characteristics of a specific transaction, or to ensure the effectiveness of the security or guarantee if the grantor becomes insolvent. These formalities have the main aim of avoiding any presumption of gratuity in an insolvency scenario that could challenge the validity of such guarantees and activate any potential clawback claim from third-party debtors. The Spanish Supreme Court, in a ruling of 2014, highlighted the importance of ensuring that the guarantor receives any direct of indirect benefit for the provision of the guarantee.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

All directors should act when conducting business with the diligence of an "orderly entrepreneur". Moreover, any individual forming part of a management body should generally comply with the various duties foreseen in the applicable law, the articles of association and other internal rules with due care, abiding by the shareholders' decisions and following standard market criteria that enhance the performance and growth of the business. Furthermore, all directors should avoid any situation when a potential conflict of interest may arise in the performance of their duties and shall refrain from adopting decisions when they can reasonably foresee that such decisions may have a negative impact on the business.

This last duty is inextricably linked with any potential liability towards them when adopting the decision to secure borrowings from a different member of the group. In an eventual insolvency scenario, there is a potential risk that the insolvency administrators might presume that the granting of collateral by the company could have resulted in the insolvency and allege that it is detrimental to the insolvency estate. In these situations, it is paramount to follow the guidelines established in question 2.1 above as well as to include certain limitation language in the collateral documentation and in the corporate resolutions, to mitigate any potential liability.

The existence of a detriment to the estate of the guaranteeing company can be challenged by evidencing that there is a regular trend of providing borrowing and guarantees among companies belonging to the same group or by attesting that the guarantee entailed some economic advantage to the guarantor.

2.3 Is lack of corporate power an issue?

Yes, in Spain the agreements need to be executed by duly empowered representatives of the company with sufficient corporate power to act on its behalf.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Usually, no governmental consents or filings are required to grant guarantees or security interests in Spain (see question 3.11 below) unless the company falls under the scope of any public regulation or is directly or indirectly governed by any public authority, where the adoption of such actions can be limited or subject to further formalities and consents.

Regarding internal corporate approvals, in general terms, any actions or activities which fall within the scope of the corporate purpose of the company are subject to fewer formalities. However, in case of private limited liability companies (*sociedades de responsabilidad limitada*), shareholders' approval may need to be obtained before carrying out certain transactions. In public limited liability companies (*sociedades anónimas*), despite not being mandatory, the shareholders' approval is also usually obtained (see question 2.1 above for more information on corporate benefit).

If the amount of the guarantee represents an excess of 25% of the value of the assets which appear in the latest balance sheet of the company – having the consideration of an "essential asset" as per the Spanish Companies Act – it is also mandatory to obtain the shareholders' approval as the shareholders' meeting (not the board) holds exclusive competence to adopt any decision involving the disposal of assets exceeding such threshold. The aim of this regulation is: (i) to reserve for the shareholders the approval of certain transactions which, due to their financial significance, can have similar effects to those of a structural modification, even though, from a technical perspective, they do not constitute such kind of transaction; and (ii) to protect the minority shareholders.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, although certain limitation language is included in case of a disproportionate benefit between the borrowing company and the guaranteeing/securing company (see question 2.2 above for more information).

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control regulations on the enforcement of a guarantee. However, Spanish Insolvency Law imposes an important restriction on lenders facing imminent or real insolvency of its debtors, as any termination clauses solely based on insolvency of the debtor which may have been included by the parties in an agreement are deemed as non-applicable or non-enforceable.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

The most commonly used types of collateral in the framework of a financing transaction are generally classified into two main groups: (1) *in rem* security interests, the most frequent being: (i) mortgage over real estate (*hipoteca inmobiliaria*); (ii) ordinary pledge over movable assets with transfer of possession (*prenda ordinaria*) (e.g., pledge over shares, over credit rights or over bank accounts); (iii) chattel mortgage (*hipoteca mobiliaria*) over business premises, aircraft, machinery or equipment; and (iv) non-possessory pledge over assets (*prenda sin desplazamiento de la posesión*); and (2) personal guarantees, mainly being first demand guarantees (*garantías a primer requerimiento*) or sureties (*avales*).

The main difference between *in rem* security interests and personal guarantees is that, in the former, a specific asset secures fulfilment of the obligation, while in the latter, an individual or corporate entity guarantees fulfilment of the obligation. The collateral value of the *in rem* security is linked to the value of the underlying secured asset, while the value of the personal guarantees relies on the estate of the guarantor considered as a whole. As briefly highlighted below, there are also material differences in proceedings for their treatment and enforcement during insolvency (*concurso*) under the Spanish Insolvency Act (*Ley Concursal*).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Spanish law does not provide for a so-called "universal security" over the global debtor's assets. Therefore, traditionally, a security agreement is usually required in relation to each type of asset. Nor does it generally admit the creation of a "floating" lien or encumbrance (i.e., a variable guarantee over assets) except for certain mortgages over real estate (*hipoteca flotante*) and some analogous figures that enable the creation of security over several assets such as the pledge over inventory or the pledge over furniture, fixtures and equipment (FF&E), generally used in real estate transactions. As a basic premise, it is paramount to flag that only financial entities (and not investment funds) and certain public administrations holding tax credits against the debtor can be beneficiaries of the so-called floating mortgage (*hipoteca flotante*) that allows security over different obligations under a single umbrella agreement.

The creation of guarantees and security interests requires the notarisation of the agreements by means of which they are granted. Such notarisation allows the agreements to qualify as executive title (*título ejecutivo*) in an enforcement scenario, pursuant to article 517 of the Spanish Law on Civil Procedure. Notarial deeds (being either *pólizas notariales* or *escrituras públicas*) provide certainty of the date and content of the applicable document *vis-à-vis* third parties. Furthermore, some of these types of security interests are subject to compulsory entry on public registries, such as the Land Registry (*Registro de la Propiedad*) (e.g., real estate mortgage) or the Chattel Registry (*Registro de Bienes Muebles*) (e.g., mortgage on inventory or non-possessory pledge over assets), while such registration is not required for other collateral (e.g., ordinary pledge with transfer of possession).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Real property is taken as security by means of a real estate mortgage (*hipoteca inmobiliaria*). Under Spanish law, real estate mortgages cover: (i) the plot of land and the buildings built on it; (ii) the proceeds from any insurance policies covering such property; and (iii) the improvement works carried out on the property and natural accretions. Should the parties agree to it and convey it on the relevant deed by means of which the mortgage is formalised, such mortgage may also include movable items located permanently in the mortgaged property.

Security over machinery and equipment may be created by means of a chattel mortgage (*hipoteca de maquinaria industrial*) or a non-possessory pledge (*prenda sin desplazamiento de maquinaria industrial*). The choice will depend on whether the specific asset meets certain legal requirements.

Further formalities for the abovementioned security (other than notarisation of the security agreement as set forth under question 3.2 above) involve the registration of such security with the corresponding Spanish registries: the Property Registry (*Registro de la Propiedad*) with regard to the mortgages, and the Chattel Registry (*Registro de Bienes Muebles*) with regard to the non-possessory pledge. Registration within the Property Registry is mandatory for mortgages; the mortgage does not formally exist until it is recorded in the Property Registry corresponding to the domain where the plot is located.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables can be taken in two different manners: (i) by creating a possessory pledge (*prenda ordinaria*); or (ii) by creating a non-possessory pledge (*prenda sin desplazamiento de la posesión*) which needs to be registered in the Chattel Registry.

With regard to the possessory pledge over receivables, it is necessary to notify the assigned debtor in order to avoid the application of any set-off or release of the payment obligations of such assigned debtor by way of payment to the security provider.

The non-possessory pledge (*prenda sin desplazamiento de la posesión*) does not require notification to the relevant debtor, since publicity *vis-à-vis* third parties is obtained through the filing of such pledge with the relevant Chattel Registry.

Further to the above, those claims which are secured by a pledge over future receivables shall be considered as "specially privileged" in an insolvency proceeding, so long as the following requirements are met: (i) the security interest granted is documented by means of a public deed (*escritura pública*) when it comes to ordinary pledges; or (ii) the security interest is formalised by means of a deed (*póliza notarial*) and is registered in the relevant Chattel Registry in case of a non-possessory pledge. Specially privileged credits will be settled by way of resorting to the pledged assets and will not benefit the remaining creditors of the insolvent debtor until and only until the credit of the secured party is fully settled.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

The pledge over bank accounts is simply a pledge over the receivables arising in favour of the holder of a bank account *vis-à-vis* the bank, which should typically correspond or be equal to the account balance.

The formal requirements that apply are identical to those of any other possessory pledge over receivables. The creation of the pledge does not imply, unless otherwise agreed by the parties (typically in project finance transactions when special accounts are envisioned to control cash flows), the blocking of the amounts deposited in such bank account, although some reservations as to how the balance may be disposed by the debtor are typically included in the security agreement.

On a separate note, in the event of pledges over bank accounts securing cash settlements of financial instruments (such as netting-based financial agreements), it is possible to subject the pledge to a specific regime regulated under Royal Decree 5/2005, which enables the secured party to perform the direct sale (without following court or out-of-court enforcement proceedings) of the balance deposited in such account in case an event of default occurs.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes, it is certainly possible, and it is one of the most common and frequent types of security in Spanish financing transactions.

If the shares to be pledged belong to a private limited company (*sociedad limitada*), and taking into account that quota

units (*participaciones*) are not represented by issued certificates (contrary to shares (*acciones*) of public limited companies (*sociedad anónima*)), possession is transferred by means of the execution of a notarial deed of pledge and the registration of the pledge in the Registry Book of Shareholders (*Libro Registro de Socios*) of the relevant pledged company. It is customary that the granting of the pledge is also recorded in the title of ownership to further attest the granting of such collateral and prevent further liens or encumbrances over such asset.

When the shares belong to a public limited company (*sociedad anónima*), transfer of possession is achieved as follows: (i) if the share certificates (*títulos múltiples* or *resguardos provisionales*) have been issued, by endorsing the relevant title certificate and registering the pledge in the Registry Book of Shares (*Libro Registro de Acciones*); or (ii) if no share certificates have been issued, by means of the registration of the pledge in the Registry Book of Shares.

In both cases, it is also advisable (and standard market practice) for the pledgee to request and obtain a certificate issued by the company's secretary representing that the pledge has been registered in the Registry Book of Shareholders or the Registry Book of Shares (as applicable), which will also comply with the requirement of notifying the pledge to the company whose shares are being pledged. Also, such kind of certificate normally includes several representations of the company such as the absence of previous liens or encumbrances over such shares.

When the pledged company's shares are represented by means of book entries (*anotaciones en cuenta*), the pledge must be registered in the relevant account, becoming enforceable against third parties once registered in the book entry register. In the case of shares traded on a Spanish secondary market, the book entry register will be held by a central clearing house. On request, the entity responsible for the book entry register will issue a certificate stating that the pledge has been entered.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, Spanish law foresees a specific mechanism for creating security over inventory, which is the non-possessory pledge over inventory (*prenda sin desplazamiento de inventario*). As provided in questions 3.2 and 3.3 above, this type of collateral requires notarisation as well as registration in the relevant Chattel Registry to be perfected. The notarial deed will need to include a very comprehensive description of the inventory for the pledge to be duly recorded in the relevant registry and also the identification of the premises where such inventory will be located throughout the life of the pledge.

However, it is also possible to create a security over inventory by granting a chattel mortgage over a business (*hipoteca de establecimiento mercantil*), which will include not only the inventory, but the whole business.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Subject to the financial assistance and the corporate benefit previously explained under question 2.1, as a general rule, the principle of integrity (*principio de especialidad*) (by virtue of which a security interest can secure only one main obligation and its ancillary obligations, such as interest, costs, etc.) must be complied with, which in practice means that when there are two different main obligations which need to be secured, two different security interests (over different assets or portions of the same asset) must be created. However, a certain degree of flexibility is envisioned under Spanish law for those transactions where, despite the existence of several obligations, all of them abide by a clear and single purpose and an inextricable link can be evidenced between them. In these situations, the parties involved in the transaction can resort to certain figures to circumvent the principle of integrity such as the equalisation of rank among the security or the creation of second and subsequent ranks in the security.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

For possessory pledges to be enforceable *vis-à-vis* third parties, a notarised agreement (*póliza notarial*) or, as the case may be, a deed (*escritura pública*) must be entered into. This is due to the fact that it is presumed that these public documents verify the date and the terms and conditions of the pledge.

Some other types of security are subject to compulsory notarisation and registration on public registries which has certain implications in terms of cost, mainly due to: (i) registration fees, which vary in accordance with the amount of the secured liability (approximately 0.02% of the secured liability); and (ii) stamp duty of 0.5% to 2% of the secured liability (principal, interest and any related costs), depending on the region where the collateral is located. Stamp duty is not levied on ordinary pledges.

Notarial fees are calculated on the basis of fixed criteria, which provide a means to calculate the amount of their fees and which vary in accordance with the amount of the secured liability (approximately 0.03% of the secured liability), although in transactions with an aggregate value over six million euros (€6,000,000), such fees may be reduced if negotiated with the notary.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

For security documents that need to be filed within a public registry, the expected elapsed time from the date the documents are notarised to the actual registration by the public registry is usually from two to six weeks. This timeframe is not mandatory by law and therefore largely depends on the public registry and the amount of work of such registry. Nevertheless, on occasion, public registries consider that necessary amendments need to be made to the relevant security document in order to comply with registration criteria, which may delay registration and increase the previously mentioned term.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Regulatory or other consents with respect to the creation of security over real property or machinery would apply only in very limited cases, depending on the exact location of the asset, its nature and the parties involved (e.g. mortgage over administrative concessions, which would require the approval by the relevant administrative body).

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no special priority or other concerns worth noting that arise as a direct consequence of the revolving nature of the financing.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

As explained in question 3.2 above, in Spain security interests are almost always notarised. To appear before a Spanish notary, all parties must be duly empowered (they can act under powers of attorney, which in case of foreign entities must bear an apostille in accordance with The Hague Convention or a legalisation from the relevant consulate or other competent body). The original power of attorney will need to be provided to the Spanish notary so that due capacity of the authorised representative is duly attested.

Signature in counterparts is not used in Spanish law-governed agreements. It is worth mentioning that all parties that are signatories to a Spanish notarial deed must have a Spanish Tax Identification Number (*Número de Identificación Fiscal* or "NIF"), even for non-resident parties and their non-resident attorneys (either individuals or entities), which must request such number before the Spanish Tax Authorities (*Agencia Tributaria*).

Additionally, the Spanish Anti-Money Laundering Law (*Ley 10/2010, de 28 de abril, de prevención del blanqueo de capitales y de la financiación del terrorismo*), requires certain disclosure obligations when executing transactions before a Spanish notary (with certain exceptions, such as those for listed companies or certain financial institutions). In particular, individuals executing a public deed before a notary on behalf of a company need to disclose the identity of the ultimate beneficial owner (*titular real*) of the company, which is:

- the ultimate shareholder or shareholders (individuals) of the company, in the event that a certain person holds (individually), directly or indirectly, a stake exceeding 25% in the share capital of this company; or
- the individual which directly or indirectly controls the management of such company (being understood as control the capacity to name more than half of the members of such management body).

In the event that no individuals hold such a direct or indirect stake or control, the directors/members of the management body of the company are to be regarded as the ultimate beneficial owners and need to be identified too by providing a copy of their passports.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Generally, Spanish law prohibits funds being provided (whether by way of loans, guarantees or any other kind of financial support made available before or after the acquisition) by a target company to a third party so that the third party is able to acquire the target company's shares or quotas, or by any other company in the group to which the target company belongs.

Financial assistance is currently prohibited in Spain for:

(a) *sociedades anónimas* (S.A.) (public limited companies): for their own shares or the shares of any direct or indirect parent company; and

(b) *sociedades de responsabilidad limitada* (S.L.) (private limited companies): for their own units and the units of any member of their corporate group.

This prohibition to give financial assistance includes assistance whether by provision of funds or by way of granting of loans, credits, guarantees, security or otherwise. The legal sanction is the nullity of the agreement and, if fraud can be evidenced, nullity of the agreements for the actual acquisition of the shares.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Spanish law does not recognise trusts as a legal concept. Therefore, security trustees, although used in transactions where foreign lenders are involved, are seldom used for a Spanish security package. Instead, lenders tend to appoint an agent for the Spanish security, which holds the security in its own name and on behalf of the other lenders.

It is possible for a security agent to enforce claims on behalf of the lenders and the other secured parties, as long as each party grants a notarised power of attorney in favour of the security agent. Such power of attorney must expressly authorise the security agent to carry out the enforcement proceedings on behalf of the lenders.

This system nevertheless has two issues: from a practical perspective: (i) Spanish banks are reluctant to grant powers of attorney to other banks, and prefer to appear themselves throughout the enforcement proceedings; and (ii) from a legal perspective, authors and case law are inconsistent regarding the role of an agent acting on behalf of a syndicate of lenders upon enforcement.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

As stated in question 5.1 above, the appointment of an agent for Spanish security is usual market practice for cross-border financings. The capacity of the agent to act on behalf of the rest of the parties will be evidenced by means of the due empowerment complying with all the relevant formalities.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Debt is traded through assignment (*cesión*) in Spain, and due to the accessory nature of security interests under Spanish law, any

assignment of a participation in a secured financing agreement would automatically entail the proportional assignment of the security interests granted to secure such assigned debt by virtue of article 1,528 of the Spanish Civil Code.

However, for certain types of collateral (mainly those acceding to registers such as mortgages and non-possessory pledges), in order to be effective against third parties, the assignment of the relevant collateral must be notarised and registered with the relevant public registry.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

In general, interest that Spanish borrowers pay for loans made to domestic lenders (other than financial institutions) is subject to 19% withholding tax in 2021. Likewise, interest income payable on loans made to non-EU tax residents is subject to 19% withholding tax, unless a lower rate applies under a tax treaty (treaty rates range between 0% and 15%) provided that the foreign treaty lender is the "beneficial owner" of the interest. Interest payments to EU residents and EU permanent establishments (except those residing in tax-haven jurisdictions) are not subject to withholding tax (irrespective of whether payments are made to a financial institution or a company) provided that the EU lender is the "beneficial owner" of the interest (please refer to the recent ECJ judgments, of 26 February 2019, on the Danish cases and their impact on the concept of "beneficial ownership", as they provide guidance on the interpretation of this concept).

Since 2012, under the Spanish Corporate Income Tax Act, there have been some limitations to the deductibility of financial expenses:

(a) Financial expenses derived from intergroup (under Section 42 of the Spanish Commercial Code) indebtedness are not tax-deductible if the funds are used to make capital contributions to other corporate group entities, or to acquire from other corporate group entities shares in other entities, unless the taxpayer proves there are valid economic reasons for doing so.
Overall, financial expenses deriving from indebtedness used for any other reason are fully deductible, unless anti-abuse clauses apply.
Additionally, interest paid for leveraged buy-out share acquisitions, where within four years following the acquisition, the acquired entity is included in the tax group of the acquirer or is merged with acquirer, is not tax-deductible unless the following requirements are met:
    - Indebtedness must be lower than 70% of the purchase price.
    - Indebtedness will be reduced proportionally in the eight years following the transaction by up to 30% of the mentioned price.

(b) Net financial expenses (financial expenses minus financial income) exceeding 30% of the operating profit for the financial year are not tax-deductible, with a minimum of €1 million deductible amount guaranteed. Net financial expenses that, by applying the 30% limit, are not tax-deductible, may be deductible in the following financial years without a time limitation. If the 30% limit is not reached, the difference may increase the applicable limit for the following five financial years.

(c) Interests paid on participative loans granted by another company, which is part of the same group of companies under Section 42 of the Spanish Commercial Code, are not tax-deductible.

Additionally to the limitations set above, financial expenses, arising from transactions carried out between related parties, are not tax-deductible when the interest paid is not taxed – or taxed at a nominal tax rate lower than 10% – because of a different characterisation of the financial instrument under local regulations (e.g. when those interest paid are considered as dividends under the lender's local regulations).

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Spain currently has more than 90 income tax treaties in force and a solid treaty network with Latin American countries that reduce or eliminate Spanish taxes payable to residents of treaty countries. In this sense, on 7 July 2017, Spain signed the OECD multilateral instrument, which modifies a large number of existing bilateral tax treaties by including anti-tax avoidance measures developed in the BEPS project.

These provisions could affect the tax treatment of interests paid by Spanish borrowers to foreign lenders but a case-by-case analysis should be carried out.

The main tax incentive is the Spanish international holding companies ("ETVEs") regime, a well-established legal framework that has helped Spain become one of the most favourable jurisdictions in the EU to channel and manage international investments. ETVEs can benefit from an exemption on inbound and outbound dividends and capital gains provided several requirements are met. Since ETVEs are Spanish regular entities, they are treated like regular limited liability companies, thus benefitting from tax treaties signed by Spain and from EU Directives.

Under Spanish law, no relevant additional taxes apply to foreign investors besides those applicable to Spanish investors.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

In general terms, lending or the granting of a security by a foreign lender to a Spanish company would not create a taxable presence (i.e. a permanent establishment) in Spain for a foreign lender.

Under current Spanish Corporate Income Tax regulations, interest paid to the lenders will not be subject to any withholding or deduction, provided that the lenders are lending entities or financial credit establishments entered on the special registries of the Bank of Spain and have their registered office in Spain, or entities resident in the European Union that have submitted certification of their tax residence provided that they are the "beneficial owners" of the interest (the "beneficial ownership" concept should be analysed in light of the criteria provided by the recent ECJ judgments on the Danish cases).

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

To be able to enforce any rights regarding third parties and benefit from summary proceedings (see question 7.3 below), a

loan, a guarantee or a security document must be notarised and eventually registered (depending on the asset).

For more detailed information on notarial and registry fees and stamp duty tax, please see question 3.9 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Most tax consequences do not differ as a result of the tax residency of the lender. Exceptionally, adverse tax consequences (documentation obligations and other anti-abuse measures) might arise when the lender is a tax resident in a tax-haven jurisdiction.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, courts in Spain recognise a foreign governing law in contracts in line with Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations ("Regulation Rome I").

Regulation Rome I has *erga omnes* effects. Hence, whatever it is, the foreign law chosen to govern a contract is enforceable, irrespective of whether or not it is an EU Member State.

Spanish Courts will certainly recognise a contract governed by foreign law; however, the choice of the parties will not avoid the application of *ius cogens* provisions of Spanish law that cannot be derogated by private agreement (public policy) between the parties such as those relating to consumers' interests, labour law and insurance or distribution contracts. Also, the content and validity of foreign law must be proved in the proceedings; if the foreign law is not proved, the court will resort to Spanish laws.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The following distinctions must be made: (i) judgments rendered by NY courts; (ii) judgments rendered by EU Member States' courts; and (iii) judgments rendered by UK courts.

First, regarding judgments by NY courts, Regulation Brussels I recast does not apply. In the absence of a multilateral or bilateral treaty between Spain and the United States addressing the matter, under Spanish Act 29/2015, on International Cooperation, final judgments rendered by US courts will have the same force as given in the US provided that they comply with the requirements for its recognition set forth in article 46 of the Act on International Cooperation (*inter alia*, the judgment does not infringe Spanish public policy, the defendant has been properly served with the originating process, the matter is not subject to Spanish exclusive jurisdiction for certain matters, or is not in contradiction with a previous Spanish judgment). Once the exequatur is granted, the judgment can be enforced according to the rules set forth in the Spanish Civil Procedure Act.

Second, regarding judgments by EU Member States' courts, Council Regulation (EC) No. 1215/2012 of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ("Regulation Brussels I recast"), establishes that a judgment rendered in an EU Member State is to be recognised without special proceedings in any other EU Member State, unless the recognition is contested. Under no circumstances can the merits of a foreign judgment be reviewed. A declaration that a foreign judgment is enforceable is to be issued following purely formal checks of the documents supplied.

However, a judgment will not be recognised if: (i) the recognition is manifestly contrary to public policy in the EU Member State in which recognition is sought; (ii) the defendant was not served with the document that instituted the proceedings in sufficient time and in such a way as to enable the defendant to arrange for his defence; (iii) it is irreconcilable with a judgment given in a dispute between the same parties in the EU Member State in which recognition is sought; (iv) it is irreconcilable with an earlier judgment given in another EU or non-EU country involving the same cause of action and the same parties; or (v) the judgment was adjudicated by a court lacking jurisdiction in case of exclusive jurisdiction.

Third, regarding judgments by UK courts, Regulation Brussels I recast (described above) applies to the enforcement of judgments rendered in proceedings brought before 31 December 2020 (Article 67(2) of the Brexit Withdrawal Agreement). For other judgments, currently the Hague Convention 2005 applies to the recognition and enforcement of UK judgments provided that the Convention's scope of application is met. We note that this scope excludes a number of subject matters in its Article 2(2) (including, without limitation, insolvency matters, wills and succession, family matters, claims for personal injury, carriage of passengers and goods, rights *in rem* in immovable property) and only covers judgments given by courts designated in an exclusive choice of court agreement.

Provided the Convention's requirements are met, the requested court shall not review the merits of the judgment and the grounds for refusal of recognition are limited in Article 9 of the Hague Convention: (i) agreement null and void; (ii) lack of capacity of a party; (iii) procedural irregularities (lack of notice); (iv) judgment obtained by fraud in connection with a matter of procedure; (v) incompatibility with public policy of the requested state; (vi) inconsistency with a judgment given in the requested state between the same parties; or (vii) inconsistency with an earlier judgment given in another state between the same parties and on the same cause of action.

Where the Hague Convention 2005 does not apply, enforcement may be requested in Spain based on the provisions of the Spanish Act on International Cooperation (addressed above).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

This depends primarily on whether the enforcement action is grounded on an executive title, such as public instruments (i.e. a public deed), or on an ordinary title, such as private contracts:

(a) Executive titles can be enforced directly, through summary proceedings, which consist of a swift procedure that should take between nine and 18 months. Otherwise, the

so-called ordinary proceedings, which inevitably lead to a decision which should be enforced through an enforcement proceeding, may take on average between 12 and 18 months plus the nine to 18 months of the enforcement proceeding.

(b) Enforcement of a UK court decision under the Hague Convention 2005 would require a previous (specific) exequatur procedure that would normally take between five and eight months. For UK court decisions outside of the Hague Convention 2005 scope, ordinary prior exequatur proceedings are required, which takes on average between seven and 10 months. Once the judgment has been recognised, enforcement will follow the same proceeding as explained in point (a) above. For NY court decisions, the same ordinary prior exequatur proceedings (seven to 10 months) followed by the same proceeding outlined in (a) would apply.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Enforcement of collateral security is typically carried out through a public auction (by means of an online auction), in the context of judicial or notarial proceedings. For notarial enforcements, see question 8.4 below. Additionally, the enforcement of pledges over credit rights may also be achieved through set-off or assignment of claims.

The rights derived from the relevant security can be judicially enforced either through declaratory civil proceedings or summary proceedings. The latter action is faster and more effective, while the former is costly and time-consuming. However, to start summary proceedings, certain requirements must be met, particularly the determination of the due and payable amount in accordance with the Civil Procedure Act.

Once the court has published a date for auction, the debtor will only be able to object under limited circumstances, such as the prior extinction of the pledge, full payment of the secured obligation, the existence of a material mistake or the existence of abusive clauses.

Concerning the enforcement of pledges over shares, the Financial Collateral Directive was transposed in Spain by means of Royal Decree Law 5/2005, which sets forth a speedy proceeding that applies to obligations of a "financial" nature and which permits direct appropriation of the collateral by the creditor where the financial agreement expressly states so.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Generally, there is no distinction between domestic and foreign entities when it comes to foreclosing Spanish security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Bankruptcy declaration triggers an automatic stay of one year (unless the debtor gets the approval of a composition agreement or files for liquidation earlier). This automatic stay concerns secured creditors with collateral over assets that are necessary to continue the ordinary course (except security interests subject to the special regime on financial collateral). Exceptionally, the above standstill period will not apply if the insolvency judge determines that the assets which constitute the object of security are not devoted to the business activity of the insolvent company, do not constitute a productive unit of such company or, eventually, such asset is not necessary for the continuation of the business operations.

During the stay, the bankruptcy officer may decide to treat the secured claim as an administrative expense (pre-deductible claims from the estate) in order to avert enforcement of the security interest.

This automatic stay can also apply if the debtor serves an article 583 notice, which enables the debtor to negotiate an out-of-court solution to financial distress in a four-month period. The stay of enforcement actions, which does not apply to public claims, lasts for a three- or four-month period (there are different criteria) and concerns assets that are necessary to continue the ordinary course. Yet any enforcement action conducted by holders of financial claims may be stayed if the debtor obtains a standstill supported by 51% of the financial claims. Security interests subject to the special regime on financial collateral escape this automatic stay in any event.

Lastly, if the secured creditor fails to enforce the security interest prior to liquidation (or reinitiate the formerly stayed enforcement proceeding as a result of bankruptcy declaration), it may lose control over the collateral if the liquidation plan sets forth the sale of the business unit as a going concern. In exchange for losing control to enforce the security interest on a stand-alone basis, secured creditors obtain a portion of the price equivalent to the weight of the collateral in the estate. If that percentage of the price is less than the value recognised in the proceeding for the security interest, secured lenders that did initiate the enforcement proceeding prior to bankruptcy declaration, but did not reinitiate it after the one-year automatic stay, such lenders have a veto right as to the approval of the liquidation plan, unless 75% in value of the secured claims from the same class (financial, labour, public, commercial) were to consent to it.

Lastly, the Civil Procedure Act provides the moratorium on enforcement on the grounds of criminal procedure may halt the enforcement and performance of such agreements until the criminal court issues a final resolution in such proceedings.

On another front, the Civil Procedure Act provides a moratorium on enforcement on the grounds of criminal procedure which may halt the enforcement and performance of such agreements until the criminal court issues a final resolution in such proceedings.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes, Spain has been a party to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention") since 1977, and it is therefore subject to recognition and enforcement of foreign arbitral awards in the terms established therein.

Given that Spain has not presented any reservations to the New York Convention, its proceedings are applied to the enforcement of all arbitral awards, including those rendered in countries that did not sign the convention. The Spanish Arbitration Act specifically establishes that the exequatur of foreign awards will be governed by: (i) the New York Convention, without prejudice to the provisions of other, more favourable international

treaties on the granting of foreign awards; and (ii) the proceedings established in the civil procedural system for judgments handed down by foreign courts.

Spanish courts will not re-examine the merits of the case. However, an arbitral award might not be recognised if certain requirements are not met (e.g. the arbitration agreement is not valid, irregularity in the composition of the arbitration authority or in the arbitral procedure, etc.). Furthermore, an award will not be recognised if the subject matter cannot be settled by arbitration in Spain or the recognition is contrary to the public policy of Spain.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy declaration triggers an automatic stay of one year (unless the debtor gets the approval of a composition agreement or files for liquidation earlier). This automatic stay concerns secured creditors with collateral over assets that are necessary to continue the ordinary course of business (except security interests subject to the special regime on financial collateral or relating to collateral located outside of Spain).

During the stay, the bankruptcy officer may decide to treat the secured claim as an administrative expense (pre-deductible claims from the estate) in order to avert enforcement of the security interest.

This automatic stay can also apply if the debtor serves a "583.1" notice, which enables the debtor to negotiate an out-of-court solution to financial distress in a four-month period. The stay of enforcement actions lasts for a three- or four-month period (there are different criteria) and concerns assets that are necessary to continue the ordinary course. Yet any enforcement action conducted by holders of financial claims may be stayed if the debtor obtains a standstill supported by 51% of the financial claims. Security interests, subject to the special regime on financial collateral, escape this automatic stay in any event. Besides, public claims cannot be affected in any way by a "583.1" notice.

Lastly, if the secured creditor fails to enforce prior to liquidation, it may lose control over the collateral concerning business units sales, in which case it would get a portion of the price equivalent to the weight of the collateral in the estate. Even secured creditors having enforced prior to liquidation may lose control over the collateral within the framework of business units sales, provided they receive a percentage of the price equivalent to the security interest value as recognised in the bankruptcy proceeding (otherwise, individual consent would be needed unless 75% of the secured claims from the same class sign off). The claim comprising the difference between the resulting price and the value of the secured claim (the deficiency claim) will be classified as unsecured.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Pursuant to compulsory priority rules, claims are divided into privileged, ordinary, and subordinated. Privileged claims, which are in turn divided into special privileged (secured) claims and general privileged claims (such as certain torts, tax, social security and employees' claims), are given preferential treatment over ordinary claims, which in turn have preference over subordinated claims. A controlling principle is the equal treatment of creditors from the same class.

Administrative expenses (*créditos contra la masa*) have a cash flow privilege over claims (*créditos concursales*). In contrast to administrative expenses, claims can only be settled pursuant to a plan of reorganisation or with the proceeds arising out of liquidation (either piecemeal or, preferably, as a going concern business). Having said that, secured creditors may auction or repossess the collateral to apply the proceeds thereof to settle their claims (over which administrative expenses have no priority).

Acts or transactions beyond the ordinary course of business entered into within two years prior to bankruptcy declaration may be subject to clawback, so long as: (i) the debtor does not receive reasonably equivalent value in exchange; or (ii) certain creditors are preferred to others when the company is currently insolvent (i.e. unable to regularly pay its debts as they come due). The hardening period in both cases is two years.

The law sets forth certain rebuttable and non-rebuttable presumptions of transactions that are detrimental to the estate. There are also certain safe harbours (namely acts and transactions done within the ordinary course of business, and certain ring-fenced out-of-court solutions).

Actual intent or fraud is not required to bring a clawback action successfully. Yet, in case of actual fraud the reach-back period is four years (and the action can be brought both within and aside from an insolvency proceeding). Moreover, fraud is a requirement to claw back security interests subject to the special regime on financial collateral.

Concerning acts or transactions subject to foreign law, the defendant may thwart the clawback action by proving that such act or transaction is ring-fenced under applicable law.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Governmental entities of any type (whether territorially based – such as national, regional, municipal authorities – or of a functional nature) are excluded from bankruptcy proceedings. However, companies directly or indirectly controlled by governmental entities are subject to general bankruptcy law.

Additionally, certain types of companies (such as insurance companies) are subject to specific insolvency regulations, although the composition, appointment and operation of the insolvency administration will still be regulated by general bankruptcy law.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes, out-of-court enforcement proceedings, available for certain types of security, are typically carried out by a Notary Public and take the form of a public auction. The terms and conditions of such auction are not entirely regulated in the law and hence they usually follow the provisions agreed by the parties in the relevant security documents. Absent a specific agreement, the Notary Public also tends to follow equivalent provisions applicable to judicial enforcements.

In the case of security over bank accounts or listed securities, particularly when the secured obligation consists of cash settlement agreements or derivative contracts, secured lenders may appropriate directly and immediately the secured assets (or offset), without conducting a public auction. Equally, certain regional laws (such as Catalonian law) expressly permit either private sales or, in the case of highly liquid security, appropriation by set-off.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The submission by the parties of an agreement to a foreign jurisdiction is valid, binding and enforceable in Spain:

(i) in the case of submission to the courts of an EU Member State: in accordance with the provisions on *prorogation of jurisdiction* contained in Regulation Brussels I recast (*supra* question 7.2), except in cases where the rules on exclusive jurisdiction of the Regulation are to be applied (in general, concerned with proceedings referred to: (a) *in rem* rights or tenancies in immovable property; (b) the validity of the constitution, nullity or dissolution of companies or other legal persons, or the validity of the decisions of their organs; (c) the validity of entries in public registers; (d) the registration of patents, trademarks, designs or other similar rights subject to deposit or registration; and (e) the enforcement of judgments);

(ii) in the case of submission to non-EU foreign courts covered by existing conventions in force in Spain: in accordance with the applicable international bilateral conventions (*ad ex*. Hague Convention of 30 June 2005 on Choice of Court Agreements currently applicable to exclusive choice-of-court agreements designating UK courts); and

(iii) in the case of submission to foreign courts not covered by conventions: in accordance with the Spanish Organic Law of the Judiciary, such submission would be valid, unless the exclusive jurisdiction of the Spanish courts is violated (in general, the same cases described *supra* in (i) (a) to (e), with regard to Regulation Brussels I recast).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Under Spanish law, the waiver of sovereign immunity (either of jurisdiction or of execution) by a foreign state is legally valid and enforceable. The waiver may be explicit (by means of an international agreement, a written contract or a declaration, or a written communication made within the proceedings to the relevant tribunal) or tacit (as a result of certain acts on the side of the foreign state), in accordance with Spanish Organic Law 16/2015 of 27 October 2015.

Absent the waiver of sovereign immunity, no asset owned or controlled by a foreign state and allocated to public and official (i.e., non-commercial) purposes can be seized or subject to enforcement proceedings in Spain. This includes assets: (a) used by the diplomatic missions or consular offices of the foreign state for the performance of their duties and functions (including bank accounts, with the exception of accounts exclusively used for commercial purposes); (b) used for military purposes; (c) of the central bank or similar monetary authority of the foreign state and used for the performance of their duties and functions; (d) forming part of the foreign state's cultural heritage or with scientific, cultural or historical interest (with the exception of assets offered for sale); and (e) official vessels and airships, exclusively attached to public services of a non-commercial nature.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There is no need for foreign or local lenders or agents under a syndicated facility to be resident, licensed, qualified or entitled to do business in Spain to execute or enforce any rights in Spain under any financing agreements or collateral agreements, provided that, in the case of foreign lenders (and where and if applicable), they are licensed, qualified or entitled to do business in their own jurisdiction of incorporation. Consequently, there is no material distinction between domestic and foreign creditors for the purposes of granting loans or security. Nevertheless, foreign lenders are still subject to some of the abovementioned formalities, such as the obligation to obtain a Spanish tax identification number (NIF) (as explained in question 3.13 above).

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

Despite COVID-19, the Spanish notaries have had the duty to continue to provide their services since their public office is deemed as an "essential" service due to the importance of their duties in Spanish economic activity; however, during the hard lockdown period, transactions to be formalised had to abide by the criteria of "safe" and "urgent".

Having said that, document execution and delivery requirements have not been affected by COVID-19 and we do not foresee substantial amendments to the execution process and formalities in the coming months.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Most of the relevant issues have already been covered in the previous questions. However, we take the opportunity to point out that the Spanish Companies Act sets out the conditions under which a Spanish company (whether in the form of a public limited liability company (*sociedad anónima*) or in the form of a private limited liability company (*sociedad de responsabilidad limitada*)) may issue and guarantee debt securities.

Because of recent amendments to such law, limited liability companies are now allowed (as opposed to the previous regulations in this regard) to issue and guarantee bonds and other securities that create or recognise debt, except for convertible instruments (i.e., securities which can be converted into equity).

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The debt capital markets in Sweden have been very strong during the last couple of years. The local banks remain strong and international banks and financial institutions are showing increasing interest in doing business in Sweden. Competition among lenders is fairly intense as many Swedish blue chip companies have limited need for debt funding due to strong balance sheets and plenty of liquidity. Another development that has increased the competition among debt providers is the development of a substantial and growing Swedish bond market where bonds are issued under local law documentation. Debt funds have also entered the market, primarily within leveraged finance and real estate finance.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

The general rule under Swedish law is that a limited company (*Sw. Aktiebolag*) is free to guarantee the obligations of one or more other members of its corporate group, subject to certain restrictions described below under questions 2.2 and 4.1.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

A guarantee or security interest granted by a limited company may be invalid and unenforceable if the transaction reduces the company's net worth and cannot be commercially justified (i.e., lacking sufficient corporate benefit). Such a transaction is considered to be a value transfer under Swedish law. A value transfer may only take place if the company's restricted equity is fully covered after the transfer and the transfer can be justified in light of any additional funding requirements that might follow from the company's nature of business as well as the company's consolidation requirements, liquidity and financial position in general. In some situations, all shareholders may need to approve the transaction. The transaction will be considered to be an unlawful value transfer if these requirements are not fulfilled.

In the event of an unlawful value transfer, the recipient of such transfer must return what he or she has received if the company shows that the recipient knew or ought to have realised that the transaction constituted a value transfer from the company. If a deficiency arises when restitution is made as described above, then those involved in the decision to make the value transfer will be liable for such shortfall. The same applies to those involved in implementing the value transfer. A director can therefore be held responsible for any losses incurred by the company as a result of guarantees and security interests being issued or granted without sufficient benefit for the issuing company.

Granting guarantees and security for wholly owned subsidiaries is typically considered to be commercially justified and therefore not subject to the value transfer restrictions referred to above. However, upstream and cross-stream guarantees and security interests, as well as guarantees and security interests for subsidiaries that are not wholly owned, are sensitive and may not be considered to be commercially justified. The value transfer restrictions may therefore be relevant in case of such guarantees and security interests.

2.3 Is lack of corporate power an issue?

Lack of corporate power is generally not an issue when Swedish companies enter into financing arrangements.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental or other consents or filings are required in order for a Swedish limited liability company to provide guarantees or grant security interests. Shareholder approval is generally not formally required for granting guarantees and security interests, but may sometimes be advisable.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

As further described in question 2.2 above, the granting of guarantees and security interests may in certain situations be deemed to constitute value transfers and is as such only allowed if the company's restricted equity is fully covered after the value transfer and the transfer can be justified in light of any additional funding requirements that might follow from the company's nature of business, as well as the company's consolidation requirements, liquidity and financial position in general.

Guarantees and security interests granted by an insolvent Swedish company will be subject to clawback risk should the company enter into bankruptcy within certain hardening periods. Any director of an insolvent company that gives preferential treatment to certain creditors of the insolvent company may be held criminally liable as well as liable to pay damages.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Sweden has no exchange control provisions or similar obstacles restricting the enforcement of a guarantee issued by a Swedish limited company.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are a number of different types of collateral and security interests that can be made available under Swedish law. The most common security interest under Swedish law is the pledge. Under Swedish law, as a general rule, any property or asset can be validly pledged.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Swedish law does not recognise the concept of a general security agreement covering all or almost all of the assets of a security provider. Instead, the starting point is that separate security agreements must be entered into in respect of separate assets or separate classes of assets.

Notwithstanding the above, it is possible to grant security over different assets and different types of assets by way of one single security agreement. However, this is often rather impractical, as different perfection and enforcement requirements often apply for different types of assets, which makes all-inclusive security agreements rather extensive and burdensome to draft and apply.

The most common way to take security over assets in general is by way of a floating charge, in accordance with the Floating Charges Act. As described in question 3.9 below, floating charges may be subject to stamp duty.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

The primary means of taking security over real property (i.e., land and buildings and other fixtures thereon) is by way of real estate mortgages. However, such real estate mortgages may, as described in question 3.9 below, be subject to stamp duty, so alternative security arrangements such as share pledges over ring-fenced property companies are also common.

Certain equipment and machinery that is more or less permanently incorporated into a real property can, subject to the prevailing circumstances, be either included in the real property (and thus covered by a real estate mortgage) or be considered as assets that are separated from the real property and therefore can be subject to other security arrangements besides a real estate mortgage.

Collateral can be taken over machinery in a variety of different ways depending on the type of machinery. Machines that are movable goods can be pledged as collateral, but this requires that the movable goods are handed over to the pledgee or to a third party representing the pledgee. If the security provider needs to continue to use the machinery, then a so-called chattel sale (*Sw. lösöreköpsregistrering*) can be made whereby a perfected security interest is created by way of a public announcement followed by a registration with the Swedish Enforcement Authority (*Sw. Kronofogdemyndigheten*). An alternative way to take security over movable goods is to instead issue a floating charge as further described in question 3.2 above.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security can be taken over receivables and such security is established through a notification of the debtor under the receivable that is subject to such security arrangement. In order for the security interest to be perfected, all payments under the receivables must – as a general rule – be paid to the secured party or to a representative of the secured party. This can sometimes be commercially sensitive as well as administratively onerous at least as regards account receivables. It is therefore quite common with delayed perfection so that the notification of the debtor and the redirection of payments are only made following a certain credit event relating to the security provider.

It should be noted that relying on delayed perfection (in respect of receivables as well as any other security interests) stands the risk of clawback during certain hardening periods should the security provider file for bankruptcy shortly after the completion of delayed perfection. An alternative way to take security over receivables is instead to issue a floating charge as further described in question 3.2 above.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Security can be granted over cash deposited in bank accounts. Such security is granted by way of the bank account being pledged to the secured party. It should be noted that Swedish law contains very strict perfection requirements regarding bank account pledges. In order for the pledge to be perfected and enforceable, the pledgor must be deprived of all disposal rights to the bank account. Bank account pledges are therefore not suitable for bank accounts used in the day-to-day activities of the pledgor.

Due to the restrictions set out above, the standard approach in Sweden is to take security over deposit accounts rather than current accounts used for daily business. To the extent that current accounts are pledged, it is common to use delayed perfection arrangements so that the pledgor is only deprived of its disposal rights over the pledged current account following certain credit events. As mentioned above, these types of arrangements stand the risk of clawback during certain hardening periods in case the security provider subsequently enters into bankruptcy proceedings. If the account bank is also the lender, then the right to set-off in insolvency may mitigate the clawback risk.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Security over shares is one of the most common security interests in Sweden and is established through a pledge agreement.

The perfection requirements for a share pledge depend on whether the shares are represented by physical share certificates or if the shares are dematerialised (i.e., in register form). Physical share certificates must be handed over to the secured party or to a third party representing the secured party, whereas dematerialised shares are generally pledged via account entries with the Central Securities Depository as further set out in the Swedish Financial Instruments (Accounts) Act. If the dematerialised shares are held on a custody account, security over the shares is perfected by notifying the custodian appointed in respect of the custody account.

A share pledge agreement in respect of shares in a Swedish limited company does not have to be governed by Swedish law and can, for example, be governed by English or New York law. However, Swedish law would nevertheless as a general rule still apply in respect of perfection requirements. Furthermore, Swedish law contains certain mandatory duty of care provisions that are aimed at protecting a pledgor, for example, in connection with a security enforcement. It is therefore advisable that the share pledge agreement is governed by Swedish law and this is also the prevailing market standard.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

As mentioned above under question 3.1, any property or asset can be validly pledged as long as it meets certain criteria. However, in order for an inventory pledge to be perfected and enforceable, the pledgor cannot remain in the possession of the pledged inventory. Inventory pledges are therefore very impractical. A more common way to take security over a floating asset base such as inventory is instead to issue a floating charge as further described in question 3.2 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, please see above under questions 2.1 and 2.2 and below under section 4 for further details. The restrictions described above in respect of granting of guarantees also apply to the granting of security.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

No notarisation or registration costs, stamp duties or other fees are payable in relation to the granting of security over receivables and shares.

An application for new real estate mortgages is subject to a stamp duty of two (2) per cent, payable on the face value of such new real estate mortgages. Existing real estate mortgages can, however, be re-pledged an infinite number of times without incurring any additional stamp duty.

An application for new floating charges is subject to a stamp duty of one (1) per cent, payable on the face value of such new floating charges. As with real estate mortgages, existing floating charges can also be re-pledged an infinite number of times without incurring any additional stamp duty.

Finally, it should be noted that minor application fees are payable when applying for new real estate mortgage or floating charges, as well as when applying for a chattel sale or security over certain intellectual property to be registered.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Most security interests can also be established more or less immediately and there are no significant costs for granting security other than the stamp duty referred to in question 3.9 above.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

There are no such consents required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

There are no such requirements.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

The restrictions on financial assistance are set out in the Swedish Companies Act. According to the Companies Act, a Swedish limited company may not pay an advance, grant loans or provide security for loans to a borrower (or certain affiliates to such borrower) for the purpose of funding such borrower's acquisition of shares in the company or any parent company in the same group as the company granting the financial assistance.

A Swedish limited company can therefore not support borrowings incurred for the purposes of (a) and (b) in the question above. As regards (c), there is some uncertainty under Swedish law. It is clear that the intention of the legislator has been that such financial assistance shall be forbidden, but the relevant provisions of the Companies Act seem to indicate otherwise. Great caution should therefore be exercised when considering such transactions.

It should be noted that Swedish law provides for some opportunities to grant financial assistance after the completion of an acquisition. Furthermore, there is a regime in the Companies Act whereby exemptions can be granted for otherwise unlawful financial assistance. Finally, the financial assistance prohibition may be restricted to acquisition of parent entities within the same Swedish group, so each situation needs to be carefully analysed.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Lenders may appoint a facility and/or security agent to represent them in all matters relating to the finance documents as well as any security interests. Such agents are allowed to enforce any rights that the lenders might have under the finance documents. Furthermore, the agent may enforce any collateral security and apply the proceeds from such enforcement in order to satisfy the secured claims of the lenders. As it is uncertain if foreign law trusts would be recognised under Swedish law, it is advisable that such representatives are also appointed to act as agents.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Please see question 5.1 above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

A transfer of a loan is perfected and made valid and enforceable against third parties by way of notification of the debtor under the loan that is being transferred.

A guarantee in respect of a loan obligation will continue to apply and may be called upon by any new lender that has validly acquired the loan that is being guaranteed. The guarantor is sometimes notified of the loan transfer in order to avoid the guarantor fulfilling its guarantee obligation by way of payments to the initial holder of the loans.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

The main principle is that Swedish law neither contains any obligation to withhold tax as regards interest payable on loans made to a domestic lender or foreign lender, nor any withholding on proceeds of a claim under a guarantee or the proceeds following from an enforcement of security interests.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No tax incentives are provided preferentially to foreign lenders.

No taxes apply to foreign lenders provided that such foreign lenders do not have any permanent establishment in Sweden with which the income from the loan, guarantee or security interest is effectively connected.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No, provided that such foreign lender does not have any permanent establishment in Sweden with which the income from the loan, guarantee or security interest is effectively connected.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No. Please see question 3.9 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are no adverse consequences for a Swedish borrower if some or all of the lenders are non-Swedish, as long as such loans are made on market terms and are not made between related parties.

Swedish legislation does not contain any thin capitalisation rules. However, Swedish legislation does contain interest deduction restriction rules on intra-group loan structures including back-to-back structures involving third-party lenders (e.g., banks). These rules apply both for loan structures involving only Swedish companies as well as loan structures involving both Swedish and non-Swedish companies.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The application of foreign law is recognised by Swedish courts, except to the extent that provisions in foreign law are contrary to the *ordre public* (i.e., such provisions that are inconsistent with fundamental principles of the legal system in Sweden). A Swedish court may enforce foreign law contracts if it has jurisdiction.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A final and conclusive judgment rendered by a federal or state court located in the State of New York would in principle neither be recognised nor enforceable in Sweden as a matter of right without a retrial on the merits (but will be of some persuasive authority as a matter of evidence before the courts of Sweden

or other public authorities). However, according to Swedish Supreme Court case law, judgments (i) that are based on a jurisdiction clause (the Swedish court may assess whether the jurisdiction clause validly appoints the foreign court), (ii) that were rendered under observance of due process, (iii) against which there lies no further appeal, and (iv) the recognition of which would not manifestly contravene fundamental principles of the legal policy of Sweden, can under certain circumstances form the basis for an identical Swedish judgment without a retrial on the merits.

A final, conclusive and enforceable judgment given by an English court would – pursuant and subject to the provisions of the Hague Convention of 30 June 2005 on Choice of Court Agreements (the "Hague Convention") – be recognised and enforceable in Sweden. The Hague Convention only applies in international cases to exclusive choice of court agreements concluded in civil or commercial matters. In order to enforce a judgment under the Hague Convention in Sweden, the concerned party must submit an application for enforcement (*Sw. exekvatur*) to the relevant Swedish district court (*Sw. tingsrätt*) and comply with the procedures of that court (as required).

A judgment rendered by an English court and which would not fulfil the requirements under the Hague Convention would not be recognised or enforceable in Sweden as a matter of right without a retrial on the merits.

Finally, it should be noted that Sweden has acceded to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York, 1958 (the "New York Convention"). A final and conclusive arbitral award, which is enforceable in England or New York and has been duly served on the relevant party, rendered by an arbitral tribunal in England or New York, will be recognised and enforceable by the courts of Sweden, according and subject to the New York Convention and the Swedish Arbitration Act (*Sw. lag (1999:116) om skiljeförfarande*). In order to enforce an arbitral award under the New York Convention in Sweden, the concerned party must submit an application for enforcement (*Sw. exekvatur*) to Svea Court of Appeal (*Sw. Svea hovrätt*) and comply with the procedures of that court (as required).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

If the company in payment default has no legal defence, the time from filing a suit to obtaining a judgment is about two to six months. The judgment can, upon application, be enforced by the Enforcement Authority more or less immediately if delay places the applicant's claim at risk and the judgment debtor does not apply for refusal of enforcement with the designated district court. The application for enforcement (*Sw. exekvatur*) of a foreign judgment or an arbitral award normally takes approximately three to six months.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

If the pledge agreement has an enforcement clause, the creditor is free to enforce the collateral according to the regime set out in such enforcement clause. Otherwise, the creditor may seek enforcement (assuming he has a title of execution) with the Swedish Enforcement Authority. The procedure is governed by the Enforcement Execution Act.

Notwithstanding the above, certain security interests, such as, for example, real estate mortgages and floating charges, can only be enforced through the Swedish Enforcement Authority.

There is a general duty of care obligation under Swedish law whereby a secured party must also look after the interests of the security provider when enforcing security interests. Any excess amounts following such enforcement must also be accounted for and paid out to the security provider.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

If required by an EU or EFTA defendant (i.e., including a Swedish defendant), a foreign plaintiff not domiciled in an EU or EFTA country must furnish security for the legal costs that he might be obliged to pay as a result of the proceedings. By virtue of several multilateral treaties to which Sweden is a party, plaintiffs of a large number of countries have been relieved from the obligation to furnish security.

There are no restrictions for foreign lenders in the event of foreclosure on collateral security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes. Please see question 8.1 below.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Foreign awards based on an arbitration agreement are recognised and enforced in Sweden. In 1972, Sweden ratified the New York Convention without reservation. Its provisions have been incorporated into Swedish law by the Swedish Arbitration Act. Please see questions 7.2 and 7.3 for further information.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Following a bankruptcy order, no independent enforcement is, as a general rule, available for secured creditors. However, a creditor that has a valid and perfected possessory pledge (*Sw. handpanträtt*) may sell such collateral at a public auction, subject to such auction not occurring earlier than four weeks after the meeting for administration of oaths. Such creditor must also give the administrator the opportunity to redeem the collateral to the bankruptcy estate.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The Swedish Bankruptcy Act states that certain transactions can be made subject to clawback, and thus be recovered to a

bankruptcy estate. There are several different circumstances that might give rise to such recovery.

There is a general right to clawback addressing *improper transactions* whereby: a creditor has been preferentially treated; the assets of the debtor have been withheld or disposed of to the detriment of the debtor's creditors in general; or the debtor's total indebtedness has been increased. Such transactions can be recovered if the debtor was insolvent, or became insolvent as a result of the transaction, and the benefitting party was aware, or should have been aware, of the debtor's insolvency and the circumstances making the transaction improper. An improper transaction is subject to a five-year hardening period, and a transaction made more than five years prior to the bankruptcy may only be recovered if the transaction was made to a party closely related to the debtor (e.g., a person who has a substantial joint interest with the debtor based on entitlement to a share or financial interest equivalent thereto, or who through a management position has a decisive influence on the business operations conducted by the debtor).

In addition to the general principle of recovery, there are a number of recovery rules addressing specific types of transactions (e.g., gifts, payment of wages, payment of debts, granting of guarantees or granting of security interests). The majority of the specific rules differ from the general recovery rule in that they do not require the debtor to be insolvent or the benefitting party to have any knowledge of the debtor's insolvency. Furthermore, the hardening periods vary depending on the type of transaction and range between three months and three years.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

No. All natural persons and legal entities may be subject to bankruptcy proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes. A creditor that has a title of execution (e.g., judgment, an arbitral award or a summary decision under the Summary Proceedings Act) can seek enforcement with the Swedish Enforcement Authority. The procedure is governed by the Enforcement Execution Act. A decision by the Enforcement Authority may be appealed to the district court.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes. Swedish law permits that parties agree between themselves to have their disputes adjudicated outside Sweden. The parties are free to choose the forum. If the agreement is exclusive it will divest the Swedish court of jurisdiction, at least if a foreign court is willing to hear the case. Where one party is a weaker party, e.g. an employee or a consumer, a jurisdiction clause (i.e., an agreement on the forum) that limits such party's access to Swedish courts will be disregarded, at least if the submission to foreign jurisdiction leads to the application of a foreign law that is less favourable to the employee or the consumer (than Swedish law).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes. It is, for example, generally accepted under Swedish law that a valid arbitration clause constitutes a waiver of sovereign immunity.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Granting of credit to a company (i.e., not to a consumer) does not in itself require a licence or authorisation under Swedish law, but this may be required in case the lender conducts other types of financial activities as well. A Swedish lender might – even if no licence or authorisation is required – be obliged to notify its activities to the Swedish Financial Supervisory Authority pursuant to the Currency Exchange and Other Financial Operations Act (the "Financial Operations Act") and may thereby be subject to certain limited supervision, e.g. in the form of ownership assessments. The Financial Operations Act does not apply to non-Swedish entities granting credit to Swedish companies.

There is no specific Swedish regulation applicable to agents or security agents.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

There have been no changes to formalities as a direct consequence of the COVID-19 pandemic. However, there have been some developments in relation to electronic signatures, where, for example, the Swedish Companies Registration Office must accept certain advanced electronic signatures. As a consequence of the pandemic and for practical reasons, many financing agreements are today signed by way of electronic signatures.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The key legal issues to be considered when lending to Swedish entities, and taking security over Swedish assets, have been addressed above.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

2021 has been driven by the COVID-19 pandemic and a state-backed credit support programme for Swiss companies implemented by a Swiss bank-driven initiative. M&A activities remained a driver for financing transactions, but deal values were generally lower than in previous years. The market saw several COVID-19-related restructuring transactions. Further, negative interest rates and the change from LIBOR to other interest rates kept market participants busy.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Many transactions and, in particular, deal values remain confidential. The most prominent transaction published in 2021 was the CHF 1.5 billion COVID-19-related and state-backed credit package for Switzerland's national aviation group "Swiss".

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

A company can guarantee borrowings of one or more other members of its corporate group. In case such other member of its corporate group is a direct or indirect shareholder of the guarantor or a subsidiary of such shareholder (i.e. a sister company of the security provider), the financial assistance restrictions described under question 4.1 apply.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

If the guarantee/security is not at arm's length, the financial assistance restrictions described under question 4.1 apply unless the guarantee/security is granted to a fully owned (direct or indirect) subsidiary of the guarantor/security provider. If such restrictions are not incorporated into the guarantee/security agreement, directors are exposed to liability risks. The law is not settled and there is only a limited set of precedents in relation to the enforceability of such a guarantee/security.

2.3 Is lack of corporate power an issue?

Yes, the law is not settled and there is only a limited set of precedents in this regard (see questions 2.2 and 4.1).

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental or other consents or filings or other formalities are required except that, in practice, shareholder approval is sought in case of guarantees that require financial assistance restrictions because they are granted for the benefit of other members of the guarantor's corporate group that are either (direct or indirect) shareholders of the guarantor or subsidiaries of such shareholder.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Except for the financial assistance restrictions described under question 4.1, no such limitations are imposed on the amount of a guarantee. However, the directors of a Swiss company risk liability if a company prefers some creditors over others in case of a near insolvency or bankruptcy situation. This has the factual consequence that a company will not pay a guarantee if its directors determine that insolvency/bankruptcy cannot be avoided. In such scenario, guarantee claims will have to be filed with the bankruptcy or similar administration.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Currently, there are no exchange control or similar obstacles in Switzerland.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Typical collateral to secure lending obligations are pledges or transfer of ownership (for security purposes) of certain assets

such as shares, cash, intellectual property or real estate, as well as security assignments of certain receivables.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Certain types of security interests (e.g. pledges or security transfers) may only apply to a specific class of asset and, therefore, it is rarely possible under Swiss law to cover all the types of assets that an entity may hold under one single security agreement. In theory, this would be possible if a company only held assets over which a single security interest can be taken. However, even in this case the general security agreement must cover different perfection requirements that may apply to various types of assets, which would defeat the purpose of facilitating the procedure of taking security over multiple assets in a single agreement. Consequently, it is standard practice in Switzerland to use separate agreements for each type of asset.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Real property – land

Collateral over land is possible under Swiss law. For the purpose of securing lending obligations, the common forms used to create such collateral are either a security transfer of mortgage notes (*Schuldbriefe*) or a land charge (*Grundpfandverschreibung*).

Security transfer of mortgage notes

Mortgage notes are financial instruments representing a personal claim against the debtor that is secured by a pledge on real property. Mortgage notes exist in the form of bearer or registered certificates or in paperless forms.

Instead of a security transfer, it is also possible to pledge mortgage notes. However, practitioners generally prefer a security transfer of legal title over the creation of a pledge. The advantage of the former is the transfer of legal title of the mortgage notes will not become part of the debtor's bankruptcy estate.

In order to create a real estate security based on mortgage notes, such notes – if not already issued – must first be created, which requires a notarial deed. The parties then enter into a written security transfer or pledge agreement and transfer the legal title of the mortgage notes, either by transfer of possession in the case of paper mortgage notes, or registration of the transfer in the land register in the case of paperless (registered) notes.

Land charge

A land charge is a mortgage that is entered into the land register and secures any kind of claim, whether actual, future or contingent. Other than in the case of mortgage notes, the secured claim is not entered in the land register and neither the land charge nor the secured claim is evidenced in the form of a negotiable instrument. For certain reasons, the land charge is less commonly used than mortgage notes. To grant security in the form of a land charge, the parties must enter into an agreement regarding the creation of the land charge in the form of a notarial deed and file this deed with the land register. Once the land register has registered the land charge, the security is created.

Real property – plant

As a matter of principle under Swiss property law, structures become part of the land on which they are built. An exemption from this principle is an independent building right with a duration of at least 30 years, which can be established on land for the purpose of building a structure such as a plant. In this case, Swiss law recognises the building right as a real property in its own right. In either case, a mortgage security over a land or a building right where the plant has or will be built is possible and follows the same principles and procedures as laid out above (see Real Property – Land).

Machinery and equipment

It is possible to grant a pledge over movable assets such as machinery and equipment. However, since Swiss law does not recognise the concept of a floating charge, taking security over machinery or equipment is impractical and rarely pursued in a lending transaction.

A security over machinery or equipment can be created by a pledge or a security transfer of legal title in the machinery or equipment. These security interests entitle the pledgee or transferee to liquidate the machinery or equipment in case of enforcement. Unless specific rules apply in relation to certain types of movable assets, perfection of a pledge over movable assets requires the transfer of physical possession of such asset. The security is only established once the pledgor gives up its possession over the relevant assets and is no longer in the position to exercise independent possession rights. This makes it impossible to grant security over machinery and equipment while allowing the pledgor to make use of such assets.

An exception applies to certain types of movable assets, which are subject to specific laws. Most importantly, security over aircraft, ships and railroads is perfected by the entry of the security in the respective public register (such registration replaces the requirement to transfer possession).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables can generally be taken in the form of a pledge or assignment. However, in either case, the prerequisite for creating such security is the assignability of the receivables. This means that the assignability of the receivables must not be prohibited by applicable laws or excluded by contract or by the personal nature of the receivable (e.g. family law claims, but according to Swiss case law there are also receivables where the personal nature is less evident). If the assignability is restricted in an underlying contract, it is common to request the assignor to seek a waiver of such restriction from the debtor.

The steps to perfect a pledge or assignment of receivables are as follows:

- The pledge or assignment of receivables requires a valid security agreement in written form, and in the case of assignment, a written declaration of assignment by the assignor (which in practice is part of the security agreement).
- Existing written acknowledgments of debts representing the pledged or assigned claim must be handed over to the pledgee or assignee.

The notification of debtors is generally not a requirement to perfect the pledge or assignment except where a waiver of a restriction of the assignability in an underlying contract has to be obtained or where a second-ranking pledge over receivables is created. However, as long as a notification to a debtor has not been made, a debtor may in good faith pay its debt to the assignor without becoming liable to the assignee. Therefore, it is market standard in Swiss security assignment agreements to include an obligation to notify debtors at the time of signing of the assignment agreement or as soon as possible thereafter. Debtors of

trade receivables, however, are generally only notified after the occurrence of an event of default in order not to prejudice the legitimate business interests of the security provider.

Even though the notification of the debtor is in most cases not a requirement to perfect a security over receivables, a pledgee or assignee must be entitled to notify debtors at any time, i.e. even before an enforcement event. If such right is not granted to the assignee, the pledge or assignment for security purposes may be qualified as a conditional security interest that only arises once the secured party has notified the debtor.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Security over cash accounts can be taken in the form of a pledge or a security assignment. Cash deposits held in bank accounts are treated as claims of the beneficiary against the bank. Therefore, the creation of security over cash deposits is based on the same principles and procedures that apply to security over claims and receivables. In case of a pledge over a cash account, the bank should always be notified. The Swiss bank's general business terms usually provide for a first-ranking security interest over the bank account. A third party therefore obtains a second-ranking security interest over a Swiss bank account only, unless the bank waives its priority rights. To create and perfect such second-ranking security interest, the bank as first ranking pledgee must be given notice.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

It is possible to create a security interest over shares of a Swiss company, the most common form to take such security being a pledge (even though a security transfer of title or security assignment may also be possible in certain cases). Swiss law does not mandatorily require a Swiss company to issue share certificates. Thus, shares of Swiss stock corporations may or may not be in certificated form, which may affect the procedure to perfect a share pledge:

- Irrespective of whether share certificates have been issued, creation of a valid security interest over shares requires a valid written security agreement.
- If shares are certificated, the share pledge must be perfected by transferring the original share certificates to the pledgor. In case of registered shares (*Namenaktien*), which have become the common form of shares in Swiss stock corporations, the share certificates must be endorsed in blank.
- Uncertificated shares must be pledged, transferred or assigned in writing.

A security over shares over a Swiss company governed by New York or English law is possible but not recommended. Such security would give rise to conflict of law issues and may not be valid *vis-à-vis* a third party, which may impede an effective enforcement in Switzerland.

The Federal Intermediated Security Act ("**FISA**") sets out rules on how intermediated securities are granted. Under the FISA, a security interest over intermediated security can be created by either transferring or crediting such securities to the securities account of the secured party. Alternatively, the security over intermediated security can be granted by an agreement between the security provider and the intermediary (a so-called control agreement) setting forth an irrevocable requirement for the intermediary to comply with instructions from the secured party only.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over inventory can be taken in the same manner as in the case for security over movable assets or machinery or equipment (please see question 3.3 above). In the absence of a floating charge concept in Switzerland, a security over inventory is possible but impractical.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A company can grant a security interest to secure its own obligations under a credit facility as well as obligations of a third party, such as another borrower or guarantor. In case such third party is a direct or indirect shareholder of the security provider or a subsidiary of such shareholder (i.e. a sister company of the security provider), the financial assistance restrictions described under question 4.1 apply.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Most common forms of Swiss collateral such as share or bank account pledges or security assignments are not subject to notarisation or registration requirements. Therefore, no notarisation or registration fees apply to these types of collateral. If security is granted over real property, notaries' fees, registration fees (for the land register) as well as cantonal and communal stamp duties may be payable depending on the location of the real estate and the transaction value.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

In the limited cases where a notification or registration is advisable, it is not time-consuming and can be achieved within a couple of days. In case of a mortgage over real property, however, the notarisation and entry into the land register may take longer.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Except for security granted over certain assets of regulated entities, there are generally no regulatory consents required with respect to the creation of security.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no special priority or other concerns due to the fact that borrowings under a revolving credit facility are secured.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In case of a mortgage, the issuance of mortgage notes or the entry or establishment of a land charge must be notarised.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company
In general, the provision of a guarantee or other security by a Swiss company for the benefit of a direct or indirect shareholder of the guarantor/security provider ("up-stream") or a subsidiary of such shareholder (i.e. a sister company of the security provider, "cross-stream"), is subject to financial assistance restrictions. The law is not settled in this regard and there is only a limited set of precedents in relation to this matter. In practice, the company's articles of association are amended to explicitly allow such guarantees/securities and the guarantor's/security provider's liability is limited contractually to its freely distributable reserves, i.e. to an amount that could also be distributed as a dividend to its shareholders. Further, board and shareholders resolutions are sought in relation to the entry into such a guarantee/security arrangement.

(b) Shares of any company which directly or indirectly owns shares in the company
Please refer to the answer under (a).

(c) Shares in a sister subsidiary
Please refer to the answer under (a).

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

To enforce lenders' rights under loan documents, the concept of an agent is recognised in Switzerland. The appointment of an agent is frequently used in syndicated facilities governed by foreign law where Swiss parties are involved.

It is not possible to set up trusts under Swiss law in the absence of a substantive trust law. Foreign trusts, however, are recognised in Switzerland since the Swiss Private the Swiss Private International Law Act ("**PILA**") transposes certain provision of the Hague Convention on the Law Applicable to Trusts and on their Recognition (Hague Trust Convention), which is applicable in Switzerland. Subject to the conditions of PILA and the Hague Trust Convention, a decision by a foreign court on trust-related matters is recognised.

Whether a security agent or security trustee can enforce its rights in respect of a Swiss law-governed security interest depends on the nature of such security interest:

- Swiss law pledges are subject to the principle of accessority (*Akzessorietätsprinzip*), which means that the creditor of the secured claims and the pledgee must be identical. Consequently, the pledge cannot be granted to a third party as pledge holder. The pledge can be granted to numerous creditors, i.e. to lenders as a group under a syndicated financing. However, due to frequent changes of lenders and since involvement of all lenders in the procedure of perfecting or enforcing a pledge is not practical, it is possible that a lender as a secured party is represented by a third party acting as security agent as direct representative in the name and on account of each lender.
- Accessority does not apply to security assignments or security transfers. For these types of collateral, the security agent or security trustee can hold the assigned claims or transferred rights in its own name and on account of itself and the other secured parties.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

The concepts of agents and foreign trustees are recognised in Switzerland.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

There are no special requirements. The transfer is possible and can be effected by way of assignment (to which the guarantor usually gives consent in advance under the loan documents).

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

With regard to a deduction or withholding taxes on interest payments, interest paid on loans extended to a Swiss borrower are generally not subject to Swiss withholding tax. However, withholding tax applies to interest payments on bonds (at a rate of 35%). According to guidelines of the Swiss tax authorities, a loan is considered a bond if either the aggregate number of non-bank lenders (including sub-participations) exceeds 10 under financing arrangements with identical terms, or if the aggregate number of non-bank lenders of a Swiss borrower exceeds 20. Against this background, transfer restrictions and other Swiss 10/20 non-bank rules-related language must be incorporated into the relevant loan document.

The restrictions may under certain circumstances also apply if a Swiss company does not act as borrower but solely as guarantor or security provider. A guarantee or security for the benefit of a foreign borrowing subsidiary – i.e. a guarantee by a Swiss company of a downstream nature – may trigger Swiss interest withholding tax on bonds or debentures in respect of interest payments by the foreign borrowing subsidiary. This may be the case if a Swiss guarantor uses the proceeds directly or indirectly in Switzerland and has more than 10 non-bank lenders in a facility with identical terms or more than 20 non-bank lenders under all its credit facilities in total.

The granting or taking of security between related party can be seen at arm's length if the security provider is paid an appropriate guarantee fee. If an up- or cross-stream guarantee that is not granted on arm's-length terms is enforced, the difference between the consideration granted by the affiliate to the Swiss security provider (if any) and an arm's-length consideration may constitute a hidden dividend distribution on which Swiss withholding tax (currently 35%) is payable. Further, in case such up- or cross-stream guarantee is enforced, any amount recovered may be considered a distribution and as such will also be subject to Swiss withholding tax. While this is generally recoverable if the recipient or beneficiary is a Swiss resident entity, a non-resident may be entitled to a refund only if there is an applicable double taxation treaty. If no double tax treaty applies, the dividend withholding tax may become the final burden for the recipient.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no particular tax incentives or other incentives provided preferentially to foreign lenders.

The Swiss Confederation and the cantons or communes levy a withholding (source) tax on interest paid to foreign lenders which benefit from mortgage security on Swiss real estate. The combined rate of the tax is between 13% and 33%, depending on the canton and commune in which the real estate is located. This interest withholding tax is reduced (to zero) under a number of double taxation treaties, including those with the United States, the United Kingdom, Luxembourg, Germany and France.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No income tax will apply to foreign lenders in these scenarios.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please see question 3.9.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are no adverse consequences in addition to those addressed in question 6.1.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The recognition of foreign governing law in contracts is subject to the PILA. Subject to the below limitations, Swiss courts will generally recognise a foreign governing law in a contract, provided that the relevant foreign law provisions are not contrary to Swiss public policy and they can be established by the parties.

The recognition of a choice of foreign law is limited to contractual matters. For security documents, Swiss law distinguishes the agreement to create the security (*Verpflichtungsgeschäft/titre d'acquisition*) from the creation of the security interest (*Verfügungsgeschäft/acte de disposition*). While the agreement can be governed by the law chosen by the parties, the law governing the creation of the security is not left to the parties' discretion.

In the context of pledges over movable assets (limited rights *in rem*), the acquisition or loss of such rights *in rem* is governed by the country where such assets are located at the time of the event giving right to that acquisition or loss. The parties can, however, subject the acquisition and loss of such rights to the law governing the agreement to create the security (art. 104(1) PILA). Such choice of law can, however, not be asserted against third parties, who can rely on the law of the location of the assets at the time of the acquisition or loss of such rights.

The acquisition or loss of rights *in rem* over real estate are subject to the law of the place where the property is located. Choice of law is not permitted (art. 99 PILA).

The pledge of claims or securities (with the exception of intermediated securities) is governed by the law of the country of the habitual residence of the pledgee, and in case of the pledge of other rights, by the law applicable to such rights. The parties can choose the applicable law to such pledge; such choice of law can, however, not be asserted against third parties (art. 105(1) PILA). In addition, irrespective of the law applicable between the pledgor and the pledgee, such law cannot be enforced against the debtor of the claim who may thus still rely on the law applicable to the actual claim, security or right.

As for the assignment by way of security of claims and uncertificated securities, such assignments are subject to the law governing the claim or the law chosen by the parties. The choice of law cannot be asserted against the debtor of the claim without the debtor's prior consent (art. 145(1) PILA).

The transfer of intermediated securities is governed by the Hague Convention on Securities Held with an Intermediary, which determines that the applicable law chosen by the parties to the relevant account agreement also applies to the disposal or encumbrance of securities held in that account. Such law can, however, only apply if the relevant intermediary has an office in the relevant jurisdiction at the time of the agreement. If that is not the case, the applicable law is the law of the jurisdiction of such intermediary's office.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The courts of Switzerland will recognise as valid and will enforce a final and conclusive civil law judgment given against a company rendered by New York courts or by English courts

without re-examination of the merits of the case, subject to the conditions set forth in the PILA. A foreign judgment will generally be recognised under the PILA provided that the following conditions are cumulatively met: (i) the foreign court had jurisdiction in accordance with the rules of the PILA; (ii) the foreign judgment does not violate the Swiss public order (for example, the general principle of fairness of proceedings); (iii) the foreign judgment is final and non-appealable; (iv) the dispute was not pending first in Switzerland or has not been already determined in a third jurisdiction (provided that the relevant judgment can be recognised under the PILA); and (v) the proceedings leading to the foreign judgment did not violate basic principles, such as, in particular, the defendant being properly served or accepting the foreign jurisdiction or the defendant being able to exercise its right to be heard.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Swiss law allows for the direct enforcement of payment claims if the creditor holds a written acknowledgment of debt or an executory title or is the beneficiary of a security interest on assets of the debtor. In the absence of such a document or pledge, the creditor generally has to file a suit by way of ordinary proceedings, on the merits of the claim. If the action is determined in favour of the creditor, it may enforce the judgment by way of initiating ordinary debt enforcement proceedings.

The enforcement of pecuniary claims, whether arising directly from a contract or from a foreign judgment, is subject to the Swiss Act on Debt Enforcement and Bankruptcy ("**DEBA**"). In such cases, the creditor will commence collection proceedings to seize the debtor's assets in order to enforce its claim. For this purpose, the creditor will file a request with the competent debt collection office, upon which the debt collection office will serve a summons for payment upon the debtor. The debtor may raise an objection against such summons for payment, in which case the creditor will apply to the competent court to have the debtor's objection lifted. This first phase of debt enforcement may generally take a few weeks or months. There are certain minor formal differences in case of proceedings aiming at the realisation of pledged assets. Overall the time for this first part remains, however, the same.

If the objection is set aside and the matter has not yet been determined on the merits of the claim, the creditor may file suit by ordinary proceedings.

In relation to part (a) of the question, the length of the proceedings will depend on whether the creditor is in possession of a written recognition of a debt by the debtor or the guarantor (as defined in the DEBA). A loan agreement or a guarantee duly signed by the debtor is generally considered a recognition of a debt, provided that the creditor can provide proof of disbursement. In such cases, the creditor's rights will be subject to summary proceedings, which may take a few months before obtaining a first instance decision. If no recognition of debt is available, the creditor will be subject to standard proceedings, which may take about a year before the first instance renders a decision. The rendered judgments are generally subject to appeal before higher cantonal instances and, as the case may be, the Swiss Federal Court, which may considerably extend such time estimates.

In relation to part (b) of the question, a foreign judgment first needs to be recognised (this can be confirmed by a court at the same time). The enforcement proceedings are, in principle, summary proceedings, which are quicker than ordinary proceedings and may take a few months. Again, the decisions are subject to the above-mentioned means of appeal.

If the debtor does not raise an objection, or, if it does, when the objection has been set aside, the debt enforcement proceedings continue by realisation of the pledged assets themselves or by bankruptcy (if the debtor may, under the DEBA, be subject to bankruptcy, which is generally the case for Swiss companies). The length of the proceedings will in part depend on the type of pledged assets (movable/immovable) and can take from several months to more than a year. In the latter case, the assets of the company are liquidated and distributed amongst the company's creditors. The length of the debt enforcement proceedings will strongly depend on the type of enforcement (seizure or bankruptcy) and, in case of the bankruptcy, on the size of the company. Given the large number of possible scenarios, the time estimate can range from months to years.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

There is no mandatory requirement for a public auction or regulatory consent in case of enforcement of collateral security. The parties can agree that the enforcement is effected by private realisation (*private Verwertung*) or appropriation (*Selbsteintritt*) and collection of the pledged assets. In addition, the parties can agree in advance that a discretionary sale (*Freihandverkauf*) is permitted. Please note, however, that the private realisation or appropriation and discretionary sale of immovable properties is generally not possible because such a permission for private sale would require the notarisation of the security agreement (which is rarely, if ever, done due to the notarisation costs). Private enforcement is in most cases faster and less formal. However, the secured party is generally required in case of a realisation of the security to obtain the best price for the relevant assets, taking into account the circumstances at the time of the sale. In addition, on bankruptcy, pledged assets will form part of the bankruptcy estate. The private enforcement of those assets is not permitted and must occur under the DEBA. As for intermediated securities which have been granted as a security, private enforcement does not have to be specifically agreed on between the parties but is only permitted if the value of the intermediated securities may be determined objectively. In case of bankruptcy, the pledged assets form part of the bankrupt estate and as a result, the private enforcement of pledged assets is no longer permitted (this restriction does not apply to intermediated securities).

In case of no agreement relating to the enforcement of collateral, such enforcement will take place by public auction in accordance with the provisions of the DEBA. According to the DEBA, if enforcement proceedings are brought against a claim secured by a pledge, the enforcement proceeding shall be continued by the realisation of the pledge (*beneficium excussionis realis*). It is, however, possible for the parties to agree that the enforcement of the claims is pursued by the creditor according to regular debt enforcement proceedings without having first to enforce the creditor's rights under any particular document and/or to institute proceedings for realisation of pledged assets first.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

There are no restrictions applicable to foreign lenders in case of (a) or (b). However, if the foreign lender intends to foreclose on a collateral consisting of Swiss residential property, this is subject to restriction under the Federal Law on the Acquisition of Real Estate by Persons Abroad. Under that law, foreign lenders (or foreign-owned Swiss lenders) are subject to certain restrictions when they take security by way of mortgage over residential property in Switzerland. The validity of the mortgage could be challenged if such restrictions are not complied with. In addition, even if the mortgage has been validly granted, the law would not enable the foreign lender to acquire the property upon its forced sale unless it has received a specific authorisation from the competent authorities in the canton where the property is located.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The DEBA provides for moratorium procedures that can be applied for before a competent court by the debtor company or, in certain cases, by its creditors. If there are prospects for a successful restructuring or a composition plan, the competent court can grant a moratorium (*Nachlassstundung/sursis concordataire*), which may result in a successful restructuring or in the confirmation of a composition agreement (*Nachlassvertrag/concordat*) that is binding on all creditors of unsecured claims. The moratorium does not directly affect the securities granted by the debtor. However, enforcement proceedings regarding securities (movable assets or claims and rights) cannot be started or continued during the period for which the moratorium is effective. As for pledges on immovable assets, they cannot be realised during that time. In addition, the composition agreement will not affect the security either so that it can be realised by the relevant creditor.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Foreign final arbitral awards obtained in the competent arbitral courts are generally recognised in Switzerland without re-examination or re-ligation of the matters provided that the conditions for the recognition and enforcement of arbitration awards set out in the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1985 ("**New York Convention**") are fulfilled, i.e. there are no refusal grounds relating in particular to incapacity of a party, violation of due process, outside of scope disputes or wrong composition of the tribunal.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In Switzerland, the enforcement of claims and security interests is generally governed by the DEBA. Insolvency proceedings are initiated by the debtor (mandatorily in case of over-indebtedness (*Überschuldung/surendettement*) according to article 725 CO) or a creditor filing a petition for the opening of insolvency proceedings based on an application for commencement of enforcement proceedings (*Betreibungsbegehren/requisition de poursuite*) with the competent debt collection office.

Insolvency results in the acceleration of all claims against a debtor (secured or unsecured), except for those secured by a mortgage on the debtor's real estate, and such claims become due. After an insolvency has been declared by the competent insolvency court, assets which are subject to a pledge will fall within the debtor's insolvency estate (*Konkursmasse/masse en faillite*) and will be realised by the insolvency administration. Lenders must, in principle, register their claims and their rights on the pledged assets with the bankruptcy administrator. The opening of bankruptcy proceedings prevents the bankrupt debtor from disposing of any of its assets. Interest in principle ceases to accrue on the bankrupt's debt but claims secured by a pledge enjoy a preferential treatment as interest which would have accrued until the collateral is realised will be honoured provided that the proceeds of the collateral suffice to cover such interest. All creditors need to participate in the insolvency proceedings and secured creditors are generally not entitled to enforce any security interest outside the insolvency proceedings (except for security over intermediated securities). The realisation proceedings according to the DEBA are conducted by way of a public auction or, subject to certain conditions, a sale by mutual agreement.

Proceeds from enforcement are used to cover first enforcement costs, then the claims of creditors secured by pledge (in accordance with their rank) and, in case of any excess proceeds, unsecured creditors.

Contrary to pledged assets, assets of which the property has been legally transferred for security purposes before the opening of bankruptcy proceedings do not form part of the bankruptcy estate. They can, therefore, be subject to private enforcement during the ongoing bankruptcy proceedings. As for future claims and rights which have been assigned for security purposes or pledged but have come into existence only after the debtor has been adjudicated bankrupt, they will fall within the bankruptcy estate of the securing party.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Unsecured claims rank in the following order: (i) prioritised claims under Swiss bankruptcy laws, such as claims of employees, claims of certain social insurances and pension funds and certain family law claims; (ii) any other unsecured claims; and (iii) any subordinated claims.

The creditors of a Swiss debtor may challenge the entering into of certain agreements and the performance of the obligations thereunder subject to the conditions set out in articles 285 *et seqq.* DEBA. A transaction may be subject to challenge if (i) no or no adequate consideration has been given so that the transaction has been made at an undervalue in the year before the adjudication of bankruptcy (article 286 DEBA), (ii) the debtor granted security for liabilities which it was not obliged to secure or discharged a debt before it becomes due or by an unusual means of payment in the year prior to adjudication of bankruptcy, at a time when the debtor was over-indebted and the secured party was or should have been aware of such over-indebtedness (article 287 DEBA), or (iii) the granting of the security occurred in the five years before the adjudication of

bankruptcy and the security provider had the intention to disfavour or favour certain of its creditors or should have reasonably foreseen such result and this intention was or must have been known to the receiving party (article 288 DEBA). As for cases (i) and (iii) for transactions with related parties, such as group companies, the burden of proof is reversed so that the challenged parties will have to prove that, in case of (i), there was no disproportion in the transaction and, in case of (iii), it could not recognise the intention to harm creditors.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Persons that are not registered in the register of commerce are not subject to bankruptcy proceedings.

Insolvencies of banks, securities dealers, insurance companies, securities firms and collective investment schemes are subject to special insolvency rules and their insolvency will be handled by the Swiss Financial Markets Authority.

Municipalities and other public bodies are not subject to debt enforcement proceedings resulting in bankruptcy. Only enforcement proceedings on seizing of assets and the enforcement of collateral are possible against Swiss municipalities.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

There is no possibility for a creditor to seize assets of a company in an enforcement other than through proceedings under the DEBA, which will always involve a court at a certain stage in order to verify the merits of a claim.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Overall, Swiss courts recognise the choice of foreign jurisdiction in civil law matters, subject to the limitations of the PILA and applicable international treaties such as the Lugano Convention. However, in certain cases, such as, for example, in matters relating to property, the jurisdiction is subject to exclusive mandatory rules so that it is not possible to freely chose the competent courts.

As for one-sided jurisdiction clauses favouring one contractual party, the French supreme court, applying the Lugano Convention, has decided that such clauses can only be accepted if they are both drafted based on objective criteria and sufficiently precise, so that they meet the predictability requirement for such clauses. This ruling has been criticised by a large number of scholars. It cannot, however, be entirely excluded that a Swiss court may take a similar view.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Persons and assets relating to a diplomatic mission are protected by immunity in accordance with the Vienna Convention on Diplomatic Relations. Switzerland does, however, recognise and enforce waivers of sovereign immunity.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licensing or other eligibility requirements in Switzerland for lenders to a company. However, under certain circumstances, the granting of credits on a professional basis by entities in Switzerland or from Switzerland may be subject to anti-money laundering rules, in which case the relevant entity needs to become a member of a self-regulatory organisation. In addition, lending activity may also give rise to a qualification as a bank if the entity refinances itself to a considerable extent with several banks and the relevant refinancing transactions exceed CHF 500 million. In such cases, a banking licence issued by the Swiss Financial Markets Authority is required. These requirements only apply if the lending activities are conducted in Switzerland. The establishment of a physical presence of a foreign bank in Switzerland is also potentially subject to licensing requirements. Foreign entities are considered as foreign banks due to (a) holding a foreign banking licence, (b) using the term bank or banker in their trade name, or (c) conducting banking activities as assessed from a Swiss law perspective. A foreign bank authorisation is necessary if such entity employs persons in Switzerland who, permanently and in a professional capacity in or from Switzerland enter into transactions, maintain customer accounts, legally bind the foreign bank or forward client orders to a foreign bank by representing it for advertising or other purposes. Entities exercising relevant activities that do not have a licence are subject to a large range of measures ranging from specific orders, industry bans and confiscation of profits to liquidation.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

We would not say that COVID-19 has significantly impacted document execution and delivery requirements, except to the extent that the logistics of signing and closing meetings have to follow the rules limiting the number of persons attending a private meeting (i.e. five as of February 2021). We expect that similar limitations will continue to apply for as long as the pandemic continues.

As far as the delivery of corporate approval documents is concerned, we note that, in order to limit the spread of COVID-19, the Swiss Federal Council has banned public and private

events (see COVID-19 particular situation Ordinance) until the end of February 2021, as of the time of writing. This prohibition also applies to shareholder/members meetings of Swiss companies which are in principle held between present shareholders/members, which under Swiss corporate law can only be held in person or through a direct representative acting under proxy. In order to enable shareholders/members to exercise their corporate rights, shareholder/members meetings can be validly held in writing (excluding, however, by email), in electronic (virtual) form or via an independent representative designated by the company. The chairman of the general meeting, the secretary and, as the case may be, the independent representative will need to be physically present at the general assembly.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Other than the above, we have not identified other material considerations which in our view should be taken into account by lenders generally.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Taking advantage of the U.S.-China trade war, since 2019, the Taiwanese government has implemented a three-year Action Plan for Welcoming Overseas Taiwanese Businesses to Return to Invest in Taiwan (the "Action Plan"), an incentive scheme for Taiwanese businesses located abroad to return to and invest in Taiwan. The Action Plan offers customised single-window service and implements five main strategies (including land acquisition, human resources, access to financing with a NT$500 billion loan subsidy for processing fee payable by corporate borrowers, stable water and electricity supplies, and tax services). In addition, while COVID-19 has severely impacted many other countries in the world, Taiwan has reported relatively few COVID-19 cases and has implemented no lockdown, which has further attracted a number of Taiwanese businesses located abroad to return to invest in Taiwan. Total investments of around NT$791 billion have been pledged by Taiwanese business operating in China under the Action Plan as of December 2020. As the investment activities are expected to increase in 2021, the lending market is expected to see positive prospects in 2021. Further, due to COVID-19, the Taiwanese government promulgated a series of special and emergency laws and regulations in 2020 to help the industries or enterprises whose operations are materially adversely affected by COVID-19 (such as aviation industries). The emergent measures include an extension of the principal repayment period, a guarantee by the Small and Medium Enterprise Credit Guarantee Fund of Taiwan of loans to be used as working capital, and subsidies for interest on working capital loans. Several syndicated loans made in 2020 were for the purpose of assisting those COVID-19-affected industries, such as for each of EVA Air and China Airlines, which secured NT$20 billion syndicated loans from banks based on the government's emergent measures.

Loan demand from wind-power projects continues to provide support for the loan market in Taiwan. The Taiwanese government approved the Special Act for Forward-Looking Infrastructure in July 2017. Against this backdrop, the government investment in large-scale infrastructure programmes (including railways, aquatic environments, green energy, digital technology, and urban and rural facilities) will total NT$882.49 billion (equivalent to around US$30.43 billion), and is expected to spur public and private investment to reach NT$1.78 trillion (equivalent to around US$61.38 billion). Among the infrastructure projects, green energy is being invested in the most, especially wind-powered energy plans. Furthermore, the Taiwanese government has been promoting a national financing guarantee mechanism since September 2020, under which the government will fund NT$6 billion, and banks NT$4 billion, to contribute to a more comprehensive green energy industry. The government has set a target of installing 5.5GW of offshore wind power capacity by 2025. Key syndicated loan offshore wind projects in 2020 include a NT$90 billion loan by Copenhagen Infrastructure Partners (CIP), a NT$2 billion loan by Tien Li Offshore Wind Technology CO., LTD, and a NT$1.3 billion loan by Ta San Shang Marine Co., Ltd. In addition, there are many syndicated or bilateral loans made for solar energy projects, including those involving relatively new designs such as solar power plants combining agriculture and solar energy production.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

(1) In February 2020, CIP secured an 18-year NT$90 billion (US$3.1 billion) syndicated loan from a consortium of 25 financial institutions. The loan will be used for construction of the Chang Fang and Xidao offshore windfarm projects.
(2) In April 2020, AU Optronics Corp. secured a five-year NT$33 billion (US$1.2 billion) syndicated loan from a consortium of 15 banks. According to local news, the loan closed 158% oversubscribed. The loan will be used for its operating working capital.
(3) In June 2020, YAGEO Corporation secured a five-year NT$49 billion (US$1.7 billion) syndicated loan from a consortium of 22 banks. The loan is the largest ever in scale in the Taiwan passive electronic components industry and will be used for its future operation development and acquiring KEMET Corporation.
(4) In June 2020, Innolux Corporation secured a seven-year NT$38 billion (US$1.3 billion) syndicated loan from a consortium of 17 banks. According to local news, the loan closed more than 160% oversubscribed. The loan will be used for its loan repayment and operating working capital.
(5) In October 2020, Quanta Computer Inc. together with its subsidiary, Quanta International Limited, secured a five-year US$1.2 billion syndicated loan from a consortium of 18 banks. The loan will be used for its loan repayment and operating working capital.
(6) In November 2020, Powerchip Semiconductor Manufacturing Corporation secured a five-year NT$29.3 billion (US$1 billion) syndicated loan from a consortium of 14 banks. The loan will be used for its loan repayment and operating working capital.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

According to the Company Act, no company can act as a guarantor of any nature, unless otherwise permitted by law or by the company's Articles of Incorporation. Thus, if permitted by its Articles of Incorporation, the company may provide guarantees for other members of its corporate group.

If the company is a public company, there will be additional restrictions. Pursuant to the Regulations Governing Loaning, Endorsement or Guarantees of Public Companies ("Guarantee Regulation"), a public company may provide guarantees only for the following companies: (1) a company with which the public company conducts business; (2) a company in which the public company directly and indirectly holds more than 50% of the voting shares; and (3) a company that directly and indirectly holds more than 50% of the voting shares in the public company. In addition, a guarantee provided by a public company should comply with the internal rules adopted in accordance with the Guarantee Regulation.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Generally, there is no concern about the enforceability under this circumstance so long as all legal requirements are satisfied. However, if a company provides guarantees for others for only a disproportionately small benefit or without benefit in return in the absence of a justifiable cause, there may be concern that the directors resolving the guarantees may breach their fiduciary duties. Further, the creditors of the guarantor may apply to the court to revoke the guarantee if, due to the guarantee, the guarantor does not have sufficient assets to repay the debts owed to its creditors.

2.3 Is lack of corporate power an issue?

Please refer to our answer to question 2.1. If a company's Articles of Incorporation do not permit the company to provide guarantees to others, but the company's responsible person, such as a director, still provides guarantees to others on behalf of the company, the responsible person alone should be liable for the guarantees. The guarantee does not constitute a valid obligation of the company.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental approval is required for a company to provide guarantees. As for due authorisation, a board resolution adopted by the board of directors of the company to provide guarantees normally would suffice, unless the Articles of Incorporation provide otherwise. In practice, however, it is not common for a company's Articles of Incorporation to require that the provision of guarantees be approved by a shareholders' meeting.

However, where a Taiwanese company provides a guarantee to its overseas affiliate (incorporated in a jurisdiction other than Mainland China) who borrows funds to make investment in Mainland China, the guarantor will require the prior approval of the Investment Commission ("IC") of the MOEA with respect to investment in Mainland China.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

The Guarantee Regulation and a company's internal rules adopted in accordance therewith impose certain limitations on the aggregate amount of the company's guarantees to all counterparties and the amount of the company's guarantees to a single counterparty. If the internal rules are incorporated into the company's Articles of Incorporation, the violation of the internal rules and the Articles of Incorporation by the company in providing a guarantee may affect the enforceability of the guarantee. By contrast, if the company only violates the internal rules in providing the guarantee, it is generally considered that violation of such limitations will only result in an administrative fine imposed by the Financial Supervisory Commission or breach of fiduciary duty by the directors, but will not affect the enforceability of the guarantees.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

A Taiwanese corporate entity or individual has an annual foreign exchange quota of US$50 million (or its equivalent) or US$5 million (or its equivalent), respectively. No prior approval from the CBC is required if the Taiwanese onshore guarantor converts New Taiwan Dollars into foreign currency for remittance to the offshore creditor and the conversion does not exceed the above quota. The CBC has the sole discretion to grant or withhold its approval on a case-by-case basis if the onshore Taiwanese guarantor's quota would be exceeded for such conversion.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Among other things, the following types of collateral are commonly seen in secured lending transactions:

(1) a mortgage over real property, such as land and buildings;
(2) a chattel mortgage over a movable asset, such as machinery and equipment;
(3) a pledge over movable assets or securities, or a pledge over the pledgor's property rights which are transferable, such as the pledgor's rights in bank accounts, accounts receivable or patents; and
(4) an assignment of property rights, which are transferable.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

As a general rule, the security provider and the security interest holder should enter into an agreement to identify the specific asset subject to the security interest. A general security agreement without identifying the specific asset, such as a floating charge, is not enforceable under Taiwanese law. In addition, different types of assets may be subject to different requirements,

such as registration or filing with the competent authorities, on the perfection of the security. We will briefly advise on such requirements in our answers to questions 3.3 to 3.7.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. In order to create a valid mortgage over the land, buildings and plant, the mortgagor and the mortgagee should enter into a written agreement, and a registration with the competent authority is required.

As for machinery and equipment, the security to be created may be a pledge or a chattel mortgage. Both security interests (pledge and chattel mortgage) give the security interest holder first priority over the machinery and equipment. To create a pledge, the pledgor and the pledgee have to enter into a written agreement and the pledgor should deliver the possession of the machinery and equipment to the pledgee, but registration with the competent authority is not required. To create a chattel mortgage, the mortgagor need not deliver the possession thereof to the mortgagee; however, registration with the competent authority is necessary in order for the mortgagee to claim the chattel mortgage against a *bona fide* third party.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. To create a pledge over receivables, the pledgee and the pledgor must enter into a written agreement. In addition, the receivables must be identifiable according to the content of the pledge agreement. Further, the obligor should be notified of the creation of the pledge in order for the pledgee to be able to claim the pledge against the obligor.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. To create a pledge over cash deposits, the pledgee and the pledgor must enter into a written agreement. The pledge shall not become effective against the account bank taking the cash deposits unless the account bank is notified of the creation of the pledge. Nevertheless, please note that the concept of a floating charge is not recognised under Taiwanese law. In other words, the pledge covers only the cash in the bank account when such pledge is created and notified to the bank at which the account was opened. The pledge will not cover the cash deposited in the bank account after the account bank is notified of the pledge. To deal with this issue, the pledgor, in practice, will be required to periodically confirm with the pledgee and the account bank the amount of cash in the bank account to ensure that the pledge also covers the cash deposited after the creation of the pledge.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes. According to the Company Act, a pledge could be created over the shares in a Taiwanese company. A private Taiwanese company may determine at its discretion whether it will issue share certificates to its shareholders, and if so, the share certificates will be in certificated or scripless form. On the other hand, a public company is obligated to issue share certificates to its shareholders.

To create a pledge over shares in certificated forms, a written agreement is required. The certificates of the pledged shares shall be duly endorsed and delivered by the pledgor to the pledgee. Furthermore, the company issuing the shares shall be notified of the creation of a pledge in order to register such pledge on the shareholders' roster. The creation of a pledge is valid between the pledgee and the pledgor when the certificates of the shares have been endorsed and delivered to the pledgee. However, the creation of the pledge cannot be claimed against the company unless the company is notified of the creation of the pledge.

To create a pledge over shares in scripless forms which are transferred through the book-entry system of Taiwan Depository and Clearing Corporation ("TDCC"), the pledgor and the pledgee have to sign a form prescribed by the TDCC and have the pledge registered with the TDCC.

A pledge over shares can also be created based upon the document governed by New York or English law, as long as the creation and perfection of the pledge follow the procedures and requirements described above.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

A floating charge over the inventory is not enforceable under Taiwanese law. Please refer to our answer to question 3.2.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

(i) Yes, it can.
(ii) This issue is whether a company may provide guarantees for others. Please refer to our answer to question 2.1.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

No notarisation or stamp duty is required for the creation of security over different types of assets, mentioned in our answer to question 3.1. The registration fee for creating a chattel mortgage over a movable asset is NT$900. The registration fee for creating a mortgage over real property is equivalent to 1/1,000 of the total amount secured by the mortgage.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Regarding the registration fee, please refer to our answer to question 3.9. The authority in charge of the registration will only conduct a formality review and it is not expected that the registration will take a significant amount of time.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In addition to the requirement of registration for certain types of security interests as mentioned above, generally the creation of the security interests does not require a regulatory or similar consent.

However, it is worth noting that, before the amendment of the Company Act on August 1, 2018 which took effect from November 1, 2018, a foreign company which has not been recognised by the Taiwan competent authorities and has not accordingly established a branch in Taiwan has no capacity to act as a security interest holder. Since the amendment to the Company Act in 2018, a foreign company is not required to be recognised and set up a branch in Taiwan in order to have the same legal capacity as a local company and thus legally speaking should be able to act as a security interest holder unless otherwise provided by law. However, according to a ruling issued by the Ministry of Interior dated December 17, 2018, the foreign company who wishes to obtain a real estate mortgage as security still needs to register and have a branch in Taiwan. Although there is no similar ruling in connection with chattel mortgage, as of now, in practice, a foreign company without a branch in Taiwan still has to register and have a branch in Taiwan in order to obtain a chattel mortgage.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Take a real property mortgage, for example. The mortgage can be divided into a general mortgage and a maximum amount secured mortgage. As for a general mortgage, the obligations to be secured should exist upon the creation of the mortgage. Otherwise, the mortgage will be held unenforceable. By contrast, a maximum amount secured mortgage is to secure the obligations created and owed to the mortgagee for a period of time. So long as the secured obligations exist at the end of the mortgage period, the mortgagee may foreclose the real property. Since the obligations under a revolving credit facility may arise and be satisfied from time-to-time according to the borrower's drawdown and repayment, the mortgage to secure such obligations should be a maximum amount secured mortgage instead of a general mortgage. The above also applies to a chattel mortgage and a pledge.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

No, there are not.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Regarding the prohibitions and restrictions on the provision of guarantees by a company, please refer to our answer to question 2.1. The provision of security other than a guarantee generally will be deemed as providing a guarantee as well, and is subject to the same prohibitions and restrictions.

In addition, according to the Company Act, a company cannot redeem or buy back any of its outstanding shares unless otherwise permitted by law. For instance, a company may purchase up to 5% of its outstanding shares and transfer the same to its employees. To give another example, a listed company may buy back its outstanding shares in the circumstances permitted under the Securities and Exchange Act. The restriction on a company's ability to buy back its outstanding shares extends to the company's controlled company; in addition, the violation of such restriction may cause the buy-back to be void. A subsidiary of the parent company cannot purchase the shares of the parent company. Nevertheless, the Company Act does not prohibit a sister subsidiary from purchasing the shares of another sister subsidiary if the other sister company, together with its parent company, does not directly or indirectly hold more than 50% of the sister company.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

As general practice for a syndicated loan, syndicated banks will appoint an agent bank to act for and on behalf of the syndicated banks, including registering the agent bank as, for instance, a mortgagee and foreclosing the mortgaged property. In addition, there will be a clause in the syndicated loan agreement to the effect that the syndicated banks' claims against the borrower under the syndicated loan agreement are joint and several. Given this, the agent bank may claim the whole amount of the loan from the borrower and distribute the proceeds obtained therefrom to the syndicated banks in accordance with their proportion of participation in the loan.

Nevertheless, under Taiwan law, it is questionable whether or not a third party, who is not a creditor/lender, could validly hold the collateral as a trustee or a security agent for other creditors/lenders. Pursuant to the Civil Code, a mortgage/pledge would not be validly created in favour of the creditor/mortgagee/pledgee if there is no underlying credit owned by the mortgagee/pledgee against the debtor.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

As advised in question 5.1 above, in practice, if the lenders' claims against the borrowers are joint and several, one of the lenders may be appointed as the agent bank by syndicated banks to act for and on behalf of all the syndicated banks, including registering the agent bank as, for instance, a mortgagee and foreclosing the mortgaged property.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The transfer of the loan from Lender A to Lender B will not

be effective against the borrower and the guarantor until either Lender A or Lender B has notified the borrower and the guarantor of such transfer.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) For a domestic non-bank lender who is a Taiwan resident or a profit-seeking enterprise with a fixed place of business in Taiwan, the withholding tax rate for interest is 10% but such withholding tax is applicable to corporate borrowers only. Individual borrowers are not required to withhold tax on interest.

For a foreign lender who is a non-Taiwan resident or a profit-seeking enterprise without a fixed place of business in Taiwan, the withholding tax rate for interest applicable to a corporate borrower is 20%, but if the interest derives from short-term commercial papers, securitised instruments, government/corporate/financial institution bonds, or conditional transactions, the withholding tax is 15%. Moreover, most of the tax treaties provide a reduced income tax withholding rate of 10%. Taiwan has signed tax treaties with 33 jurisdictions; namely, Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Eswatini, France, Gambia, Germany, Hungary, India, Indonesia, Israel, Italy, Japan, Kiribati, Luxembourg, Malaysia, the Netherlands, New Zealand, North Macedonia, Paraguay, Poland, Senegal, Singapore, Slovakia, South Africa, Sweden, Switzerland, Thailand, the United Kingdom and Vietnam.

(b) Where the portion of the proceeds is to indemnify the principal of the loan made by the lender, it will not be subject to income tax. If the portion of the proceeds is to indemnify the default interest sustained by the lender, it may be subject to income tax as mentioned above. Moreover, in the event that the proceeds include a penalty pursuant to an agreement between the lender and the borrower, such penalty will be subject to income tax unless the lender proves that the penalty is to indemnify losses suffered by the lender.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

(1) Income tax on the following categories of income shall be exempted:

- Interest derived from loans offered to the Taiwanese government or legal entities within the territory of Taiwan by foreign governments or international financial institutions for economic development, and interest derived from the financing facilities offered to their branch offices and other financial institutions within the territory of Taiwan by foreign financial institutions.
- Interest derived from loans extended to legal entities within the territory of Taiwan by foreign financial institutions for financing important economic construction projects under the approval of the Ministry of Finance.
- Interest derived from favourable-interest export loans offered to or guaranteed for the legal entities within the territory of Taiwan by foreign governmental institutions and foreign financial institutions which specialise in offering export loans or guarantees.
- Moreover, some of the tax treaties provide an exemption from income tax withholding for interest payment. For example, the Netherlands-Taiwan Tax Treaty provides that the interest which is paid in respect of a bond, debenture or other similar obligations of a Taiwanese public entity, or of a subdivision or local authority of Taiwan, should be taxed only in the Netherlands.

(2) For the purposes of effectiveness or registration, there is no tax applicable to foreign investments, loans, mortgages or other security documents.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No, a foreign lender (except for a foreign entity's Taiwan branch) will not be subject to Taiwan income taxes solely because of a loan to or guarantee and/or grant of security from a Taiwanese company.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please refer to our answer to question 3.9.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

A thin capitalisation rule was incorporated into the Income Tax Act effective from January 28, 2011. That is, retroactively from January 1, 2011, if the ratio of a company's debts (to its related party) to its equity exceeds a certain ratio, the interest expense arising out of the portion of the debts exceeding said ratio is not deductible, except for financial institutions (including banks, cooperatives, financial holding companies, bills finance companies, insurance companies, and securities firms). The Ministry of Finance, by referring to international practices, has set a safe harbour debt-equity ratio of 3:1.

The same treatment in respect of the thin capitalisation rule applies to both domestic and foreign lenders.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Generally, the choice of a foreign governing law to govern a contract would be recognised as a valid choice of law and given effect by the courts of Taiwan, provided that the relevant

provisions of the foreign governing law would not be applied to the extent such courts hold that: (i) the application of such provisions would be contrary to the public order or good morals of Taiwan; or (ii) such provisions would have the effect of circumventing mandatory and/or prohibitive provisions of Taiwan law. However, where the contract is about the creation/perfection of a security interest, such as a pledge and mortgage, the choice of law will be subject to the conflicts of law of Taiwan.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Any final judgment rendered by a foreign court shall be recognised and enforceable in Taiwan without a review of the merits, provided that the court of Taiwan in which the enforcement is sought is satisfied that:

(i) the foreign court rendering the judgment has jurisdiction over the subject matter according to Taiwan law;
(ii) the judgment and the court procedures resulting in the judgment are not contrary to the public order and good morals of Taiwan;
(iii) if a default judgment was entered into against the losing party, the losing party was (a) duly served within a reasonable period of time within the jurisdiction of such court in accordance with the laws and regulations of such jurisdiction, or (b) process was served upon the losing party with the judicial assistance of Taiwan; and
(iv) judgments of the Taiwan court are recognised by the foreign court on a reciprocal basis.

To our knowledge, there is reciprocity for enforcement of judgments between Taiwan and New York/England.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) Depending on the complexity of the case in dispute, it could take half a year to one year or longer for each of the district court, the high court and the Supreme Court to render a judgment. Regarding the enforcement of the final judgment against the assets of the company, it also depends on the value and types of the company's assets. For example, to foreclose a mortgaged real property, it may take from several months to one year or longer to conduct the auctions for the real property if there is no bidder or if the bid price is below the set auction price.
(b) Depending on whether the Taiwan court or the counterparty has raised any objections to the elements set forth in our answer to question 7.2, it may take months or one year or longer for the Taiwan court to render a judgment recognising the foreign judgment. In addition, as mentioned in point (a) above, the enforcement of a final judgment against the assets of the company depends on the value and types of the company's assets.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

(a) Depending on the types of collateral security, foreclosure of collateral security through a court proceeding may require a public auction. For instance, if the real property is foreclosed through a court proceeding, the court will designate an expert to assess the value of the real property and hold a public auction to sell it. If the real property has not been sold due to the fact that no bidder attended the auction or the bidding price is below the auction price set by the court, the court will have to reduce the auction price and repeat similar exercises to sell the real property in accordance with the Mandatory Execution Act. Accordingly, foreclosing the real property may take longer through a public auction than by other means of enforcement such as a private agreement between the mortgagor and the mortgagee to settle debts by transferring ownership of the real property to the mortgagee.
(b) Generally, no regulatory consent is required in order for the security interest holder to enforce the collateral interest.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

(a) Generally, no. However, according to the Code of Civil Procedure, if a plaintiff has no domicile, office, or place of business in Taiwan, the court shall, by a ruling on motion filed by the defendant, order the plaintiff to provide a security for the litigation expenses. Such requirement will not apply in cases where either the portion of the plaintiff's claim is not disputed by defendant or the plaintiff's assets in Taiwan are sufficient to compensate the litigation expenses.
(b) Please refer to our answer to question 3.11.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Regarding bankruptcy, all enforcement actions against the debtor will be stayed by the bankruptcy of the debtor and all unsecured creditors must follow the bankruptcy proceeding administered by the court to file their claims against the debtor. Nevertheless, if a creditor, such as a lender, has a mortgage, pledge or right of retention over the debtor's assets, the lender may enforce such collateral security without going through the bankruptcy proceeding.

As for reorganisation, all enforcement actions against the debtor subject to reorganisation will be stayed no matter whether the lender is a secured (such as a mortgagee or a pledgee) or unsecured creditor. The lender may not foreclose the collateral security regardless of other stakeholders and should follow the reorganisation proceeding administered by the court.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

According to the Arbitration Law, a foreign arbitration award would be recognised and enforceable by the courts of Taiwan without reviewing the merits, provided that none of the following exist:

(i) where the recognition or enforcement of the arbitral award is contrary to the public order or good morals of Taiwan; or
(ii) where the dispute is not arbitrable under the laws of Taiwan.

In addition, if there is no reciprocity in the recognition and enforcement of an arbitral award between Taiwan and the country in which the arbitral award is made or the country whose arbitration rules are applicable, the Taiwanese court may dismiss the petition for the recognition of a foreign arbitral award.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Please refer to our answer to question 7.6 regarding foreclosure of the collateral interest by a lender. In addition, if a lender's claims cannot be fully satisfied by foreclosing the collateral security, the lender may still participate in the bankruptcy proceeding as an unsecured creditor to seek possible repayment.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

There are no preference periods with respect to the security. The bankruptcy administrator may, within six months of the bankruptcy adjudication, apply to the court for the invalidation of the following acts of the debtor: (1) provision of security for outstanding debts within six months prior to the bankruptcy adjudication; and (2) repay the debts not yet due. In addition, the bankruptcy administrator shall, within two years after declaration of the bankruptcy proceeding, file with the court to rescind the transaction which the bankrupt conducted with or without consideration before the bankruptcy proceeding if such transaction is deemed detrimental to the rights of the bankrupt's creditor and is revocable under the Civil Code.

As for preferential creditors' rights, below are certain examples:

(i) land value increment tax, land value tax and house tax levied on the sale of the real property which will rank prior to the mortgagee and the unsecured creditors;
(ii) the following labour claims will rank prior to unsecured creditors: (a) labour wages due and payable by the employer but overdue for a period of fewer than six months; (b) retirement payments payable by the employer pursuant to the Labour Standards Act but not yet paid; and (c) severance payable by the employer pursuant to the Labour Standards Act or Labour Pension Act but not yet paid; and
(iii) fees and debts incurred for the benefit of the bankruptcy estate which will rank prior to unsecured creditors.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The following may apply for bankruptcy adjudication: (1) natural persons; (2) juristic persons; and (3) partnerships and any other incorporated association with a representative or an administrator. An unincorporated association without a representative or administrator is excluded from a bankruptcy proceeding, and there is no special legislation applicable to such entity. Banks and insurance companies are excluded from bankruptcy proceedings and will be subject to the proceedings provided under the Banking Act, Deposit Insurance Act and Insurance Act.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

According to the Civil Code, the creditor may initiate certain self-help remedies to seize the debtor's property and will not be liable therefor, provided that: (i) the assistance of the court or of other relevant authorities is not accessible in time and the satisfaction of the creditor's claim will be impossible or manifestly difficult without the self-help remedy; and (ii) the creditor shall apply for the court's assistance immediately after the self-help remedy is exercised. A creditor and the security provider may sign an agreement whereby the ownership of the mortgaged or pledged security will be transferred to the mortgagee (only in relation to the real estate mortgage) or pledgee automatically when the debtor defaults. However, in the case of a mortgaged security, such agreement to transfer cannot be enforced against a *bona fide* third party, unless the mortgage is registered with the competent authorities.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The Judicial Yuan of Taiwan has held an internal conference and reached a conclusion that a submission to jurisdiction clause will be valid in the absence of any of the following circumstances: (1) it would be unfair for the subject matter to be adjudicated by the chosen jurisdiction; (2) the consent of a party to submit to the chosen jurisdiction was obtained by fraud, duress or other unlawful means; (3) the parties were not equal-footed when they entered into the submission to jurisdiction agreement; (4) it would be inappropriate or inconvenient for the chosen jurisdiction to adjudicate the subject matter; and (5) the country of the chosen jurisdiction does not recognise and enforce judgments of Taiwan courts on a reciprocal basis. The conclusion made by the Judicial Yuan is, however, subject to test in court.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, it is. It will be binding upon that party under Taiwan law unless (i) the waiver would be contrary to the public order or good morals of Taiwan, or (ii) the waiver would have the effect of circumventing mandatory and/or prohibitive provisions of Taiwanese law.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There is no particular licensing or other eligibility requirement to lend money to a company in Taiwan. However, the Company Act provides that the capital of a Taiwanese company shall not be lent to any person unless the lending arrangement is due to a business transaction or is necessary for short-term financing and the aggregate amount of such short-term financing should not exceed 40% of the company's net value. As a result, in local practice, no company in Taiwan except banks, securities firms, insurance companies or pawn shops may engage in lending as an ordinary business. Taiwan has not opened the establishment and operation of lending/finance companies. Accordingly, currently it is not possible to set up a company to operate a lending business in Taiwan.

Since there is no particular licensing or eligibility requirement, the main distinction under the laws of Taiwan between a lender that is a bank versus a lender that is a non-bank, would be the application of the above lending restriction under the Company Act to a non-bank lender.

There is no particular licensing or other eligibility requirement or restriction on a foreign lender for making a loan to Taiwanese borrowers outside of Taiwan, regardless of whether the foreign lender is licensed or not. Nevertheless, a foreign company is not allowed to operate any business in Taiwan without setting up a branch in Taiwan. Thus, if lending is the foreign company's business, making a loan to Taiwanese borrowers by the foreign company which does not have a branch in Taiwan on a repeated and continuous basis may violate the Company Act. Furthermore, as advised in our answer to question 2.6, in the case of a foreign loan to a Taiwanese borrower, the foreign exchange control would apply unless such foreign debts have been registered with the CBC by the Taiwanese borrower.

There are no special licensing and other eligibility requirements in Taiwan for an agent under a syndicated facility to lend to a company in Taiwan. However, in practice, an agent is normally a member of the syndication and the creditor's rights of the syndication members are joint and several in order to allow the agent to claim the repayment/payment and the collateral on behalf of the other syndication members. Given that a foreign bank does not have a banking licence in Taiwan, whether a foreign bank which acts as a facility agent and carries out payment/repayment matters would be deemed to "handle remittance of funds" under Article 29 of the Banking Act, an activity exclusively reserved for banks, is still subject to the views of the Taiwanese banking regulators or the test of Taiwan courts.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

As mentioned in our answer to question 1.1, based on the previous experience of SARS, the spread of COVID-19 has been relatively well controlled in Taiwan and except for certain industries (such as aviation and travel agencies), the daily life of general public and business activities of enterprises has not been greatly impacted by COVID-19. Therefore, the document execution and delivery requirements and mechanics in Taiwan, in both regulatory and practice aspects, are basically the same as the pre COVID-19 era. Given the effective control of COVID-19 in Taiwan, we do not anticipate any major changes in 2021 in this regard.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

For foreign lenders who will participate in financing in Taiwan, please refer to our answer to question 3.11 regarding the ability of a foreign entity without a local presence to take collateral security, especially the real estate mortgage and chattel mortgage.

If a foreign lender provides a loan with a term of more than one year to a Taiwanese company in which it owns shares or capital, or a Taiwanese partnership in which it is one of the partners, or a Taiwanese business of which it is the sole proprietor or a branch created by it, please note that a prior approval from the Investment Commission of the MOEA is required.

As to foreign exchange control, please refer to our answer to question 2.6.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Trends

Based on our observations, as well as feedback from bankers, financiers and market leaders, the lending market in the UAE has been supported by the measures taken by the Central Bank of the UAE ("CB UAE") to limit the negative effects of the COVID-19 pandemic. The CB UAE announced the AED 100 billion Targeted Economic Support Scheme ("TESS"), which came into effect on 15 March 2020. TESS consists of an AED 50 billion allocated facility from the CB UAE for collateralised loans to be provided at zero cost to all banks licensed to operate in the UAE (the "TESS Facility") and AED 50 billion by way of funds freed up from banks' capital buffers. The TESS Facility allows banks to draw down on funds provided by the CBUAE at no cost. These funds can then be substituted for the payments the banks would be expecting from their clients, allowing the banks to defer the expected payments from their clients to a later date. The maturity date for the TESS Facility is currently 30 June 2021 (extended twice from 15 September 2020 and 31 December 2020). Given this environment, lenders have been cautious to provide fresh financings to new clients and have been focused on re-financings for existing clients, involving adding supplemental facilities or amending existing facilities to extend maturities.

From an Islamic finance perspective, many leading Islamic banks and financial institutions, including Dubai Islamic Bank, Emirates Islamic Bank and Abu Dhabi Islamic Bank, announced significantly reduced profits in 2020 largely due to reduced revenues and increased provisions for impairment charges. Dubai Islamic Bank, Emirates Islamic Bank and Abu Dhabi Islamic Bank decreased their net profits in the first nine months of 2020 by 22.2%, 133.2% and 39.4%, respectively, with Emirates Islamic Bank posting a loss of AED 311 million. The asset-based nature of asset financing is well suited to the principles of Islamic financing, and there is a growing trend of *Shari'a*-compliant financing in the aviation, shipping and infrastructure industries. *Ijara* arrangements are often used to replicate conventional lease agreements, providing a viable *Shari'a*-compliant alternative to conventional aircraft and shipping financing. *Istisna* contracts are also useful in circumstances where aircraft are purchased directly from the manufacturer and the financing is put in place before such aircraft are delivered. In addition, we have witnessed and are witnessing tangible interest by Islamic financial institutions in gaining exposure to asset-backed or asset-based lending in non-Islamic jurisdictions including the United States, the United Kingdom, and the European Union. We have continued to see an increase in the utilisation of parallel Islamic funding structures with conventional funds based in the United States that are investing in various types of real estate, such as post offices, hotels, offices, and industrial units. Such funds are looking to the region to tap the liquidity in the market, whilst being mindful of the intricacies of *Shari'a* compliance.

The UAE experienced an economic retraction, with the UAE Central Bank estimating annual overall real GDP growth to be approximately -6% for 2020. UAE banks remain well capitalised, and the cost of funding decreased in 2020 as EIBOR trended lower and the UAE Central Bank cut its benchmark interest rate by 50 basis points over the course of the year to 1.50%, imitating the cuts made by the US Federal Reserve. These factors have been supportive for the lending environment; however, given the effects of the COVID-19 pandemic and the response of the CB UAE, which allows borrowers to defer their payment obligations, banks and other loan market participants (particularly in the project finance space) remain cautious, and we have continued to see financial institutions shy away from long tenors, with export credit agencies and development institutions stepping up to play a larger role in the financing of major projects in the region. We also note that, as of the time of writing this chapter, although the UAE is not imposing extensive restrictions on residents and individuals are permitted to attend work and leisure activities, it is likely that the effects of COVID-19 will still have a dampening effect on the UAE lending market in 2021.

Background to legal regime

When reading this chapter, it is important to note that the UAE provides the option for companies to incorporate either "onshore" (for which it was previously the case that 51% of the company must be owned by a UAE national or 100% by a Gulf Cooperation Council ("GCC") national) or "offshore" (in one of over 40 free zones, including, but not limited to, the Dubai International Financial Centre ("DIFC") and the Abu Dhabi Global Market ("ADGM")). However, Federal Decree by Law No. 19 of 2018 regarding Foreign Direct Investment ("FDI Law"), promulgated on 30 October 2018, permits 100% foreign direct ownership of onshore UAE companies operating in certain sectors of the economy. This was a strategic move to prioritise growth in those sectors. However, it should be noted that Article 7 of the FDI Law contains a "negative list" of sectors which are excluded and remain subject to the original 49%/51% ownership thresholds. These sectors include, but are not limited to, the exploration and production of petroleum materials, military sectors, and banking and finance. The UAE has further loosened foreign ownership

restrictions by enacting Federal Decree 26 of 2020, which amends Article 10 of the Commercial Companies Law (Federal Law No. 2 of 2015 concerning Commercial Companies) (the "CCL 2015") and allows the Cabinet of the UAE to exclude a company from any term or provision which stipulates the percentage of ownership of UAE nationals or their involvement in the management of this company. This change to Article 10 does not mean that foreign ownership laws are completely abolished; however, it means that the default provision is no longer that 51% of an onshore company's shares must be owned by a UAE national or 100% by a GCC national. As most free zones will only have the power to regulate and promulgate laws regarding the incorporation of companies, each free zone typically has its own companies laws and regulations. These laws and regulations permit 100% foreign ownership in their respective free zone. The focus of this chapter will be on onshore UAE companies and companies incorporated in the DIFC and ADGM (as the DIFC and ADGM are the most relevant free zones insofar as financial institutions and their activities are concerned). The Constitution of the UAE 1971 (the "UAE Constitution") was amended on 27 March 2004 to allow the establishment of financial free zones (the DIFC and ADGM, by way of example) and grants them the legislative power to enact their own civil and commercial laws for the companies registered within those free zones. Both the DIFC and ADGM have enacted comprehensive laws and regulations (in many cases imported from English law) but excluded criminal law, as the Federal Penal Code 3 of 1987 (as amended) still applies to such free zones. In addition, the DIFC and ADGM have their own court systems.

Practitioners should also be aware that *Shari'a* (Islamic law) is a main source of legislation as confirmed by Article 6 of the UAE Constitution, and companies operating, lending or taking security in the UAE should be sensitive to UAE law and customs. A key example of this relates to the language used in *Shari'a*-compliant transaction documentation. Terms such as "lender", "borrower", "debt", "interest" and "loan", although used within this chapter to assist the reader, are not *Shari'a*-compliant and should be interpreted as (and used when working on *Shari'a*-compliant deals) "financier", "obligor", "profit", "facility" or "financing", as applicable.

Legislation

A value-added tax ("VAT") regime was enacted pursuant to Federal Decree Law No. 8 of 2017 (the "VAT Law") (based on the principles contained in the Unified GCC Agreement for VAT which was published in the Kingdom of Saudi Arabia's Official Gazette in April 2017), introducing a VAT at a rate of 5% across the UAE as of 1 January 2018. As a consequence, facility agreements now must contain provisions regulating the payment of VAT by the borrower. Lenders and borrowers also need to assess the applicability of VAT to commodity trades used in commodity *Murabaha* financings.

In 2016, Federal Decree by Law No. 9 of 2016 on bankruptcy (the "Bankruptcy Law") came into effect, introducing the UAE's first stand-alone bankruptcy legislation. The Bankruptcy Law has introduced restructuring and standardised insolvency procedures in the UAE. In addition, the Bankruptcy Law applies across the board to companies governed by the CCL 2015, some free-zone companies, sole establishments and civil companies conducting professional business.

The Bankruptcy Law has also introduced three main procedures for a business in financial difficulty: a protective composition; a restructuring scheme; and insolvency and liquidation. The implications of the Bankruptcy Law on the lending market in the UAE are touched upon in this chapter, particularly with regard to the rights of secured creditors in enforcing their security interests during bankruptcy proceedings. The Bankruptcy Law has given support to companies experiencing economic difficulty by providing different routes through which such companies can continue as a going concern and avoid liquidation.

In late 2016, Federal Law No. 20 of 2016 on the pledge of moveables as security for debt (the "Pledge Law") was enacted. However, the Security Register (as defined below) was not established until April 2018. This was a significant legislative development which substantially changes or regularises the manner in which a charge can be created over moveable assets. The Pledge Law provided lenders with the ability to register effective pledges over tangible or intangible moveable assets that exist in the present or in the future, a problem both lenders and debtors have struggled with for some time.

The Pledge Law changed the position of taking a pledge over moveable assets by removing the need to transfer the possession to the mortgagee or third party as bailee. An electronic security register (the "Security Register") has been established to record the rights of the parties under the pledge and to establish priority *vis-à-vis* competing creditors. The removal of the need to take possession over the asset has been a welcome modernisation of the law, which removes an administrative burden for commercial parties and encourages uninterrupted trading in the assets that are secured. This has been significant in situations where a transfer of possession was not practical or possible. The Pledge Law has now been superseded by Federal Law No. 4 of 2020 on Securing the Rights in Movables (the "New Pledge Law"), which came into force on 29 May 2020. The New Pledge Law retains the key features of the Pledge Law described above, while clarifying certain items, such as making it clear that the outright sale of receivables should be perfected by registration on the Security Register.

The New Pledge Law had a positive reception; however, due to the untested nature of the Pledge Law and New Pledge Law, we have seen circumstances where parties have continued to err on the side of caution and have chosen to take security under both the New Pledge Law as well as other available forms of security (where possible) to secure their positions.

Further detail on the practical effect and operation of the New Pledge Law is clarified by the executive regulations of the Pledge Law (Council of Ministers Decree No. 5 of 2018, the "Executive Regulations"). The Executive Regulations were issued pursuant to the Pledge Law; however, it is still effective in accordance with the provisions of the New Pledge Law. The New Pledge Law has provided greater confidence to both lenders and borrowers in the UAE lending market, and the Executive Regulations provide detailed guidance on the practicalities and documents needed for security registration.

The DIFC also recently introduced a number of new laws and regulations enhancing its corporate regulatory framework. Significant changes were established by the new DIFC companies law (DIFC Law No. 5 of 2018) (the "New DCL"), which came into effect on 12 November 2018. One important change is the reclassification of companies, whereby "Limited Liability Companies" are now categorised as either "Public Companies" or "Private Companies".

The DIFC also introduced a new insolvency law (DIFC Law No. 1 of 2019) (the "New DIL"), which came into effect on 6 May 2019 and adopts the UNCITRAL Model Law, in order to facilitate cross-border cooperation for multijurisdictional insolvency proceedings.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The USD 941,000,000 financing made available by Japan Bank for International Cooperation (JBIC); Mizuho Bank, Ltd;

Sumitomo Mitsui Banking Corporation; Sumitomo Mitsui Trust Bank, Limited; BNP Paribas Fortis SA/NV; and Standard Chartered Bank to Fujairah Power Company F3 LLC for the Fujairah F3 IPP project. The Fujairah F3 IPP project is a 2,400-MW natural gas-fired combined cycle power plant located in Qidfa, Fujairah. This financing reached financial close in July 2020 and aligns with the broader UAE Energy Strategy 2050.

The issuance of USD 1,000,000,000 2.942% coupon bonds issued by the Sharjah Sukuk Programme Ltd in June 2020 and maturing in June 2027. The bonds trade on the Irish stock exchange and had HSBC, Arab Banking Corp., Dubai Islamic Bank, Gulf International Bank, Mashreqbank and Sharjah Islamic Bank as bookrunners.

The AED 397,500,000 senior project facilities made available by Dubai Islamic Bank PJSC in April 2018 to Reem Integrated Healthcare Holdings, for the development of the Al Reem Integrated Health & Care Center in Abu Dhabi. The 10-year facility was split as an AED 280,000,000 *Istisna*/forward lease, AED 87,500,000 *Ijara* and an AED 30,000,000 profit rate swap. The transaction reflects a trend in project financing where risk aversion from financial institutions translated into a highly structured deal, with a subordinated mezzanine financing tranche with Tor Asia Credit Master Fund LP as Mezzanine Creditor (among others) and a second ranking facility with Al Tamouh Investments Company LLC as Vendor Creditor which were brought in to cover the equity gap. It also highlights the increasing investment in healthcare projects in the UAE.

The USD 400,000,000 project bond coordinated by Citigroup and HSBC issued in November 2018 for the refinancing of debt linked to the Fujairah 1 (F1) IWP project, a fully operational power and desalinated water plant in the Emirate of Fujairah, with Abu Dhabi Water and Electricity Company ("ADWEC") as offtaker.

The Abu Dhabi Future Energy Company PJSC and Sharjah Environment Company LLC Waste to Energy project. The project is innovative as it is the first Waste to Energy project to be financed on a non-recourse basis in the Middle East region and the first long-term project financing in the Emirate of Sharjah. The debt financing of USD 164,000,000 was made available by Abu Dhabi Commercial Bank, Abu Dhabi Fund for Development, Siemens Bank, SMBC and Standard Chartered and it closed in December 2018. It was structured as a 20-year door-to-door soft mini-perm with a target refinancing date at Year 2 post Scheduled Project Commercial Operation Date and a minimum Debt Service Coverage Ratio of 1.20×.

The USD 1,500,000,000 financing in April 2018 of the Mohammed bin Rashid Al Maktoum Solar Park Phase 4 by Chinese banks ICBC, Bank of China and Agricultural Bank of China, which will see a heavy presence from Chinese contractors, including Shanghai Electric, Dongfang Electric and Harbin Electric. The deal was structured as a seven-year soft mini-perm loan. The Mohammed bin Rashid Al Maktoum Solar Park is the largest thermo-solar power plant in the world.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

A company can generally guarantee the borrowings of members of its corporate group in the UAE, subject to certain restrictions as set out in the response to question 4.1.

For both onshore and offshore entities, authority to provide guarantees is predominantly governed by the relevant entity's constitutional documents and obtaining the relevant corporate authorisations (see the response to question 2.3). Guarantees must be in writing and specify the amount secured by the guarantee. The purpose of the guarantee must be clearly defined from the outset as per the laws of the UAE.

Generally, guarantees provided under certain Islamic financing structures that are subject to *Shari'a* principles may not be permitted, if their objective is to guarantee a specified return to the lenders or investors. Further, all documents relating to a *Shari'a*-compliant transaction must be pre-approved in writing by *Shari'a* scholars who issue compliance certificates (each, a "*Fatwa*" and collectively, "*Fatawa*") per transaction and are expected to audit the transaction on a regular, often annual, basis to ensure that it continues to comply with *Shari'a* and its requirements, as interpreted by the relevant *Shari'a* scholars and documented in the relevant *Fatwa*.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Whilst no specific restrictions are identifiable, the main concern revolves around a director's fiduciary duties to the relevant company.

Onshore

A director of an onshore company in the UAE is required to act in the company's best interests, as set out in the CCL 2015. The directors of an onshore company must have regard to the legislative requirement for the pursuit of profit (CCL 2015 Article 8), and to further the company's objectives (CCL 2015 Article 22). With those interests in mind, there are also some distinct provisions to which directors should adhere, including a restriction on guaranteeing any loan agreement with a board member and third party (CCL 2015 Article 153) and entering into any loan agreements (typically interpreted as including guarantees) for a term that exceeds three years (CCL 2015 Article 154) (see the response to question 2.3).

Offshore

Similarly, free zone entities place similar responsibilities on the directors. The New DCL states that directors must, amongst other things, "exercise independent judgment, exercise reasonable care, skill, and diligence and avoid conflicts of interest" (New DCL Articles 71, 72 and 73, respectively). In relation to the ADGM, Chapter 2 of Part 10A of the ADGM Companies Regulations 2020 (the "ADGM Companies Regulations") also requires that directors perform the same duties listed above in the New DCL. The New DCL is widely considered to have broadened the scope of duties for directors of DIFC companies and both the New DCL and the ADGM Companies Regulations closely align with the directors' duties under the English Law Companies Act 2006.

Directors for both onshore and offshore companies should therefore take care when committing a company to guarantee the financial risk of another entity, and should conduct appropriate due diligence to ensure that the company is able to meet its payment obligations and that the company is not insolvent or likely to become insolvent.

2.3 Is lack of corporate power an issue?

Similar to the Western markets, the first step for both onshore and offshore companies is to review their constitutional documents to ensure that the company can provide a guarantee.

Onshore

By way of its constitutional documents, an onshore company may grant management broad powers that enable it to run the company without involving its board of directors and shareholders (subject to certain restrictions for public companies – explored in more detail below).

In respect of onshore public joint stock companies ("PJSCs"), directors may not enter into a loan agreement (which is interpreted by most practitioners and based on most court rulings to include guarantees) for a term that exceeds three years (CCL 2015 Article 154), unless the constitutional documents expressly permit this. If not expressly permitted, shareholder approval should be obtained. For onshore limited liability companies ("LLCs"), which had previously avoided hefty regulation, directors should be aware that CCL 2015 now includes an article (Article 104) that states that the provisions therein, which apply to PJSCs and private joint stock companies ("PrJSCs"), shall now also apply to an LLC unless otherwise stated. On 29 April 2016, the UAE Ministry of Economy published Ministerial Resolution No. 272 of 2016 (the "Resolution"). The Resolution seeks to clarify which provisions regarding PJSCs also apply to LLCs. Although the Resolution clarified many provisions in the CCL, one example being that managers of LLCs can now be held liable to the LLC and/or its shareholders for "errors in management" (which need not be gross errors), certain provisions remain unaddressed, for example, whether Article 153, which prohibits providing loans to directors and their relatives, also applies to LLCs.

Offshore

Offshore companies must similarly act in accordance with their articles, though notably they need not comply with the CCL 2015, except to the extent that they also operate onshore within the UAE. It should be noted that the relevant DIFC and ADGM laws also include provisions to protect third parties dealing with companies in good faith. For example, Article 21 of the New DCL and Article 35 of Part 4 of the ADGM Companies Regulations both state that a person acting in good faith shall not be affected by any limitations in the articles of a company relating to the ability of the directors to bind the company. This approach is broadly consistent with the UK Companies Act 2006.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In general, no governmental consents or filings are required in order to give effect to a guarantee in the UAE. However, a guarantee should be properly authorised by the company's constitutional documents and authorisations as previously stated. For onshore companies, a guarantee's form and substance should satisfy the requirements of the Civil Transactions Law (Federal Law No. 5 of 1985, as amended) (the "Civil Transactions Law") and the Commercial Transactions Law (Federal Law No. 18 of 1993) (the "Commercial Transactions Law"), as applicable. Practitioners should also consider that offshore companies may have their own legislation that governs such form and substance.

Additionally, if a transaction needs to comply with *Shari'a* principles, the pre-approval of *Shari'a* scholars is required as more fully described in the response to question 2.1.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

As mentioned above, depending on the *Shari'a* structuring of the transaction, certain guarantees that assure a specified return for the lender may be restricted, and specific advice should be sought in this regard.

Onshore

For onshore companies, the Civil Transactions Law (Article 1061) requires that guarantees must be issued with respect to a specified debt or certain amount. In addition, the guarantee should be within the capacity of the guarantor to discharge. Therefore, whilst there is not a limit *per se*, a guarantor should not guarantee more than it can afford to repay. Guarantees should also be specific in nature, and whilst judgments have been made in the UAE that have recognised "all-monies" guarantees, the above restrictions should be carefully considered on a case-by-case basis.

Offshore

There are no such limitations placed on DIFC or ADGM companies, other than those outlined in the response to question 2.2.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange controls in the UAE that would restrict the enforcement of both onshore and offshore guarantees, aside from certain restrictions arising under international sanctions or local boycott regulations.

Onshore

The interpretation of the limitation period for onshore companies may affect enforcement of guarantees. Article 1092 of the Civil Transactions Law states that in relation to a surety, a creditor should claim the debt within six months of the date on which payment fell due. The Supreme Court in Abu Dhabi has stated that Article 1092 shall only apply to guarantees with respect to civil transactions and has found that the six-month time bar does not apply to guarantees in commercial transactions, particularly where the beneficiaries are financial institutions. In commercial transactions, if there is no time limit specified in the bank guarantee, the general limitation period under UAE law of 10 years shall apply as provided, as UAE law does not provide a specific limitation period specifically for bank guarantees. It is therefore common practice to disapply the provision that states the limitation period is six months in the relevant transactional documents, though it is not clear if this would succeed in ensuring that the provision would not have effect.

Offshore

Certain free zones have passed specific regulations that apply *in lieu* of the UAE Code of Civil Procedures (Federal Law No. 11 of 1992, as amended) (the "Code of Civil Procedures") and the Commercial Transactions Law. For example, the Law of Damages and Remedies DIFC Law No. 7 of 2005 in the DIFC states that, excluding fraud, a claim cannot be commenced more than six years after the date of the event(s) that gave rise to the claim. However, should the free zones' legislation be silent regarding limitation periods, the period will be the same as under UAE law. The ADGM incorporates a number of English law statutes, including the Limitation Act 1980, by virtue of the Application of English Law Regulations 2015. Under the Limitation Act 1980, a claim that is founded on a simple contract cannot be commenced more than six years after the date of the event(s) that gave rise to the claim. Where the claim is founded on a deed, a claim cannot be commenced more than 12 years from the date of the event(s) that gave rise to the claim.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Although there are differences between the types of collateral available to onshore and offshore companies, both allow (with certain restrictions and limitations) security over: (i) real estate/land; (ii) tangible moveable property (e.g. machinery or stock); (iii) shares; (iv) receivables; and (v) cash deposits.

As outlined above, the New Pledge Law governs the process of taking security over a wide variety of moveable property located onshore in the UAE, both tangible and intangible. The law has alleviated the more cumbersome aspects of taking security over moveable property, which was generally previously governed by the Civil Transactions Law and the Commercial Transactions Law. Some assets, such as shares, do not fall within the parameters of the New Pledge Law.

For each free zone, the Federal or Emirate decree that created the free zone should be reviewed, as it may grant authority for that free zone to regulate matters relating to the taking of and enforcing of security. Most free zones will only have the power to regulate and promulgate laws regarding the incorporation of companies, and therefore the relevant Federal laws of the UAE and specific Emirate will continue to apply to all aspects not expressly regulated by the free zone. In relation to the DIFC, the creation, perfection and enforcement of security is governed by the DIFC Law No. 8 of 2005 ("DIFC Law of Security"), the DIFC Security Regulations, the DIFC Financial Collateral Regulations and the DIFC Real Property Law (DIFC Law No. 10 of 2018). Such regulations more closely mimic common law-based regulations governing the taking of security.

In relation to the ADGM, the law relating to security is broadly governed by the ADGM Real Property Regulations 2015 ("ADGM Property Regulations"), the ADGM Companies Regulations and the ADGM Insolvency Regulations 2015 ("ADGM Insolvency Regulations"). The legislation in the ADGM is also closely aligned with English law, with the most common form of security being taken over collateral being a charge. The law also recognises the distinction between the concept of fixed and floating charges, which is a distinction that also exists under English law. A fixed charge would commonly be granted over machinery and shares, whereas a floating charge usually covers all other current and future assets, including stock-in-trade, and a mortgage would typically be taken over land. Debtors with a fixed charge have very limited ability to dispose of their assets, whereas debtors with a floating charge are free to dispose of their assets in the ordinary course of business.

Foreign lenders should also bear in mind that ownership of land may be restricted to UAE (or GCC) nationals in certain Emirates. This has also been confirmed by the FDI Law, as land features as one of the sectors on the aforementioned negative list. Dubai, however, is generally more progressive in this regard, as it permits foreign ownership of land in certain designated areas (Regulation No. 3 of 2006 Determining Areas for Ownership by Non-UAE Nationals of Real Property in the Emirate of Dubai). Such restrictions could affect the perceived value placed on any such security by lenders; the ability of a foreign lender to enforce its security package over, for example, real estate in an area that is not designated as freehold or over shares in a company incorporated onshore up to a percentage that exceeds the maximum that foreigners are entitled to own should be borne in mind when negotiating the security package for any given transaction. This often triggers the need to consider a structured solution, or the involvement of a security agent or trustee.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Whilst general overarching security agreements can be provided in the UAE, the general practice and advisable approach is to have separate agreements wherever possible. Further, as certain security documents may have to be notarised and registered with different government entities, particularly in relation to land and shares, it may create uncertainty and result in additional costs if they were to be included in the same agreement.

Additionally, in *Shari'a*-compliant transactions, *Shari'a* scholars will insist on the separation of subject matters in documentation to ensure that there is a reduced chance of material ambiguity (*Gharar*) in the agreements.

The procedures for the relevant security agreements vary from asset to asset (see the responses to questions 3.3 and 3.8).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Onshore

A person or company owning property in the UAE (with the legal capacity to sell) can create a mortgage in favour of a mortgagee licensed by the UAE Central Bank. The mortgage can be over: (i) land and buildings; (ii) a leasehold interest; and/or (iii) a building erected on leased land.

In order to perfect a valid mortgage in the UAE, the land mortgage agreement (generally pre-printed documents prescribed by the relevant authorities) must be: (i) executed in writing in Arabic in the presence of a notary public or the relevant land department; and (ii) provided to the mortgage registrar with the land department or the local municipality of the relevant Emirate. A fee, which is usually payable, is dependent on the specific Emirate; however, it can commonly be linked to a percentage of the mortgage amount (see the response to question 3.9).

As discussed in the response to question 3.1, foreign lenders should also bear in mind that ownership of land, onshore companies and other assets may be restricted to UAE (or GCC) nationals in certain Emirates and, as such, the involvement of a local bank or a local/regulated security agent or trustee may be necessary. Furthermore, regardless of foreign ownership restrictions, certain types of security can only be given in favour of a bank licensed by the UAE Central Bank.

Lenders should also be aware that it is possible to take mortgages over ships and aircraft under the laws of registration of the relevant assets. In the case of mortgages over aircraft, the mortgage instrument may be filed with the General Civil Aviation Authority and a UAE pledge will also typically be taken over these assets. It is also worth noting that, in 2008, the UAE ratified the Convention and Aircraft Protocol on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment, commonly known as the Cape Town Convention.

Offshore

Interests in land in free zones may be subject to the regulations of such free zone. Property within the DIFC is governed by the DIFC Real Property Law, which outlines that land transactions must be registered in a central register administered by the DIFC and should include: (i) a description to identify the property; (ii) a description to identify the interest to be mortgaged; and (iii) a description of the secured debt or liability.

The ADGM Property Regulations govern property within the ADGM and also provide that the Registrar shall maintain a real property register which shall record all documents relating to the creation or transfer of property rights in the ADGM.

As with land, security over machinery and equipment in free zones may be subject to the respective free zone regulations, and the relevant Federal or Emirate decree which created the free zone should always be consulted. The DIFC and the ADGM, unlike UAE law, generally allow for the registration and enforcement of a floating charge (see the response to question 3.7 below).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, typically security over receivables is taken by an assignment of the contractual rights under the agreement giving rise to the receivables.

Onshore

The New Pledge Law applies to the creation of security over receivables from third parties. The law provides that security may be created over receivables so long as the parties enter into a written agreement that complies with the requirements of the Executive Regulations (a "Pledge Contract"). In accordance with Article 4 of the Executive Regulations, a Pledge Contract must contain a description of the property being pledged, which includes:

(i) a description of the pledged property, indicating quantity, piece, type, category or item, in a manner that indicates the essence of the pledged property;
(ii) a phrase indicating the creation of the right of pledge over the entire current or future moveable property;
(iii) a phrase indicating the creation of the right of pledge over the entire moveable property; and
(iv) a phrase indicating the creation of the right of pledge on a certain category or type of moveable property, whether current or future property, such as the phrase "all equipment" or "all the current or future receivables".

The process of online registration under the New Pledge Law requires the following details:

(i) general information on the notice and security type (e.g. security right, finance lease, operating lease or consignment);
(ii) details of the party granting the security;
(iii) details of the creditor that will be receiving the benefit of the security;
(iv) details of other interested parties;
(v) a description of the moveable collateral that will be pledged as referred to above (there is no requirement to disclose the loan documents or proprietary information); and
(vi) statistical information (e.g. currency of the obligation, value of the obligations, type of collateral and related sector).

It should be noted that statistical information will not be made public on the Security Register, but should benefit the UAE by being a source of statistical data, which could assist with policy decisions. The registration process for initial security interests comes with a nominal fee of AED 100.

In addition to registration, it will also be necessary to notify any possessor of the secured property of the security interest being created if the relevant property is not in the possession of the security provider.

Offshore

Rules for assignments vary depending on the free zone. Security over receivables in the DIFC is governed and permitted by the DIFC Law of Security and the DIFC Security Regulations. Notably, the DIFC does not provide different rules depending on the asset to be secured (excluding land); hence, all security to be taken in the DIFC must "attach" to be effective. For "attachment" to occur:

(i) a value must be given;
(ii) the debtor must have rights in the collateral or the power to transfer its rights in the collateral to a security party; and
(iii) one of the following: (a) the obligor must be bound by a security agreement that provides a description of the collateral; or (b) the collateral must be a negotiable document of title, a negotiable instrument, money, deposit account or financial property and the secured party must have control pursuant to the obligor's security agreement.

Perfection of the relevant security is attained once: (i) it is "attached"; and (ii) a "financing statement" is filed with the DIFC Security Registrar. The "financing statement" should be filed within 20 days of the date of the security agreement and will lapse five years from the date it is filed (notwithstanding the term of the security agreement itself), pending a continuation statement.

However, it should be noted that a financing statement is not appropriate for security taken over the assignment of certain receivables (as set out in the DIFC Security Regulations) and monies held in an investment account (as defined in DIFC Personal Property Law (DIFC Law No. 9 of 2005)).

In relation to the ADGM, the ADGM Property Regulations permit for the assignment of choses in action, which includes receivables. However, it is necessary that the debtor be notified before such assignment.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Onshore

The New Pledge Law governs the taking of security over funds deposited in a UAE-licensed bank. The law provides that the security shall be created by the parties entering into a written agreement which complies with the requirements of the Executive Regulations. The New Pledge Law provides that future property may be secured, which is particularly relevant in respect of security over cash deposits. The previous position was that the credit balance had to be fixed and identifiable, i.e. no floating charges were permissible, which in effect meant that the borrower had to maintain a blocked account. This resulted in some foreign lenders also requiring that additional security be taken over offshore accounts where floating security is recognised and enforceable. The New Pledge Law is therefore a welcome development for banks when taking local law account pledges.

Offshore

Currently, the only free zones permitted to regulate banks are the DIFC and the ADGM. The relevant account charges are regulated by the DIFC Security Law and the ADGM Companies Regulations, respectively. The procedure and restrictions (including monies held in an investment account) for the DIFC are set out in the response to question 3.4. For any other free zone, UAE law applies.

In the ADGM, companies are permitted to create charges in accordance with the ADGM Companies Regulations. The

charges must be registered with the Registrar of companies which must be provided with a statement of particulars which includes details such as the name of the company that is having their assets charged, the instrument creating the charge and the date of creation of the charge. The charge needs to be registered and failure to do so will result in the charge being void against creditors of the company. The instrument creating a charge is also required to be made available for inspection to any creditor or shareholder of the company at no cost and to any person upon payment of a fee, which is to be prescribed by the company.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Security can be taken over shares in the form of a share pledge in relation to all onshore types of companies, including onshore LLCs and most offshore companies. The pledge documentation should always be governed by the relevant jurisdiction of the share register, which would typically be UAE onshore law or in the case of the DIFC or ADGM, DIFC law or ADGM law, as applicable.

Onshore

The procedure for pledging shares in a PJSC or PrJSC is by the physical delivery of the share certificates to the pledgee and entry of the pledge in the company register (though if the shares are not in certificated form, physical delivery is not required). A PJSC will usually be required to be listed at one of the UAE's stock exchanges and the pledge should be recorded in the share register maintained by the relevant exchange. A PJSC will appoint a share register keeper (such as the Dubai Financial Market ("DFM") or Abu Dhabi Securities Exchange ("ADX")) to record the pledge. Upon such registration, the pledgee typically has the right to collect dividends and entitlements attached to the shares, though in most cases these are returned to the borrower (with certain limitations) unless the borrower defaults.

Onshore LLCs did not previously have any clear legal guidance on how their shares could be pledged, and the pledge perfected. However, the CCL 2015 implements a new system (under Article 79) that allows pledges of shares in an LLC to be made in accordance with such company's articles, and under an official notarised document to be registered at the registrar of companies. In Dubai, it is a requirement that pledges over shares must be registered with the Department of Economic Development to be effective.

As indicated, subject to the FDI Law, lenders should also bear in mind that foreign investors are still restricted in their ownership of capital regarding onshore companies (at least 51% should be owned by a UAE national) and therefore enforcement can be difficult. Typically, a local security agent or trustee will need to be engaged.

Offshore

Most offshore companies (including the DIFC and the ADGM) have physical share certificates that can be pledged and delivered, although this is not always the case. Most free zones also have their own registration requirements for such security, which may include execution of certain forms and filing of executed documents with the relevant free zone registrar.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Onshore

The New Pledge Law governs the validity and enforceability of security over, *inter alia*, raw and primary products and commodities, equipment, machinery and work tools. The formalities of registration are as set in the response to question 3.3 above, and the security will have to be registered on the Security Register. As the law remains largely untested, we have yet to understand how the enforceability of such security shall operate in practice.

Prior to the introduction of the New Pledge Law, the most common way to take security over machinery and trading stock was by way of a commercial mortgage. To register a commercial mortgage, it has to be executed in writing and the agreement has to be notarised and registered in the commercial register of the relevant Emirate's Department of Economic Development. Notice of the mortgage is to be given in two local Arabic newspapers two weeks prior to such registration. The registered mortgage will only be valid for a period of five years unless renewed and updated (notwithstanding the term in the underlying agreement).

Offshore

Security over such assets in free zones is subject to the relevant free zone requirements and applicable regulations. In the DIFC and ADGM, for example, it is possible to create a security interest over future assets/advances, acquired assets and the debtor's right to use, or dispose of all or part of the relevant items in line with the procedure set out in the response to question 3.4 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Both onshore and offshore companies should be able to grant a security interest to secure their own borrowings and those of other borrowers subject to the requirements and restrictions set out herein.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Stamp duty and taxes are not applicable for either onshore or offshore companies given the nil rate of direct tax applicable to most sectors in the UAE (see the response to question 6.1). Many financial services are also exempt from VAT, including the issuance, allotment or transfer of an equity or debt security. However, transfers of land may incur registration fees akin to stamp duty, payable to the relevant Emirates' land registry. These costs vary from Emirate to Emirate.

Notarisation is commonplace in the UAE, and even if not expressly required, may be used in order to add authority to documents. Fees in relation to this are normally charged depending on the document that is to be notarised. For example, notarisation fees for a share pledge agreement are approximately AED 1,300.

The Executive Regulations prescribe nominal fees for different services (which include the registration of pledged property and the modification of registration) for registration which range from AED 50 to AED 200. The exact fees are outlined in a schedule to the Executive Regulations.

Onshore

Onshore mortgage registration fees vary among Emirates; the Dubai Land Department, for example, currently charges 0.25% of the value of the mortgage amount. The fees for registration of other types of security vary depending on which Emirate the security is registered in but commonly involves a percentage of the amount secured and is subject to a cap.

Offshore

Registration varies in the DIFC; for example, a mortgage fee is USD 100 (or USD 273 for an Islamic mortgage), and if the property has not yet been registered with the DIFC Registrar of Real Property an additional fee (currently 5% of the total value of the property) is also payable. The cost of filing a new "financing statement" (see the response to question 3.4) is currently USD 5,000.

In relation to the ADGM, the application to register a mortgage is charged at 2% of the principal amount of the value secured by the mortgage and is capped at USD 300,000.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

In comparison to the United Kingdom and United States, the process of securing assets is generally more complex and expensive. Arguably, the relevant free zones have a more straightforward approach, although it is still more uncertain than the established Western systems. This is somewhat due to a lack of formalised or standard structure of registrars for registration of each type of security in the relevant Emirates. The Security Register for the registration of security over moveable property alleviates some of this uncertainty; however, its practical use remains largely untested due to its infancy. The Security Register also allows searches to be made by details of the pledgor and "Notice Registration Number".

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Typically, no regulatory or similar consents are required prior to the creation of a security. However, to the extent that a regulatory or government-owned body must accept registration of a certain security, this may be deemed a form of consent. Moreover, in circumstances where the secured assets are equities that are listed on an exchange such as the DFM, the consent of the Clearing Settlement and Depository division of the DFM (the "CSD") may be required. The CSD may also request certain documents to be provided before giving such consent. Further, any security against government-owned assets will require consent from the Department of Finance or the Supreme Fiscal Committee, as applicable.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no specific concerns or case law relating to such matters that are apparent.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

The procedures and requirements for security are set out in the answers to the questions above. For both onshore and offshore companies it should be noted that signing in counterparts is generally accepted practice; however, for enforcement purposes, there should always be a "counterparts" provision in the documentation. Though counterparts are generally accepted, it is also advisable, based on judicial precedents, to encourage the signing parties to initial every page and clearly identify themselves and their authorities.

For onshore entities, executing specific security documents, including signing powers of attorney, in front of the relevant notary public and/or registrar may be necessary. Notably, the concept of a deed is not recognised in the UAE outside the DIFC and ADGM and therefore security documents will be entered into by simple contract. In addition, certain assets will require registration in a specified form as dictated by the relevant government or regulatory authority. In the case of corporate signatories, it is good practice that a company stamp should also be affixed. Offshore entities will typically follow the relevant execution requirements in their jurisdiction of incorporation.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Onshore

The CCL 2015 states that a PJSC or PrJSC or any of its subsidiaries "*may not provide financial aid to any shareholder to enable the shareholder to hold any shares, bonds or Sukuk issued by the company*" (Article 222). The definition of such financial aid includes the granting of security over a company's assets or a guarantee for the obligations of another person to a third party. On 28 April 2016, the UAE Ministry of Economy issued guidance, by way of Ministerial Resolution No. 272 of 2016, confirming that the financial assistance prohibition will not apply to LLCs.

Offshore

For the DIFC, a public company and its subsidiary is prevented from providing financial assistance by granting security and providing guarantees by a company limited by shares in relation to the acquisition of shares in itself or in a holding private company unless: (i) such assistance would not materially prejudice the interests of the company and its shareholders or the company's ability to discharge its liabilities as they fall due and must be approved by the shareholders (90% in share value); (ii) finance or financial assistance is part of the company's ordinary business and is on ordinary commercial terms; or (iii) it is specified in the DIFC Company Regulations (2018) as exempt.

In relation to the ADGM, Chapter 2 of Part 17 of the ADGM Companies Regulations generally prevent a public company or a subsidiary of a public company (whether private or public) from providing financial assistance by granting security, a guarantee or an indemnity in relation to the acquisition of shares in such public company. The ADGM Companies Regulations also prohibit a public company from giving financial assistance for

the acquisition of shares in its private holding company. This distinction between public and private companies largely aligns with the English law Companies Act 2006.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Onshore

In the UAE there is no concept of a trust as is commonly the case in civil law systems; however, the concept of agency exists. Syndicated loan transactions will typically involve the appointment of a security agent that is responsible for holding and enforcing security on behalf of the relevant syndicate of lenders. It is best practice for the security agency agreement that appoints the relevant security agent to include parallel debt provisions to ensure that each lender retains the ability to enforce directly against the borrower.

Additionally, it is important to note many forms of security may only be granted to banks licensed by the UAE Central Bank (for example, the Dubai Economic Department will only register share pledges in favour of banks licensed by the UAE Central Bank). It is also important to note that certain assets may only be able to be held by a UAE national or a UAE incorporated entity due to foreign ownership restrictions (subject to the FDI Law).

Offshore

The DIFC and ADGM are a mix of common law and civil law systems, and both recognise the concepts of trust and agency. As such, a security trustee or a security agent may enforce security on behalf of a syndicate of lenders.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Agency is recognised, and in the DIFC and ADGM both agency and trustee roles are recognised, as more fully described in the response to question 5.1.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Provided that the transfer of the loan from Lender A to Lender B is effective and perfected, there should be no additional requirements to make the loan enforceable by Lender B. Under UAE law, there is no concept of novation; however, assignment of both obligations and benefits under a contract is permissible. By contrast, the DIFC and ADGM recognise the concept of novation.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Whilst the UAE has tax laws, the governmental authorities do not currently impose corporate taxes on companies other than on branch offices of foreign banks and certain energy companies (e.g. oil, gas and petrochemical). However, the VAT Law which levies 5% tax on certain commercial activities is based on the principles contained in the Unified GCC Agreement for VAT, published in the Kingdom of Saudi Arabia Official Gazette in April 2017. Other GCC nations such as the Kingdom of Saudi Arabia and the Kingdom of Bahrain have also introduced a VAT regime. The Sultanate of Oman originally planned to introduce VAT in 2019; however, reports suggest that VAT will not be introduced until April 2021 and reports suggest that the State of Kuwait will also postpone VAT implementation to April 2021.

Companies with annual supplies in the UAE above AED 375,000 have to register for VAT. If a company has annual supplies above AED 187,500 it can voluntarily register. Similar to Western markets, if a company is engaged in the supply of goods or services that are subject to VAT (including at the zero rate), the company will be entitled to reclaim VAT that it incurs on its costs. Where the company is engaged in activities that are exempt from VAT and it cannot reclaim VAT incurred on costs, VAT will be a cost to its business (as suppliers will charge VAT that cannot be reclaimed). Reports from consultancy firms indicate that the introduction of VAT in the UAE and the Kingdom of Saudi Arabia had a negative short-term impact on the relative economies of each nation, as inflation has increased.

No withholding tax is currently payable in relation to principal payments, interest payments and other fees associated with the granting of loans. Currently, customs duties are typically very low, and personal income tax is not applicable; however, there are municipality service charges on individuals in the UAE by way of hotel, service charges and housing fees.

Various fees are payable for transferring property or land from one name to another (akin to stamp duty), including registration and notarisation fees (see the response to question 3.9).

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No preference is given to foreign lenders or financiers; however, the nil tax rate (subject to some exceptions as outlined in the response to question 6.1) is viewed as an incentive to invest in the region.

See the response to question 3.3 in respect of costs of registration. It should be noted that some free zones do not recognise the registration of security; hence the lenders have to rely on their contractual remedies in a default situation.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

See the response to question 6.1.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Other than as outlined in the response to question 3.9, the costs to the lender are those that are imposed on it in its own jurisdiction of incorporation, if any.

Additionally, if a transaction is to be structured Islamically in accordance with the principles of *Shari'a*, this may also increase costs due to the document-heavy nature of such transactions and the need to involve *Shari'a* advisory boards.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Onshore

Yes, both the Code of Civil Procedures and the Civil Transactions Law provide for the recognition of foreign governing law in contracts, provided that the conditions set out in the Code of Civil Procedures are satisfied. However, if a UAE Court accepts jurisdiction, especially in an enforcement scenario where assets are located in the UAE, it may ignore the choice of foreign governing law in a contract and apply UAE law insofar as enforcement relates to the domicile of the parties, and the location of assets in the UAE. There are some claims where the parties cannot contract out of the application of UAE law; for example, real estate disputes where the real estate is onshore in the UAE.

Offshore

In the DIFC, Article 6 of the DIFC Judicial Authority Law (Dubai Law No. 12 of 2004 (as amended)) provides that the DIFC Courts may apply the laws of another jurisdiction where the parties to a dispute have explicitly agreed that such laws shall govern a dispute between the parties, provided that such law does not conflict with the public policy and morals of the UAE. In the ADGM, under Article 13 of Abu Dhabi Law No. 4 of 2013, the parties may agree to contract out of the ADGM Courts' jurisdiction and subject any dispute to the jurisdiction of any other court or arbitral tribunal.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Onshore

The Code of Civil Procedures sets out in Article 235 the basis upon which UAE Courts will recognise and enforce foreign judgments or orders.

Article 235 provides that a foreign judgment may be recognised and enforced if:

(i) the law of the country in which the judgment was issued would recognise and enforce a UAE Court judgment. This usually means that the two countries have a bilateral treaty providing for recognition and enforcement of judgments. As neither the United States nor the United Kingdom have such treaties with the UAE, judgments would not be automatically enforceable without re-examination of the merits;

(ii) the UAE Courts have no grounds for jurisdiction to try the case in which the order or judgment was made;

(iii) the foreign court had jurisdiction in accordance with the rules governing international judicial jurisdiction within that country's own laws;

(iv) the parties to the action in which the foreign judgment was issued received proper notice;

(v) the judgment is final and not subject to appeal in the jurisdiction in which it was issued;

(vi) the judgment does not conflict with a judgment already made by a UAE Court; and

(vii) enforcement of the judgment does not conflict with the morals or public order of the UAE.

As a result, although a UAE Court may enforce a foreign judgment if it satisfies all of the conditions set out in Article 235, it is usually difficult for these requirements to be met. The fact that an applicant is seeking to enforce a judgment in the UAE implies that there is a nexus to the UAE in the factual circumstances underlying the case. On that basis, it is likely that a UAE Court may assert jurisdiction and reopen the merits of the case. A common pitfall for potential enforcement is to prove that the UAE Courts did not have jurisdiction to try the case, and, even if all the other conditions set out in Article 235 are satisfied, the UAE Courts may refuse to enforce the foreign judgment on these grounds.

The UAE is signatory to many bilateral treaties and international conventions for the mutual recognition of judicial and arbitral awards.

Offshore

The DIFC Courts Law (DIFC Law No. 10 of 2004 (as amended)) provides the DIFC Courts with discretion to ratify judgments of foreign courts. The DIFC Courts Law also requires that the DIFC Courts abide by any mutual enforcement or judicial cooperation treaties entered into between the UAE and other countries. The DIFC Courts have entered into a Memorandum of Guidance with each of the United States District Court for the Southern District of New York, Singapore, Australia and both the Commercial Court and Queen's Bench Division of the Courts of England and Wales (amongst others). These memoranda address only money judgments, are not legally binding, and set out guidelines to be followed by the respective jurisdictions when assessing whether to enforce the judgments of the courts of the other jurisdiction.

However, a decision in the DIFC could impact the manner in which foreign judgments are enforced onshore going forward. The DIFC Court of Appeal in the case of *DNB Bank ASA v Gulf Eyadah* [CA-007-2015] (25 February 2016) held that a foreign judgment which has been granted recognition in the DIFC Courts becomes a judgment of the DIFC Courts and therefore should be treated as such by the Dubai Courts (onshore courts). This case involved the recognition of an English Commercial Court judgment in the DIFC Courts using the Memorandum of Guidance between the English Commercial Court, Queen's Bench Division, England and Wales and the DIFC Courts.

There is also a system for enforcement between the DIFC Courts and the Dubai Courts (onshore) without review of the merits of the claim. This decision has therefore made apparent the potential for the DIFC Courts to be used as a "conduit" for an enforcement action in the Dubai Courts (onshore) against assets which are also onshore even where the parties have no connection with the DIFC. A subsequent DIFC Courts case of *Barclays Bank & Others v Essar Global Fund Limited* confirmed that where a claimant has received a foreign court judgment, it can be enforced against a Dubai-based party. This is done by virtue of the DIFC Courts acting as a conduit jurisdiction.

A further development has been the creation of the Judicial Committee under Dubai Decree No. 19 of 2016 forming the Judicial Committee of the Dubai Court and the DIFC Courts. The Decree came into immediate effect on 9 June 2016. The Judicial Committee has been created to resolve conflicts of jurisdiction between the DIFC Courts and Dubai Courts (onshore). The Judicial Committee determines any jurisdictional disputes between the Courts and also conflicting judgments of the DIFC and Dubai Courts (onshore) involving the same parties on the same subject matter, putting the legitimacy of the above-mentioned Dubai Courts conduit route into question. The Judicial Committee can also suggest rules and regulations to avoid jurisdictional conflicts arising. The Head of the Judicial Committee is the Chief Justice of the Court of Cassation in the Dubai Courts (onshore) and the other six members of the Judicial Committee are made up of judges from both the DIFC Courts and Dubai Courts (onshore). Where there is a conflict between the DIFC Courts and the Dubai Courts (onshore), either a party to the dispute or the public prosecutor can make a request for the Judicial Committee to decide which court should hear the case or, if there are conflicting judgments, rule on which judgment should be enforced. Once a case has been referred to the Judicial Committee, both courts must stay proceedings and the Judicial Committee's decisions will be binding and cannot be appealed.

Significant developments have also been made in the ADGM. On 11 February 2018, the ADGM Courts and the Abu Dhabi Judicial Department signed a memorandum of understanding ("MOU"), pursuant to Article 13 of Abu Dhabi Law No. 4 of 2013, permitting the reciprocal recognition and enforcement of judgments, decisions and ratified arbitral awards between the ADGM Courts and the Abu Dhabi Courts. Arbitral awards shall be given the same force as a binding judgment of either of the courts without the need for any further ratification by the other court. This mutual recognition and enforcement also extends to approved settlement agreements which have been certified by either court.

The intention is that, as a result of the MOU, judgments from the ADGM Courts will be enforceable in Abu Dhabi without the need for re-examination of the merits of the dispute.

The ADGM Courts, Civil Evidence, Judgments, Enforcement and Judicial Appointments Regulations 2015 permit the ADGM Courts to recognise the enforcement of foreign judgments and arbitral awards provided that the UAE has entered into an applicable treaty with the relevant country. In the absence of such a treaty, the Chief Justice of the ADGM Courts must be satisfied that the relevant foreign court has agreed to provide reciprocal recognition and enforcement for ADGM judgments.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Onshore

(i) Commencing an action for default is a relatively straightforward process. However, seeking a money judgment in the lower courts and enforcing such a judgment upon assets is usually a lengthy process that requires trying a case on the merits, and defending appeals if any are filed by an interested party. This process may in some instances, and depending upon the form of security and nature of the assets, take up to 24 months or even longer, even if there are no legitimate legal defences to non-payment.

(ii) The enforcement of a non-appealable judgment requires the filing of a separate "execution" case. Execution cases are subject to appeal. If the specific assets of the debtor in the UAE are undetermined, a series of inquiries with various UAE government authorities such as the land registries of the respective Emirate(s), the UAE Central Bank, the Securities and Commodities Authority, and the financial markets (the DFM and the ADX) must be made through the courts to identify assets. Real estate, securities and (subject to the provisions of the New Pledge Law) certain moveable assets such as vehicles and machinery will be subject to a public auction process.

Offshore

The enforcement of a security interest over assets located in the DIFC does not require a court order. The DIFC Law of Security governs the creation and enforcement of security over collateral located in the DIFC. The secured party must first notify the defaulting party to make payment or otherwise discharge its obligation to the secured party. The secured party must also notify any other priority creditors of which it is aware. If there is no objection by a priority secured creditor, the secured party may take steps to enforce its security interest over assets located within the DIFC. If the collateral is real property located within the DIFC, the secured party may record with the DIFC Security Registrar a written statement that a default has occurred and that the secured party is entitled to enforce the security interest.

The enforcement of security over a company's assets in the ADGM generally requires either the permission of the ADGM Court or consent from the administrator of the company in question.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Yes.

(i) Whilst enforcement of security previously required a court order, the New Pledge Law also introduces the concept of self-help remedies in relation to certain types of security (for example, secured bank accounts and bonds or endorsable instruments). Articles 25 to 33 of the New Pledge Law provide additional mechanisms that allow the secured party to enforce its security without recourse to a public auction through the courts. The court does, however, have the right to choose the method of sale or to stipulate a minimum limit to the sale price. Certain collateral that does not fall within the parameters of the New Pledge Law, such as real estate and shares, must still be liquidated through a public auction procedure in accordance with the Code of Civil Procedures.

(ii) The attachment and liquidation of publicly listed securities must be conducted in accordance with the procedures prescribed by the UAE Securities and Commodities Authority.

In relation to the enforcement of collateral security in the DIFC and ADGM, see the response to question 7.3.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

There are no foreign lender-specific restrictions relating to filing suit against a company in the UAE or initiating security enforcement proceedings in the UAE.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Onshore

On 29 December 2016, the long-awaited Bankruptcy Law came into effect. The law introduces a protective composition process (where the debtor is in financial difficulty but not insolvent) and a restructuring scheme (as part of bankruptcy procedure), both of which are court-driven processes. Once the court has agreed to initiate proceedings for either the protective composition or the restructuring scheme, a moratorium applies to prevent claims against the creditors. Secured creditors will thereafter have to obtain the court's permission to commence enforcement proceedings.

Offshore

It is possible for a company in the DIFC and ADGM to be subject to: (i) administration; (ii) receivership; (iii) a member's voluntary liquidation; (iv) a creditors' voluntary liquidation; (v) receivership; and (vi) compulsory liquidation. Additionally, the New DIL also provides for rehabilitation, which allows a company to submit a rehabilitation plan, provided there is a reasonable likelihood of such plan being successful and the plan is agreed upon by the company's shareholders and creditors.

The New DIL governs insolvency proceedings in the DIFC. The New DIL allows the DIFC Courts to grant a moratorium, including in relation to the enforcement of collateral, to an eligible applicant. Part 3 of the New DIL also provides for an automatic moratorium (typically for 120 days) in situations where the directors of a DIFC company have notified the DIFC Court in writing that they intend to propose a rehabilitation plan to the creditors of the relevant company.

The ADGM Insolvency Regulations provide that a company in administration will have the benefit of a moratorium, whereby security cannot be enforced over the company's property except with the consent of the administrator of the company or with the permission of the ADGM Court.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Onshore

Article 236 of the Civil Transactions Law stipulates that the same conditions set out in Article 235 for the enforcement of foreign judgments are applicable to foreign arbitral awards, which are set out in the response to question 7.2. The UAE is also a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral awards (New York, 1958), as well as other bilateral treaties and conventions dealing with the mutual recognition of arbitral awards.

Offshore

In the DIFC, an arbitral award, irrespective of the jurisdiction in which it was made, is recognised as binding within the DIFC and upon application to the DIFC Court, is enforceable. A party may challenge enforcement under certain circumstances including when: a party to an arbitration was under some type of incapacity; the underlying arbitration agreement is invalid under the laws which the parties have subjected it to; the party against whom an award was granted was not provided with proper notice; the dispute in relation to which the award was granted falls outside the scope of issues contemplated by the parties to be submitted to arbitration; the composition of the arbitral tribunal or the arbitration procedures was inconsistent with the agreement of the parties or laws of the jurisdiction in which the arbitration took place; the award is not yet binding or has been suspended by a court of the jurisdiction in which it was made; the subject matter of the underlying dispute would not have been capable of settlement by arbitration under the laws of the DIFC; or if enforcement would be contrary to public policy in the UAE.

Where the UAE has entered into a mutual enforcement of judgments treaty, the DIFC and ADGM Courts (as courts of Dubai and Abu Dhabi, respectively) will uphold the terms of the treaty.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Onshore

Enforcement actions over secured assets prior to the initiation of the protective composition or restructuring scheme (or the issuance of a bankruptcy judgment) are permissible if: (i) the underlying debts are due; and (ii) the court approves such enforcement. However, once the court has approved the composition or the plan, the trustee becomes entrusted with the sale of assets in line with the restructuring plan. The Bankruptcy Law clarifies that sale proceedings must be used first to prepay the debts due to secured creditors. However, if a secured asset is essential to the continuance of the business, the court may provide that the secured assets be substituted with other assets, provided that it does not prejudice the rights or interests of the secured creditors.

Should the preventive composition or restructuring scheme prove unsuccessful and the debtor be declared bankrupt, all debts become due and the debtor's assets must be sold in order to repay the secured creditors. If the sale does not occur within one month from the date of the bankruptcy judgment, the secured creditor may request to approve the enforcement over the secured assets.

Offshore

The New DIL and the ADGM Insolvency Regulations both allow for a moratorium, including in relation to the enforcement of collateral, to an eligible applicant.

Dubai World – Decree 57

The Special Tribunal related to Dubai World ("Tribunal") was established by Dubai Decree No. 57 of 2009 issued by His

Highness Sheikh Mohammed Bin Rashid Al Maktoum, in his capacity as the Ruler of Dubai. The Tribunal was established to hear claims against Dubai World, a Dubai Government-owned holding company, and its subsidiaries. The Tribunal was established following Dubai World's November 2009 announcement of its intention to seek the rescheduling of its debt obligations. The Tribunal applies the DIFC Insolvency Laws and, as such, allows the granting of moratoria, including in relation to the enforcement of collateral.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Yes. Secured creditors will have priority to be paid from the proceeds of the liquidation of the subject assets. It should be noted that the New Pledge Law provides that the date and time of recording the pledge in the Security Register will be effective as against all parties and seek to establish priority *vis-à-vis* competing creditors.

Following payment to the court for any fees or costs, including the fees of trustees and experts, secured creditors will be paid according to the amount of their security. Any unpaid end of service gratuity, wages and salaries of employees of the debtor will then be payable provided that their total amount does not exceed three months' wages or salary.

In the DIFC, the Law of Security ranks conflicting perfected security interests according to priority in time of perfection. The Law of Security grants perfected security interest priority over a conflicting, unperfected security interest, and provides for priority of the first security interest to attach if conflicting security interests are unperfected. In the ADGM, the priority of the charge will generally be determined from the date of its last registration and the charge will rank behind any security registered before such date.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The Bankruptcy Law applies to all commercial companies (except to entities not governed by special provisions regulating bankruptcy or subject to the provisions of the Federal Law 8 of 2004 regarding financial free zones), traders/merchants and civil partnerships (set up in accordance with the Civil Transactions Law). Individuals remain outside the scope of the Bankruptcy Law.

The New DIL applies to any company that falls under the jurisdiction of the DIFC and has been incorporated pursuant to the New DCL. The ADGM Insolvency Regulations apply to any company registered in the ADGM within the meaning of the ADGM Companies Regulations.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

As mentioned in the response to question 7.4 above, the New Pledge Law includes the concept of self-help remedies in relation to certain types of security. The direct enforcement of moveable assets is generally permissible by private sale, subject to prior agreement, notification by relevant parties and no other security interest existing. A pledge over claims and receivables may be set off if the pledgee is a bank and by claim if the account is held at another bank. Bonds and certain written instruments may be directly enforced through delivery or endorsement if their value is equal to the right of pledge, while written papers (e.g. bills of lading) may be directly enforced by application to the summary judge for the issuance of an urgent order.

In order to initiate direct enforcement, the pledgee must notify all concerned parties. There is currently no time limit for such notice. The New Pledge Law also grants authority to summary judges to issue orders for enforcement of a registered pledge.

In the DIFC, a secured party may take steps to enforce its security interest over assets located within the DIFC without a court order, whereas in the ADGM, the regime under the Insolvency Regulations will generally require the party that seeks to enforce security to obtain a court order.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes. However, if there are grounds for a UAE Court to seize jurisdiction, the UAE Courts are likely to do so. See the responses to questions 7.1 and 7.2 for more background on this topic.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Article 41 of the UAE Constitution provides that every person shall have the right to submit complaints to the competent authorities including the judicial authorities. As such, no entities (government or otherwise) are immune from being sued in the UAE. However, there are specific procedures that may have to be followed to sue certain governmental entities. Insofar as the Federal and local governments of the UAE are concerned, Article 247 of the Code of Civil Procedures contains a prohibition on the seizure of "public property" belonging to the UAE Federal Government or the governments of any of the individual Emirates to satisfy a judgment debt.

Some Emirates may also require the written consent and approval of the respective Emirate's Ruler's court or legal department be obtained prior to the filing of a claim against an Emirate's Ruler, government or government entity. For example, in the Emirate of Dubai, the Dubai Government Lawsuits Law (Dubai Law No. 3 of 1996, as amended) requires the prior approval of the Ruler of Dubai before filing a lawsuit against the Ruler or a Dubai Government entity. Article 3*bis* explicitly states that no debt or financial obligation against the Ruler or the Government may be collected by means of detainment, public auction sale or possession by any other legal procedures of the properties and assets of the Ruler or of the Government whether or not such debt or financial obligation has received a final and conclusive judgment. The requests for such approvals must be made to the Dubai Government's legal department.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements,

is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Onshore

Licensing requirements in the UAE:

The Central Bank and the Securities and Commodities Authority ("SCA", also known as "ESCA") regulates financial services in the UAE. Pursuant to Federal Law No. 10 of 1980 and Federal Law No. 14 of 2018, the UAE Central Bank regulates financial institutions, including those that wish to provide financing in or from the UAE.

Whilst there are no local licensing requirements for foreign lenders which lend to UAE companies, if such entity operates within the UAE, it must be appropriately licensed. UAE lenders, including commercial banks, investment banks, investment companies, finance companies, Islamic banks, Islamic finance companies and real estate finance companies based in the UAE are regulated by the UAE Central Bank and require a licence. Branches of foreign banks can also be licensed as commercial banks in the UAE.

In order for a company to obtain a licence from the UAE Central Bank, the requirements set out in Federal Law No. 14 of 2018 must be satisfied (see, for example, Articles 67 to 71). Specific requirements are not listed in the respective legislation, but the applicant should expect to be notified if additional documents are necessary for the licence to be issued.

UAE lenders who do not comply with the terms of the licence that they are granted may face imprisonment and/or be fined a minimum of AED 200,000 and a maximum of AED 10,000,000. Additionally, the institution may be liable for civil and criminal claims.

Additionally, an agent for a syndicate of foreign lenders is also not required to be licensed unless it is operating from and based in the UAE. Please note the requirements in respect of local agents relating to security as addressed in sections 3 and 5.

Offshore

Licensing requirements in the DIFC:

The principal regulator for regulating financial services within the DIFC is the Dubai Financial Services Authority ("DFSA"). An individual or entity based in the DIFC that provides a financial service must be authorised by the DFSA by obtaining the appropriate licence. If both the lender and the borrower are based in the DIFC, a Category 2 licence must be obtained, whereas if the lender is foreign, providing a credit facility to a borrower in the DIFC, licensing requirements do not exist.

The consequences of licensing violations can be severe. If a lender does not satisfy the requirements, the DFSA, under DIFC Law No. 1 of 2004 (the "Regulatory Law") and DFSA's Enforcement Rulebook can enforce the following actions as punishment: a fine of USD 100,000 per contravention; damages or restitution; injunctions and restraining orders; corporate penalties – unlimited fines through the Financial Markets Tribunal (the "FMT"); and a banning order through the FMT. As a consequence of violating the Financial Services Prohibition section of the Regulatory Law, lenders will also face censure by way of publication of any enforcement action leading to critical reputational damage and the loan agreement will be considered unenforceable.

Licensing requirements in the ADGM:

The principal regulator for regulating financial services within the ADGM is the Financial Services Regulatory Authority ("FSRA"). An individual or entity based in the ADGM which provides a financial service, which is classified as a regulated activity, must be authorised by the FSRA by obtaining the appropriate licence. The consequences of licensing violations in the ADGM can also be severe, with fines of up to AED 50,000,000 (in accordance with section 232 of the Financial Services and Markets Regulations 2015 and Article 23 of Abu Dhabi Law 4 of 2013).

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

Compared to other jurisdictions, the UAE had a relatively short lockdown due to the COVID-19 pandemic. At the time of writing, individuals in the UAE may now attend their offices, the notary public, social gatherings (subject to each specific Emirate's guidelines), and restaurants, and Dubai is also generally open to tourists. Given this environment, the COVID-19 pandemic has not significantly affected the execution of documents in the UAE.

Notwithstanding that the COVID-19 pandemic has not significantly affected the execution and delivery mechanics of documents, it should be noted that when the government mandated a lockdown, there was a greater focus on the ability of parties to execute documents electronically, which we discuss below.

Onshore

Federal Law No. 1 of 2006 on Electronic Commerce and Transactions generally allows documents to be executed by electronic signatures. A key limitation of this law, however, is that an individual signing must have the appropriate software to create a unique signature on the document. Additionally, the general approach of the UAE Courts has not been accommodating to electronic signatures, and financiers generally continue to insist on receiving originals for the purposes of document execution.

Offshore

DIFC Law No. 2 of 2017 (the "Electronic Transactions Law") generally allows for documents to be executed by electronic signatures and "electronic records". There is no specific case law on what constitutes an electronic record for the purposes of execution; however, the broad definitions in the Electronic Transactions Law suggest that documents can be validly executed using emails, JPEG signatures and electronic signatures created using appropriate software. In contrast to the DIFC, the ADGM has not issued a specific law relating to the execution of documents with electronic signatures. The ADGM has, however, issued consultation paper 3 of 2020, discussing the benefits of updating a clear legislative framework in relation to the electronic execution of documents.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The UAE financial services sector is still in its infancy when compared to more developed Western financial markets, and,

whilst there is extreme wealth and numerous opportunities in the region, there is still a relatively high degree of uncertainty surrounding financing transactions in the region.

A challenging obstacle is the relative uncertainty of court decisions, given that there is no concept of *stare decisis*. With the establishment of the DIFC Courts, and more recently, the ADGM Courts, which are based on common law, and not civil law systems, the judgments are, subject to certain conditions, enforceable onshore and therefore the UAE enforcement risk has somewhat been mitigated. However, even where such judgments are enforceable onshore, onshore assets are still subject to onshore rules regarding insolvency and taking of security. The promulgation of the Bankruptcy Law and the New Pledge Law have certainly solved many of the issues that lenders were facing upon enforcement over onshore assets, but they still remain largely untested. Lenders providing financing into this market should carefully assess their enforcement risk over onshore assets and the risk of onshore insolvency proceedings. Lenders should also assess their *Shari'a* risk, in particular in *Shari'a*-compliant financings. Whilst English courts have typically taken a pragmatic view of *Shari'a*-compliant financings, looking through the *Shari'a* structure and into the substance of the financing arrangements (see *The Investment Dar Company KSCC v Blom Developments Bank SAL (Rev 1) [2009] EWHC 3545 (Ch) (11 December 2009)*), there is uncertainty as to how the UAE Courts would rule in respect of claims by borrowers that their borrowings are not *Shari'a*-compliant and therefore unenforceable. In this respect, Dana Gas' claims in 2017 that two of its Islamic bonds (which are now being restructured) totalling USD 700,000,000 were no longer compliant with *Shari'a* law and the subsequent injunction approved by a Sharjah Court to prevent investors from enforcing against Dana Gas stunned the markets. Lenders are therefore strongly advised to seek advice in relation to *Shari'a* compliance issues in the UAE.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The corporate lending markets in the United States are broad and deep relative to other jurisdictions. Market trends are often associated with certain segments of the lending markets, and market segmentation in the United States is based on a number of factors. These factors include: the size of the borrower (from so-called "large-cap" borrowers, to those in the "middle-market" to "small-cap"); the credit profile of the borrower (from investment-grade to below investment-grade or "leveraged"); the type of lender (banks, *versus* non-bank lenders, please see the discussion regarding "Direct Lenders" below); the number of holders of the debt (from syndicated loans, to "club" and bilateral facilities); whether the loan is secured, and the relative positions of the lenders *vis-à-vis* one another (from senior unsecured, to senior secured, mezzanine and second-lien loans); the basis on which the loan is made and repayment is (hopefully) assured (from a company's general credit rating, to cash flow loans, to asset-based loans); and the purpose of the loans (from acquisition finance and venture finance to general working capital loans, the development of specific projects and the purchase of specific assets). While there are trends within each of these market segments, there are also some broad trends which impact multiple segments. For example:

Lower interest rates

The trend of decreasing interest rates that began in late 2019 continued through 2020, as the Federal Reserve slashed the federal funds rate twice; once on March 3, 2020, to a range of 1.00–1.25%, and again on March 16, 2020, to a range of 0–0.25% (effectively zero). The Federal Reserve's decision to lower its benchmark rate stemmed from general concerns about the growing risks to economic activity posed by the COVID-19 pandemic. This move from the Federal Reserve is intended to help boost economic activity, strengthen labor market conditions, and stabilize inflation rates. In September 2020, the Federal Reserve announced that it expects to keep rates near rock-bottom until the economy shows signs that it has weathered the COVID-19 pandemic based on certain goals set by the Federal Open Market Committee. These goals include promoting the maximum level of employment, fostering price stability and maintaining a stable inflation rate of no more than 2%, unless a higher inflation rate is temporarily necessary to achieve maximum employment or price stability goals. The Committee expects low interest rates to continue for the next three years as it does not predict the economy will achieve such stability until 2023.

CARES Act: Paycheck Protection Program and the Main Street Lending Program

Under the auspices of the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), the Federal government created loan and guarantee programs for businesses to help alleviate the economic dislocation caused by the COVID-19 pandemic. These programs, administered through participating banks, included certain loans under the Paycheck Protection Program that were "forgivable" in addition to those that were required to be repaid. Much time was spent by loan market participants analyzing the eligibility requirements for these loans, including "forgiveness" conditions, as well as the interplay of these loans on the capital structure of businesses with other forms of indebtedness, particularly in the case of the loans offered under the Main Street Lending Program, which implicated intercreditor considerations as they were, in certain cases, required to be secured on a *pari passu* basis in certain assets. The Paycheck Protection Program was reupped and expanded in December 2020 for a second round of these forgivable loans.

Certain trends in loan documentation

One of the most vibrant and innovative segments of the loan markets in the US is the fast-paced leveraged loan market. "What is market" on a variety of points, including leverage levels, spreads and covenants changes from month-to-month. Drivers of these changes include the demands of determined and resourceful borrowers and sponsors, the ebb and flow of the demand for leveraged loans, ambitions to command greater market share, due regard for credit risk and the other factors described below. Some broader trends in the market in recent years can be identified.

Convergence. The same investors often invest in leveraged loans and high-yield bonds. Leveraged loans typically have more restrictive covenants than high-yield bonds (although the

gap has narrowed substantially) and are generally secured, so recoveries on leveraged loans after default are generally better. Investors judge the relative values of each of these instruments on a company-by-company basis. With each of these asset classes "competing" with the other, over the years many leveraged loans have taken on more bond-like characteristics, including incurrence-based covenants, no caps on dispositions, and greater flexibility for restricted payments.

Covenant-Lite Loans. When demand for leveraged loans is high (and borrowers have more leverage in negotiations) the trend is toward "looser" bond-like covenants, otherwise known as "covenant-lite." In covenant-lite loans, the borrower generally pays a premium in exchange for less restrictive covenants and no financial maintenance covenants (similar to high-yield bonds). While financial maintenance covenants test the borrower on a periodic basis, covenant-lite loan agreements typically only include "incurrence" tests (which test the borrower upon a specific activity such as the incurrence of liens or debt, the making of acquisitions or restricted payments, etc.). Covenant-lite loans are viewed as having a greater risk of loss after default; with a covenant-lite loan, the first default is often a payment default, occurring long after a financial covenant default would have occurred. By that time, the borrower's financial condition is likely to have deteriorated substantially. Covenant-lite loans were popular before the financial crisis, dried up during the crisis and its aftermath, but have made a comeback in recent years and are now seen with greater frequency, including in middle market deals. The frequency of covenant-lite loans increased in 2019 and continued through the early part of 2020. However, the COVID-19 pandemic and resulting volatility in the US economy chilled enthusiasm for such borrower-friendly agreements and raised concerns about the future of covenant-lite loans. This reversal accelerated during the second quarter of 2020, when the issuance of covenant-lite loans virtually halted due to the market's reaction to the COVID-19 pandemic. Perhaps a testament to the growing affinity for covenant-lite loans, the loan market saw a bounce-back in covenant-lite loans as the economy began to stabilize during the third quarter of 2020, contradicting predictions from earlier in the year as borrowers once again were able to secure favorable terms in the midst of the pandemic. Despite the headwinds caused by the pandemic, the trend toward covenant-lite loans in the leveraged finance market remained fundamentally intact through 2020.

The Power of Equity Sponsors. Equity sponsors drive much of the volume of leveraged loans and continue to exercise their market power and push the market towards more borrower-favorable terms. "SunGard" provisions continue to be standard in commitment papers. SunGard provisions allow equity sponsors who require acquisition financing to compete with strategic buyers who do not need such financing, by aligning closely the conditions in financing commitments to the conditions in the acquisition agreement. Equity sponsors increasingly require loan arrangers to use the sponsor's form of commitment letter so the sponsor can more easily compare the proposals of different financing sources. It has also become common for sponsors to prepare initial drafts of loan documentation. Another development unwelcome to many lenders is sponsors requesting the right to "designate" counsel for arrangers.

The Borrower's Desire for Flexibility: Unrestricted Subsidiaries, Equity Cures, Builder Baskets, Incremental Facilities and Reclassification. Equity sponsors and borrowers desire flexibility in their financing documents. This comes in many forms. The "unrestricted subsidiary" concept is consistent with features seen in bond indentures and this feature has become common in leveraged loan documentation. These provisions exclude specified subsidiaries from coverage in the representations, covenants and events of default, thus allowing a borrower to use an unrestricted subsidiary to incur indebtedness and liens or make investments without being subject to loan agreement restrictions. In effect, the lender loses the ability to monitor or restrict the unrestricted subsidiaries. A trade-off is that financial attributes of the unrestricted subsidiaries are excluded from the loan agreement provisions (including any benefit the borrower may have otherwise realized from cash flow generated by such subsidiaries for purposes of loan agreement financial ratios). "Equity cure" rights remain common. An equity cure allows a borrower's shareholders to make an additional equity investment in the borrower to cure breaches of its financial covenants. Loan agreements also continue to give borrowers more flexibility around so-called "builder baskets" (also known as "available amount" or "cumulative credit" baskets), which provide the borrower with more flexibility in complying with certain negative covenants. Builder baskets will often include an initial starter basket amount, which is in turn increased by either a borrower's retained excess cash flow or a percentage of a borrower's consolidated net income or EBITDA. Builder baskets may then be further increased in amount based on the occurrence of certain events, including certain equity contributions, proceeds from the sale of unrestricted subsidiaries and declined proceeds from mandatory prepayments. Typically, borrowers are permitted to use builder baskets for capital expenditures, permitted investments and acquisitions, and often for equity distributions and voluntary repayment of junior debt (subject to leverage governors). Non-committed incremental facilities also remain common fare in loan agreements, permitting an increasing number of cases (and now even in certain middle-market credit facilities) an uncapped amount of additional debt, so long as certain *pro forma* leverage ratios are satisfied. Borrowers are also requesting that negative covenant baskets include "builders" based on a percentage of EBITDA, as well as the ability to first utilize fixed dollar baskets in the context of certain negative covenants (for instance, debt, lien, investment and restricted payment negative covenants) and, if the borrower's financial condition later improves, to subsequently reclassify amounts incurred or paid under a fixed dollar basket such that these amounts are deemed incurred or paid under a leverage-based basket instead. The result of such a reclassification is that the borrower's fixed dollar basket for a negative covenant is then freed-up, so that the borrower can then incur or pay additional amounts under the fixed dollar basket, even if the borrower's financial performance should subsequently decline.

The regulatory environment

While the Federal Reserve had kept interest rates low to boost economic activity in the wake of the financial crisis, it and other federal regulators with a mandate to protect the US economy from excessive risk-taking associated with the financial crisis tightened regulations that arguably had the effect of increasing the cost of making loans. Under the previous administration, however, federal regulators had begun to take steps to relax such regulations. For example, both the Chairman of the Federal Reserve Board and the head of the Office of the Comptroller of the Currency announced in February 2018 that the "Leveraged Lending Guidance" issued by federal regulators, which became effective in May 2013, is not legally binding on federally supervised financial institutions that are substantively engaged in leveraged lending activities. The guidance outlines high level principles designed to assist institutions in establishing safe and sound leveraged finance activities. The guidance also had the effect of increasing lending costs as lenders re-evaluated their internal policies and programs and tightened their underwriting standards to comply. In light of this shift away from

the Leveraged Lending Guidance, federally supervised financial institutions showed a renewed willingness to make loans at leverage levels higher than the Leveraged Lending Guidance allows, beginning in 2018. This trend appeared to continue through the early part of 2020 but ultimately faced some scrutiny over the year due to the COVID-19 pandemic. Similarly, the "Volcker Rule" had been facing increased scrutiny since its inception, and, as a result, federal regulators issued a final rule in 2020 amending aspects of the Volcker Rule that impacted CLO managers and banks that structure, warehouse and make markets in CLOs. The initial Volcker Rule regulations were released on December 10, 2013, implementing the statutory Volcker Rule's limits on trading operations, and private fund sponsorship and investment activities, of banking entities. The final rule amending the Volcker Rule, which became effective October 1, 2020, modifies it by broadening the scope of permissible transactions by covered funds, curbing the risks associated with extraterritorial treatment of foreign funds and allowing federally supervised institutions to participate in certain fund activities. Notably, under the amended Volcker Rule, CLO managers are permitted to purchase and hold non-loan assets; debt securities are no longer considered to be an ownership interest solely because they contain the right to remove or replace a manager for cause; and CLOs may now hold a certain amount (up to 5%) of their value in debt securities, allowing for the return of the "bond bucket" feature which was common to pre-Volcker Rule CLOs. While the amended Volcker Rule arguably loosens compliance requirements, market observers predict that the new administration will resurrect the Leveraged Lending Guidance by codifying it as a rule rather than mere guidance, thereby reimposing its compliance requirements once more.

Sanctions and Anti-Corruption Laws. Federal regulators have in recent years increased their enforcement of sanctions, anti-terrorism and anti-corruption laws, meting out record fines. In addition to being more strident in their due diligence of borrowers, lenders are requiring stronger provisions in loan agreements to try and address these issues (and to demonstrate to regulators that they are doing the same). These provisions typically require the borrower and its affiliates to comply with sanctions regulations enacted by the US and other applicable authorities, to not use any borrowed proceeds in restricted countries or in doing business with restricted entities, and to comply with and have policies to comply with anti-bribery laws. Borrowers sometimes attempt to negotiate these provisions, including by adding materiality or knowledge qualifiers, with some limited success.

Federal Income Taxes. The Tax Cuts and Jobs Act of 2017 (the "2017 Act") and the CARES Act enacted numerous and in some instances sweeping changes to the Internal Revenue Code of 1986, as amended (the "Code"), including numerous provisions that may impact the US federal income tax treatment of participants in the US lending markets. These changes may impact the tax treatment of credit support provided by non-US subsidiaries, as more fully described in question 2.6 below.

The Foreign Account Tax Compliance Act ("FATCA"), which became effective with respect to interest payments on July 1, 2014, was a major revamp of the US withholding tax regime. FATCA imposes a 30% gross withholding tax on certain amounts, including interest, paid by US borrowers to a foreign lender unless that lender (i) enters into an agreement with the IRS to identify and report specified information with respect to its US account holders and investors, or (ii) is resident in a jurisdiction that has entered into an intergovernmental agreement (an "IGA") with the United States pursuant to which the government of that jurisdiction agrees to report similar information to the United States. This sweeping law has significant impact on loan payments and receipts where it applies and has prompted loan parties to manage FATCA risk (express allocation of risk set forth in loan documentation, operation of gross-up clauses, etc.). In the US loan market, for example, loan agreements now almost universally contain provisions whereby any FATCA withholding is exempt from a borrower's gross-up obligation, and a borrower may request information from a lender to determine whether such lender is in compliance with FATCA. (It is worth noting that while current provisions of the Code and Treasury regulations that govern FATCA also treat payments of principal on, or the gross proceeds from a sale or other disposition of, debt obligations of US borrowers as subject to FATCA withholding beginning with dispositions on or after January 1, 2019, under proposed Treasury regulations, such principal payments and/or gross proceeds would not be subject to FATCA withholding; in the preamble to such proposed regulations, Treasury and the US Internal Revenue Service have stated that taxpayers may generally rely on the proposed Treasury regulation until final Treasury regulations are issued.)

Replacement of LIBOR as the benchmark rate

With LIBOR scheduled to be phased out as the global benchmark rate at the end of 2021, lenders in the US have sought an alternative benchmark rate to replace LIBOR. The rate garnering the most attention in the US loan market is the Secured Overnight Financing Rate, or SOFR, which is calculated based on the overnight rates offered on the Treasury repurchase market. The market appears to be settling on "benchmark transition" language, which is now appearing in most loan agreements with LIBOR-based pricing.

Even though LIBOR is scheduled to cease in 2021, financial regulators on November 30, 2020, announced that most legacy LIBOR products could be extended until June 30, 2023. However, US banking regulators emphasized that USD LIBOR *originations* must end no later than December 30, 2021, and that any such originations must have an alternative reference rate or a hardwired fallback.

On October 9, 2019, in an effort to provide guidance on the potential knock-on effects of replacing LIBOR with an alternative benchmark rate like SOFR, Treasury published proposed regulations to address the potential adverse tax consequences of incorporating LIBOR-replacement language into existing loan documentation. In general, these proposed regulations seek to limit the circumstances in which replacing LIBOR with an alternative benchmark rate could result in a deemed exchange of the subject debt instrument, which could have adverse consequences. These regulations are proposed to apply to transactions taking place on or after the date the final regulations are published. However, taxpayers generally may rely on the proposed regulations provided that the taxpayer and any related parties apply the proposed regulations in a consistent manner. Moreover, the IRS recently published Revenue Procedure 2020-44, which sets forth certain safe harbors pursuant to which the adoption of an amendment related to replacing a rate based on LIBOR with an alternative method or index would not constitute a "significant modification."

Continued innovations and ongoing trends in the loan markets

Given the depth and breadth in the loan markets in the US, many loan market innovations originate or are further developed here (consider, for example, the development of a sophisticated secondary trading market, certain mezzanine and second-lien structures, the securitization of loans and CLOs). Some innovations include the following:

The Unitranche Facility. One innovation that has grown in popularity in recent years (and which is now firmly established in middle-market lending in the United States and is also

prevalent in European markets) is the so-called "unitranche" facility. Unitranche loans combine what would otherwise be separate first/second-lien or senior/mezzanine facilities into a single debt instrument, where all the debt is subject to the same terms, and with a blended interest rate. Lenders in unitranche facilities typically enter into a so-called "agreement among lenders" ("AAL") which legislates payment priorities, voting rights, buy-out rights, enforcement rights and rights in bankruptcy among lenders in a manner that may not be visible to the borrower. One advantage of unitranche loans for a borrower is speed and certainty of closing (important in a competitive acquisition process), since negotiation of an intercreditor agreement typically is not a condition to funding. Another supposed advantage for the borrower is the simplicity of decision-making during the life of the loan since there is no "class voting" from the perspective of the borrower (though the AAL may impact voting issues in ways not visible to the borrower). Lenders of unitranche loans typically are Direct Lenders (and not banks). In recent years, the United States loan markets have continued to see increased complexity in unitranche structures and in the terms of AALs. Borrowers and their equity sponsors have had some success in requiring disclosure of terms of AALs, especially with respect to voting, and in some instances the borrower now executes the AAL by signing an acknowledgment to the document. The United States Bankruptcy Court for the District of Delaware implicitly recognized the court's ability to construe and enforce the provisions of an AAL (to which the borrower was not a party) in March 2015 in the *In re RadioShack Corp.* bankruptcy, signaling to lenders that AALs should be enforceable in bankruptcy.

Bank Lenders Versus Direct Lenders. Non-bank lenders, often referred to as direct lenders or alternative lenders ("Direct Lenders"), are typically speciality finance companies, sometimes organized as business development companies ("BDCs") or funds, and also include the direct lending business of large asset managers. Unlike traditional banks, Direct Lenders have greater flexibility than banks to hold leveraged loans on their balance sheets, which provides borrowers with greater deal certainty, since Direct Lenders, unlike banks, may not need to condition deal terms based on their ability to syndicate a loan. Direct lenders also often invest at different levels of a borrower's capital structure, such as by making an equity investment at the same time as providing a credit facility, which provides added benefit to equity sponsors and borrowers seeking to raise capital. While traditional banks and Direct Lenders compete for market share, especially in the middle-market leveraged lending space, some market participants point out that the relationship is actually more symbiotic in nature; for example, banks provide debt financing to Direct Lenders and underwrite equity issuances by Direct Lenders and also have analysts that "follow" equity securities of BDCs. Some banks have developed Direct Lender businesses. The introduction of the Leveraged Lending Guidance mentioned above provided a competitive advantage to Direct Lenders. The Guidance helped to open the door for Direct Lenders to become a "go to" source of capital for equity sponsors and borrowers in the leveraged-lending markets, especially for middle-market borrowers, given that such Direct Lenders were not subject to the same regulatory constraints. However, the pull back of the Leveraged Lending Guidance did not shift the needle back in the direction of traditional banks in 2020, as Direct Lenders continued to grow market share as compared to traditional banks throughout the course of the year on middle-market deals. For example, though middle-market lending levels plummeted for Direct Lenders and traditional banks alike during the first three quarters of 2020, the Direct Lending space's fourth quarter recovery eclipsed that of institutional lenders as Direct Lenders led middle-market lending for the quarter with a 109% increase in volume from the previous quarter.

Litigation Finance. While originally developed in Australia and the United Kingdom, the business of litigation finance has gained significant traction in the United States. Investors are drawn to this asset class given its attractive returns that are "not correlated to the market." The two most common types of litigation finance include (a) providing funds to a plaintiff in exchange for a commitment to receive a share of the award or settlement resulting from litigation, and (b) providing funds to a law firm in exchange for a portion of the fees the law firm may receive from its contingency cases. Such financing is typically limited recourse, meaning the investor is only repaid if the plaintiff (or law firm) wins an award. Investors can realize significant returns, usually based on "multiples" of their initial investment or a "percentage" of the overall proceeds realized. Litigation finance has its share of critics: some lament "turning the court system into a stock exchange," while other observers argue litigation finance provides "access to justice" by "leveling the playing field" when parties in litigation have unequal financial positions. The law surrounding litigation funding is unsettled and changes rapidly. While regulatory scrutiny is on the rise, the asset class seems destined for continued growth for the foreseeable future given the surge in investment and the fact that it has established itself as a very useful tool for a variety of market participants.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Given the large number of transactions in the US corporate loan markets, it is difficult to differentiate certain lending transactions as being more significant than others. Any such comparison necessarily excludes transactions for which documentation is not publicly available and therefore favors large corporate deals filed with the SEC compared to those in the middle-market, where much loan product innovation takes place. One recent notable transaction that has garnered attention in the US corporate loan market is the Serta Simmons Bedding, LLC recapitalization. This is an example of a distressed liability management transaction involving "uptiering," in which certain creditors in the capital structure of a business amplify their lien and/or payment priority position relative to other creditors in a manner that is not consensual across all constituents, but within the parameters of provisions that may not implicate formal amendments to the *pro rata* sharing provisions in the loan documents. This trend goes along with other recapitalizations or transactions involving "downtiering," in which certain assets are contributed to an unrestricted subsidiary, which may be separately financed, thereby similarly resulting in certain creditors benefitting from an amplified lien position relative to other creditors.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Generally, yes. In the US, guarantees are commonly referred to as one of three types: (a) "downstream" guarantees, whereby a parent company guarantees the debt of a subsidiary; (b) "upstream" guarantees, whereby a subsidiary guarantees the

debt of a parent; and (c) "cross-stream" guarantees, whereby a subsidiary guarantees the debt of a "sister company." Generally, "upstream" and "cross-stream" guarantees may be subject to increased scrutiny given enforceability issues in the context of a bankruptcy, as further described below.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

First, as a matter of contract law, some "consideration" (bargained-for contractual benefit to the guarantor) must be received for the guarantee to be enforceable, though this contract law threshold is typically easy to meet.

As a matter of insolvency law, certain types of enforceability issues arise in the context of a bankruptcy. These issues are analogous to, but not the same as, contractual concepts of "consideration." With downstream guarantees, there is typically little concern, since the parent will indirectly realize the benefit of a loan through the value of its equity ownership of the subsidiary (unless the subsidiary is already, or is rendered, insolvent). However, "upstream" and "cross-stream" guarantees should be subject to increased analysis since the benefit to the guarantor is less evident.

For example, a guarantee or other transaction may be voided by a bankruptcy court in the US if it is found to be a "fraudulent transfer." Very generally, under the federal Bankruptcy Code, a guarantee may be considered a fraudulent transfer if, at the time the guarantee is provided, (a) the guarantor is insolvent (or would be rendered insolvent by the guarantee), and (b) the guarantor receives "less than reasonably equivalent value" for the guarantee. (Note that both prongs of the test must occur in order for the guarantee to be voided as a fraudulent transfer; if the guarantor receives "less than reasonably equivalent value" though is nevertheless solvent at the time the guarantee is provided (after giving effect to the guarantee), then the guarantee will not likely be voided as a fraudulent transfer.) Solvency will be determined by the application of a variety of tests, such as the cash flow test, which examines the guarantor's ability to meet its projected debt obligations as such obligations fall due, and the balance sheet test, which examines whether the guarantor still has enough assets to cover its liabilities at a fair valuation. As mentioned above, in a downstream guarantee context, the parent would more likely receive "reasonably equivalent value," therefore fraudulent transfer is less of a concern for these types of guarantees. In addition to the federal Bankruptcy Code fraudulent transfer test, under state laws there exist similar fraudulent transfer statutes and a federal bankruptcy trustee may also void such guarantees under state law in a bankruptcy.

Loan documentation will often provide for solvency representations from borrowers and guarantors in order to address fraudulent transfer concerns. In some high-risk transactions (such as acquisition loans or loans provided so the borrower can make a distribution to shareholders), a third party is required to provide a solvency opinion in order to provide protection from fraudulent transfer attack, though the more common practice today is for lenders to do their own analysis given the expense of such outside opinions.

Under relevant corporate law, if a guarantee or similar transaction is structured in such a way that it would be tantamount to a distribution of equity by a company while the company is insolvent (or is rendered insolvent), or would impair the company's capital, the transaction may be improper under the corporate law and could result in director liability. See also question 2.3 below for a general discussion of corporate power issues.

2.3 Is lack of corporate power an issue?

Entity power to enter into a guarantee is generally governed by the corporation (or equivalent) law in the state in which the company is organized, as well as the company's charter and bylaws (or equivalent documentation).

For corporations, the corporation law of most states provides a broad range of permitted business activities, so few activities are considered to be *ultra vires* or beyond the power of a corporation (note that certain special purpose or regulated entities, such as banks, insurance companies, and utility companies, may be subject to additional statutes which impact corporate power). In a lending context, however, many state corporation statutes limit the power of subsidiaries to guarantee the indebtedness of a corporate parent or a sister company, and a guarantee may be *ultra vires* if not in furtherance of the guarantor's purposes, requiring analysis of the purpose of the guarantee and the benefit to the guarantor. If the benefit to the guarantor is intangible or not readily apparent, this may provide additional concern. Many corporate power statutes, however, provide safe harbors for certain types of guarantees, irrespective of corporate benefit, including if the guarantor and the borrower are part of the same wholly owned corporate family, or if the guarantee is approved by a specified shareholder vote, for the guarantor entity. For limited liability companies, state statutes are usually more generous, with a limited liability company generally able to engage in any type of legal activity, including entering into guarantees, unless the charter provides otherwise.

In lending transactions in the US, the analysis that a company has the corporate or other requisite power to enter into a guarantee is often provided in a legal opinion provided by the guarantor's internal or external counsel (though these opinions will typically assume away the tough factual issues, such as the level of corporate benefit).

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In addition to having "corporate power" (or equivalent power for other types of entities) to enter into a guarantee, the guarantee must be properly authorized, which generally means that the procedural rules of the corporation, as set forth in its charter or by-laws, must be followed and that the stockholders or the governing board take the proper measures to authorize the transaction. These procedures are customary and also typically covered in a legal opinion provided by the guarantor's counsel.

One situation that requires special attention in a guarantee context is when a guarantor is providing an upstream or cross-stream guarantee, and the guarantor has minority shareholders. In this context, often the consent of the minority shareholders would be required in order for the guarantee to be provided in order to address fiduciary duty concerns.

Generally, no governmental consents, filings or other formalities are required in connection with guarantees (though, as noted above, certain special purpose companies and regulated entities may be subject to additional requirements).

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Yes, please see question 2.2.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Generally, no. Though there are a few other issues worth mentioning that do not relate to "enforcement" *per se*. For example, there may be withholding tax issues if the payment is to a foreign lender (please see question 6.1).

In addition, there are important tax issues to consider when structuring a transaction with credit support from foreign subsidiaries of US companies, and the rules in this regard have been changed. For example, there may be adverse US federal income tax consequences for certain US borrowers resulting from the involvement of any non-US subsidiary guaranteeing or otherwise providing credit support for the debt of that US borrower. Under US tax rules, such a guarantee could be construed to result in an income inclusion, similar to a "deemed dividend," from the non-US subsidiary to the US parent in the full amount of the guaranteed debt, and this deemed dividend would generally be subject to US tax. The same result could apply, under US tax rules, if collateral at the non-US subsidiary is used to secure the loan to the US parent, or if the US parent pledges more than 66% of the voting stock of a first-tier non-US subsidiary.

Changes to the Code pursuant to the 2017 Act impacted the scope of taxpayers affected by these aforementioned US tax rules (the "Guarantee Rules"). For example, the class of non-US subsidiaries potentially subject to these Guarantee Rules was broadened to include certain non-US subsidiaries of certain non-US parents. However, the enactment of a "participation exemption" with respect to dividends received by corporate US owners of wholly owned non-US subsidiaries, and the extension of this exemption to the income inclusions that are triggered by the application of these Guarantee Rules via US Internal Revenue Service and Treasury regulations (the "956 Regulations"), which were proposed in 2018 and finalized with certain changes in 2019, may reduce or eliminate the impact of these Guarantee Rules for certain corporate US borrowers that own non-US subsidiaries. Moreover, given the 956 Regulations, lenders may now be more inclined to require non-US subsidiaries to provide a guarantee and asset pledge as credit support in respect of loans to a US corporate parent borrower (and likewise require the US corporate parent borrower to pledge 100% of its equity interests in its non-US subsidiaries).

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

A wide variety of assets (including land, buildings, equipment, inventory, accounts, contract rights, investment property, deposit accounts, commercial tort claims, etc.) are available for use as security for loan obligations with many of the most common types of collateral described more fully below. Assets used as security are often divided into two broad categories: (a) "personal property" which generally refers to property other than real property (land and buildings); and (b) real property.

The Uniform Commercial Code ("UCC") provides a well-developed and predictable framework for providing security interests in a wide variety of personal property assets. The UCC is a state law statute rather than a federal one, but the UCC has been adopted by all 50 states in the US and the District of Columbia, with only a few non-uniform amendments of significance.

Under the UCC, when a security interest "attaches," it becomes enforceable as a matter of contract by the lender against the borrower. "Attachment" typically occurs when credit is extended to the borrower, the borrower has ownership or other rights in the collateral in which to grant a security interest, and the borrower signs and delivers to the lender a written security agreement describing the collateral.

After attachment, the security interest must be "perfected" by the lender in order for the lender's security interest to have priority over the rights of an unsecured creditor who later uses judicial process to obtain lien on the collateral. Since a federal bankruptcy trustee has the same status as a state law judicial lien creditor under US law, a bankruptcy trustee will be able to set aside the security interest if the security interest is not perfected.

The method of perfecting a security interest under the UCC depends on the type of collateral in question. The most common method of perfecting a security interest is by "filing" a financing statement in the appropriate state filing office. The UCC provides specific rules for where to file a financing statement, with the general rule that the filing takes place in the jurisdiction where the borrower is located. A borrower organized under a state law in the United States as a corporation, limited partnership, limited liability company or statutory trust is considered to be located in the state in which it is organized. The filing contains only brief details including the name of the borrower, the name of the secured party and an indication of the collateral, and the filing fee is generally fairly nominal. Security interests in some collateral may be perfected by "possession" or "control" (including directly-held securities, securities accounts and deposit accounts). A security interest in certain collateral may be perfected by more than one method.

If two or more lenders have perfected security interests in the same collateral, the UCC provides rules for which lender has "priority" over the other security interest. This is usually determined by a "first-in-time" of filing or perfection rule, but there is a special rule for acquisition finance ("purchase-money") priority and special priority rules also apply to certain collateral (e.g., promissory notes, investment securities and deposit accounts) if a security interest is perfected by possession or "control."

In addition, security interests in certain types of personal property collateral may to some extent be governed by federal statutes and pre-empt the UCC rules. For example, the perfection of a security interest in an aircraft is governed by the Federal Aviation Act and the perfection of a security interest in a ship above a certain tonnage is governed by the federal Ship Mortgage Act.

The requirements for taking a security interest in real property (referred to as a "mortgage" or "deed of trust" in the US) are determined by the laws of the state where the real property is located. Typically the office in which to file the mortgage or deed of trust is in the county of the state where the land is located. These statutes are fairly similar from state to state, but less consistent than the rules for personal property. As a result, mortgage documents from state to state appear quite different, while security agreements with respect to personal property (governed by the more consistent UCC of each state) are more uniform. Lenders often obtain a title insurance policy in order to confirm the perfection and priority of their security interest in real property.

A security interest in fixtures (personal property that permanently "affixes" to land) is generally perfected by filing in the place where the real property records are filed. A security interest in fixtures may be perfected under the UCC or under the local real estate law.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

In general, a single security agreement can cover all UCC personal property that is taken for security as a loan, no matter where the personal property is located.

With respect to real property, generally a separate mortgage or deed of trust document is used for each state where real property is located, given that the mortgage document is typically governed by the laws of that particular state.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Please see question 3.1.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. Receivables are considered personal property, and a security interest in the receivables granted under a security agreement would typically be perfected by filing a financing statement in the appropriate filing office. If the receivable is evidenced by a promissory note or bond or by a lease of or loan and security interest in specific goods, the receivable may also be perfected by the lender's possession or "control." Debtors on the receivables are not required to be notified of the security interest in order for perfection to occur.

The security agreement can grant a security interest in future receivables. An already filed financing statement will be effective to perfect a security interest in a future receivable when it arises.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. A security interest granted under a security agreement in a deposit account as original collateral must be perfected by control (not by filing). To obtain control of the deposit account, a secured lender typically enters into a control agreement with the borrower and the institution that is the depositary bank by which the bank agrees to follow the lender's instructions as to the disposition of the funds in the deposit account without further consent of the borrower. Many depositary banks have forms of control agreements that they will provide as a starting point for negotiations. (However, if the secured lender is also the depositary bank or the lender becomes the depositary bank's customer on the deposit account, control is established without the need for a control agreement to perfect the security interest.)

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes. Companies are typically incorporated under the laws of individual states in the US, and usually not under federal law. Shares may be issued in either certificated or uncertificated form.

A security interest may be created by either a New York law or English law-governed security agreement. If the security agreement is governed by English law, the UCC in New York requires that the transaction bear a reasonable relationship to England for the choice of law clause to be enforceable. (Please also see question 7.1 as to the extent a court in New York will enforce a contract that has a foreign governing law.)

In general, a security interest in such directly-held shares can be perfected either by filing or by control, though perfection by control has priority. The law governing perfection of such security interest in certificated securities depends on whether perfection is achieved by filing (location of debtor) or by control (location of collateral).

If the shares are credited to a securities account at a bank or broker and are therefore indirectly held, a borrower's interest in the securities account can be perfected either by filing or control. Once again, perfection by control has priority. The law governing perfection of a security interest in a securities account depends on whether perfection is achieved by filing (location of debtor) or by control (location of bank or broker as determined usually by the law governing the securities account relationship).

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. Please see question 3.1. A security interest may be granted under the security agreement and may be perfected by the filing of a financing statement in the appropriate UCC filing office. Perfection may also be achieved by possession, though this method is seldom practical from a secured lender's perspective.

The security agreement can grant a security interest in future inventory. An already filed financing statement will be effective to perfect a security interest in a future inventory when it is created or acquired.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes to both (i) and (ii). Note that with respect to item (ii), a guarantor would be subject to the same fraudulent transfer analysis discussed in question 2.2.

A security agreement may also secure obligations relating to future loans. An already filed financing statement perfecting a security interest securing existing loans will be effective to perfect a security interest in a future loan when the loan is made.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

With respect to personal property governed by the UCC, and the filing of financing statements, there are typically no material costs and UCC filing fees are usually minimal.

With respect to real property, there may be significant recording taxes and fees. These taxes and fees will depend on the state and local laws involved. A number of practices are used in loan transactions in an attempt to minimize such costs. For example, in the case of refinancings, lenders may

assign mortgages rather than entering into new mortgages; and in the case of mortgage tax recording states, lenders may limit the amount secured by the mortgage, so that the mortgage tax payable is set at a level commensurate with the value of the property as opposed to the overall principal amount of the loans.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Please see question 3.9. In terms of a time-frame, UCC personal property security interests may be perfected in a matter of days. Real property security interests typically take longer, though they can usually be completed in a couple of weeks.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally no, except in the case of certain regulated entities where consent of the regulatory authority may be required for the grant or enforcement of the security interest.

Also, please see question 2.6 for a quick summary of tax issues that may arise in connection with foreign subsidiaries providing guarantees or collateral to secure loans to US borrowers.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Under the UCC, many traditional concerns under revolvers have been addressed by the "first to file or perfect" rule, though lenders should be aware of certain priority issues. For example, with respect to secured creditors who each have perfected security interests in UCC collateral, as stated previously certain "purchase-money" security interests and security interest in certain collateral perfected by possession or control may obtain over a security interest perfected merely by the filing of a financing statement. In addition, tax liens and some other liens created outside of the UCC may obtain priority over a UCC perfected security interest. Judgment liens may pose a priority problem for future advances, and tax liens may pose a priority problem for some after-acquired property and future advances. Otherwise, under the UCC, the first secured creditor to "file or perfect" has priority.

With respect to real property, the matter is less clear. As a general matter, absent special legislation in the state, future loans may not have same priority as loans advanced when the mortgage or deed of trust is recorded if there is an intervening mortgage, deed of trust or lien recorded before the future loan is made. Accordingly, a close review of state rules and individual state documentary requirements is required in order to ensure priority.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

With respect to UCC collateral, the documentation requirements are spelled out clearly in the UCC and the requirements generally are straightforward. No notarization is required. Under prior versions of the UCC, the debtor was required to sign a written security agreement, though as the world moves away from paper and into electronic media, the model UCC, including the UCC as adopted in New York, now requires the debtor to "authenticate a record" that may include an electronic record. Nevertheless, most lenders in corporate loan transactions still generally require a written security agreement. With respect to real property collateral, the documentary and execution requirements tend to be more traditional by looking to a writing, but various law reform efforts are under way to permit electronic mortgages and deeds of trust and electronic recording of mortgages and deeds of trust. The requirements may vary significantly from state to state (for example, real property mortgages often require notarization under state law, whereas this is generally not the case for UCC collateral).

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Generally, no. There is no "financial assistance" law *per se* in the United States, but please see the discussion of fraudulent transfer and related principles described in question 2.2.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. In loan documentation, the role is typically that of an "agent," with bond documentation typically using a "trustee."

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable; please see question 5.1.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

In a syndicated lending transaction that includes a lender acting in an agency capacity, a guarantor typically would provide a guaranty to the agent "for the benefit of the lenders under the loan agreement" (or some similar formulation). As such, it should not be necessary for a guarantor to sign the transfer (assignment) documentation in order to be bound, though the contractual language should be carefully reviewed for specific requirements. In the case of a bilateral loan, the contractual terms should also be closely reviewed, though it is advisable to obtain the guarantor's consent to such assignment in any event.

6 Withholding, Stamp and other Taxes; Notarial and other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

There is no US federal income tax withholding from payments of interest or principal to US lenders, provided certain documentation requirements are complied with. With respect to the payment of interest by US borrowers to foreign lenders (other than such payments to a US branch of a foreign lender that is engaged in business in the US), the general rule is that a withholding rate of 30% is applied to the gross amount of payments constituting interest and other income. The US has in place bilateral treaties with many jurisdictions, which reduce or entirely eliminate this withholding tax for qualifying foreign lenders. A listing of these treaties is available at http://www.irs.gov/Businesses/International-Businesses/United-States-Income-Tax-Treaties---A-to-Z. Such withholding taxes may also be avoided if the requirements of the so-called "Portfolio Interest Exemption" are satisfied. This exception is generally not available to banks, but could be available to non-bank lenders such as hedge funds. Note that under FATCA (mentioned in question 1.1), foreign lenders generally will be required to identify and report directly to the US Internal Revenue Service information about accounts in such institutions that are held by US taxpayers. The failure to comply with FATCA would result in withholding as discussed in question 1.1 above even for treaty-resident lenders, which would then be required to file a refund claim pursuant to the applicable bilateral tax treaty to recoup any amounts withheld. Generally, the proceeds of a claim under a guarantee or the proceeds of enforcing security are taxed in a manner similar to payments made directly by the borrower.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

The US federal government has generally provided few incentives targeted to foreign lenders (as there has not been a policy focus on promoting foreign loans into the United States), though please refer to the bilateral tax treaties and Portfolio Interest Exemption referred to in question 6.1.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

In general, a foreign lender, with no presence or activities in the US, does not become subject to US federal income taxation on its net income solely as a result of loaning to, or receiving a guarantee or grant of security from, a borrower or guarantor in the US. However, income derived specifically from a loan made to a US borrower (i.e., interest and other income) would be subject to gross-basis US taxation, typically at a rate of 30%, unless a treaty specified a lower rate, or the Portfolio Interest Exemption applied (please see question 6.1). Moreover, if a foreign lender has a presence or activities in the United States (for instance, employees or agents working out of, or a lending office located in, the US), the foreign lender could be viewed as being engaged in a trade or business in the US, and if so would be subject to net-basis US taxation on any income deemed "effectively connected" with that trade or business unless an applicable treaty applied to reduce or eliminate such taxation, and potentially without the benefit of any associated deductions if a United States tax return has not been filed.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

With regard to mortgages and other security documents, there are generally no taxes or other costs applicable to foreign lenders that would not also be applicable to lenders in the US (please see question 3.10 for a general summary of such costs).

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

If a corporation is "thinly capitalized" and certain other factors are present, the US tax authorities may assert that instruments described as debt actually constitute equity for US tax purposes. The effect of such re-characterization would be that payments on the instrument would not be deductible to the borrower for US federal income tax purposes and could be subject to withholding in a manner different than interest payments (for instance, because the Portfolio Interest Exemption would not be available). Moreover, even if treated as debt, US tax rules as amended pursuant to the 2017 Act generally limit a US taxpayer's deduction for interest on indebtedness to the sum of (a) the taxpayer's business interest income for such year, plus (b) 30% of the taxpayer's "adjusted taxable income" for such year. "Adjusted taxable income" generally means the taxpayer's EBITDA for taxable years through 2021 and the taxpayer's EBIT thereafter. The rules regarding this limitation are complex, particularly in the case of non-corporate borrowers, and may be subject to further clarifying guidance from the US Internal Revenue Service. If the lenders are organized in a jurisdiction other than that of the borrower, this should not impact the thin capitalization analysis itself, but, as mentioned above, may impact the withholding rate as well as any relevant "gross-up."

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Generally, yes, so long as the choice of law bears a "reasonable relation" to the transaction and application of the foreign governing law would not be contrary to the public policy of the forum state.

On a related note, in connection with a choice of *New York* law as a governing law, a New York statute allows for New York law to be chosen by parties to a contract and, with certain exceptions, such choice of law will be given effect by New York courts if the transaction exceeds $250,000 in value, regardless of whether the choice of New York law bears any reasonable

relationship to the transaction. (The choice of New York as a forum is subject to additional requirements under the statute.) California has a similar statute.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

In most instances, yes. Despite the strong commercial ties between the United States and the United Kingdom, there is no international treaty on reciprocal recognition and enforcement of court judgments (attempts to come to terms on a bilateral treaty in 1981 broke down over the negotiation of the final text). Nevertheless, the Uniform Foreign Country Money Judgments Recognition Act has been adopted by most states (including New York) and sets out basic rules of enforceability in connection with the enforcement of judgments between states in the United States, with "foreign-country" judgments treated in a similar manner as the judgment of a sister state. Generally, if a judgment is obtained in accordance with procedures compatible with United States due process principles, it will be recognized under the Uniform Act. There are many examples of English judgments having been enforced in New York courts.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In New York, a court could rule almost immediately, perhaps within three to six months or less, with enforcement against assets of the company in New York beginning as soon as the judgment was entered (unless the defendant obtained a stay of enforcement). However, in practice, particularly if an opposing party appears and raises procedural or other issues, matters could take materially longer, up to a year or more.

Enforcement of a foreign judgment is generally pursued in New York by having the foreign judgment "confirmed," with time frames similar to those mentioned above.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

In a non-bankruptcy context, the timing and restrictions that apply to enforcement of collateral can vary significantly, depending on the type of collateral and relevant state law that applies. The UCC provides a great deal of flexibility in the rules governing disposition of personal property collateral (see question 3.1). The UCC generally permits either "private" or "public" sale, with the only real limitation on the power to sell that the secured party must "act in good faith" and in a "commercially reasonable manner." Under the UCC, after the sale, the secured party generally may pursue the debtor for amounts that remain unpaid (the "deficiency"). The requirements with respect to real property collateral will vary significantly from state to state (and note in particular that in California, there may be limitations with respect the ability of a creditor to collect on a deficiency if the creditor is secured with real property collateral). With respect to regulated entities (including certain energy and communications companies) enforcement may require regulatory approval.

In a bankruptcy context, enforcement would be restricted by the automatic stay (please see question 8.1).

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

For the most part, distinctions will not be made between foreign and domestic creditors in such proceedings. However, there are certain issues a foreign lender would need to consider in connection with such activities. For example, generally a foreign creditor will need to be authorized to do business in New York before availing itself as a plaintiff of the New York courts. In addition, foreign creditors may be subject to federal or state limitations on or disclosure requirements for the direct or indirect foreign ownership of certain specific types of companies or collateral, including in the energy, communications and natural resources areas.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, please see question 8.1.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The United States is party to the New York Convention. As set forth in the Convention, the Convention requires courts of contracting states to give effect to private agreements to arbitrate and to recognize and enforce arbitration awards made in other contracting states, subject to certain limitations and/or potential challenges. Note, however, that loan agreements under New York law generally do not include arbitration clauses.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In the US, a bankruptcy proceeding may be voluntarily initiated by a company, or a company's creditors may initiate a bankruptcy filing in light of accrued and unpaid debt, creating an involuntary bankruptcy. Once a proceeding has commenced, the Bankruptcy Code provides that an "automatic stay" is automatically implemented. This automatic stay is effectively a court order that prevents creditors from taking, or continuing to take, any actions against the debtor or property in which the debtor has an interest, including enforcement actions against collateral. A creditor that violates the automatic stay could face severe penalties, including actual damages caused to the debtor and other creditors, as well as having its enforcement action

declared void (punitive damages are typically limited to individual, rather than corporate debtors). A creditor, however, may seek relief from the automatic stay by filing a motion with the bankruptcy court.

There are, however, a number of protections for a secured creditor who has properly perfected its liens and such liens are not subject to avoidance. First and foremost, in the case of a reorganization of a debtor, cash collateral cannot be used by a debtor without the consent of the secured party or authorization from the bankruptcy court. The bankruptcy court may require that a debtor provides "adequate protection" to preserve the value of the secured creditor's interest in any property being used by a debtor – for instance, a debtor may be required to issue additional or replacement liens or make periodic payments to the secured creditor. Upon a liquidation of a debtor, a secured creditor will be paid its claim (up to the value of its collateral) prior to the payment of general unsecured creditors or, alternatively, it may receive its collateral back in satisfaction of its secured claim.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

In short, yes. A lender's security interest could be voided as a "preferential transfer" if it is provided to the lender within 90 days before a bankruptcy filing (or one year if the lender is an "insider," or related party of the debtor) and as a result of the transfer the lender receives more than it would have otherwise received in a hypothetical liquidation of the debtor. There are a number of exceptions to this rule, including where there has been a substantially contemporaneous exchange, an exchange for new value, or where the transaction involves a purchase money security interest. Please also see the discussion of "fraudulent transfers" in question 2.2. There are also certain claims that may have priority even over a properly perfected security interest, including tax liens, mechanics' liens, and certain costs associated with the bankruptcy itself.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

There are a number of entities that are either excluded from the Bankruptcy Code or for which special provisions of the Bankruptcy Code or other special legislation apply, including certain banks, insurance companies, railroads, commodity brokers, stockbrokers and government entities and municipalities.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes. Outside of federal bankruptcy procedures, the UCC allows for so-called "self-help" remedies without first commencing a court proceeding. Note that the relevant provisions of a security agreement and governing law should be considered before exercising these types of remedies. These remedies typically can only be used so long as no "breach of the peace" would occur. Subject to the above, the market generally accepts these types of remedies for collateral, such as bank accounts and certificated securities. Certain states may also have alternative procedures for liquidation set forth in state law.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Generally, yes.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes. The Foreign Sovereign Immunities Act ("FSIA") codifies the law of sovereign immunity in the US. The FSIA allows for such immunity to be waived, and generally upholds waivers, with some limitations (for example, non-commercial property of a sovereign cannot be attached). Certain organizations also receive immunity under authority separate from the FSIA: the International Organizations Immunity Act covers immunity for certain institutions like the IMF, the OECD and the African Union. One issue in connection with the enforcement of such waivers is whether a borrower actually had the immunity to waive when it provided a waiver. Such scenarios arise in the context of the nationalization of a company. In such a case, a company may not have had any immunity to waive (since it was not previously owned by the state) when it entered into the loan, so any waiver provided prior to being taken over by a state may be considered void. For this reason, New York law-governed loan agreements often include a representation that a loan represents a "commercial act," which excludes the transaction from protection under relevant immunity statutes, whether or not such immunity was in fact effectively waived.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of in your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

In the US, a lender is not required to be a bank (indeed, many lenders are non-banks). A lender should be aware of any relevant state lending licensing laws which may require a lender to be licensed. In general, regulated banks do not need to be separately licensed under state law as lenders, but nonbank lenders must be aware of, and comply with, applicable lender licensing laws. These licensing laws are much more stringent in the consumer or "small loan" lending area than in the commercial or corporate lending area (where few states require the licensing of corporate nonbank lenders, California being a notable exception), although in any event nonbank lender licenses are typically easier to obtain than a "banking license."

In general, the applicability of state licensing laws is triggered by the solicitation of loans with, or the making of loans to, residents of that state. Therefore, whether a lender is a US or non-US lender generally has no bearing on whether that lender must be licensed under the laws of a given state. In some cases, one needs to be "in the business of making loans" in order for the licensing statute to be given effect (for example, the New York lender licensing law indicates those lenders who engage in "isolated, incidental or occasional transactions" are not "in the business of making loans" and therefore not covered for purposes of the statute).

Non-compliance with a license statute could have a material impact on the lender, from not being able to access a state's court system to having a loan be determined to be unenforceable. Whether an agent on a lending transaction would also need to be licensed will depend on the wording of each state's particular statute.

Note there are often contractual restrictions in New York law-governed loan documentation that require a lender be a certain type of organization that is in the business of making loans. The rationale for this is many-fold, from securities law concerns to the preference of the borrower to only deal with sophisticated financial institutions should the loan be sold.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

Unsurprisingly, COVID-19 saw an uptick in the use of electronic signatures in the United States as individuals took to remote working as a result of the pandemic, but the use of electronic signatures is not new in the United States. Statutes at both the state and federal level, such as the Electronic Signatures in Global and National Commerce Act, adopted by Congress in 2000, and various state iterations of the Uniform Electronic Transactions Act, have long validated the use of electronic signatures as a means of executing agreements in the United States.

Since the beginning of the COVID-19 pandemic in the United States, many states have authorized the use of *remote notarization in lieu* of in-person notarization requirements. Remote notarization regimes (such as New York's) typically require the use of video conference to comply with customary formalities as much as possible while maintaining social distancing and remote work protocols. Mobile notary services also saw an uptick in demand during the pandemic as well.

In light of the increased trend towards electronic signatures as a result of the pandemic, many institutional lenders have incorporated standard language into their form agreements permitting the use of electronic signatures. Such changes suggest lasting changes to how parties in the US may execute agreement after the pandemic.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The material considerations to be considered in connection with a financing in the US will vary depending on the type of financing and the parties involved, and a discussion with counsel is encouraged before entering into any financing in the US. However, the above questions address many of the main material issues that arise.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Domestic lending activities are, to a large extent, determined by compulsory lending mandated by the law and regulations for the housing, tourism, agriculture and industrial sectors of the economy. International lending has been substantially diminished given the political circumstances, including the U.S. sanctions, and, in the recent past, was mainly circumscribed to the financing of government projects and, particularly, further development of the Orinoco heavy oil basin. Political changes in Venezuela and the United States may lead to the opening of further financing possibilities.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Lending transactions in Venezuela mostly consist of restructurings and supplemental financing in the oil sector, particularly through joint venture companies chartered by PDVSA (a Venezuelan national oil company) and foreign oil companies, in which PDVSA owns the majority of the shares, and trade financing for Venezuelan imports.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

There are no particular legal restrictions for intercompany loans. However, tax provisions on presumed dividends and transfer pricing may be applicable.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

No, absent a conflict with the corporate charter or an insolvency situation.

2.3 Is lack of corporate power an issue?

Definitely. If there is no capacity to issue the consent, the act would not be valid (Article 1141 of the Civil Code and Articles 243 and 270 of the Commercial Code).

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental consent or filing is required. Shareholder approval would be necessary if the respective charter and by-laws establish that the power to guarantee third-party obligations rests on the shareholders.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

None, except that the enforceability of the guarantee could be set aside if given while insolvent (Article 946 of the Commercial Code).

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

An exchange control was legally in effect from 2003 to 2018. Formally, the exchange control was eliminated with Exchange Agreement No. 1 published on September 7, 2018, which establishes that there is free convertibility, but the system continues to some extent to be dependent on the rate reported by the Central Bank and is constrained by the reduced size of the foreign exchange market. There is no prohibition of Venezuelan companies holding foreign currency assets abroad. If the guarantor has foreign currency funds abroad, it can make the payment in foreign currency without authorisation. Government-controlled entities require Central Bank authorisation to hold foreign currency abroad.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

A security interest can be created over tangible and intangible assets, including real estate, chattel property, inventory, a business establishment, credit rights, intellectual property rights, shares and other securities.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Depending on the type of collateral, the security interest document will vary. Some security interests can be created by way of a mortgage (e.g. real estate, chattel property) and others pursuant to a pledge (e.g. shares, account receivables). Some require governmental authorisation and special filings. A single security interest document can cover different types of collateral and forms of encumbrance (mortgage, pledge without transfer of possession). Registrations of the same security interest document may be done in registries of various municipal jurisdictions.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

A real estate mortgage may cover the land and the plant (governed by the Civil Code, Article 1877), and the machinery and equipment may be covered by a chattel mortgage (governed by the Chattel Mortgage and Pledge Without Transfer of Possession Act). The mortgage document must be registered in the registry with jurisdiction over the location of the assets.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

A security interest may be taken over receivables by way of a pledge. The pledge agreement must be executed before a notary or filed with a notary (to have a certain date). Notice must be given to the debtors (notice of transfer as a security interest, Article 1550 of the Civil Code).

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A pledge agreement can be entered into in connection with the rights associated with a bank or brokerage account. Notice must be given to the bank or brokerage entity holding the account.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Shares of a Venezuelan corporation may be pledged. In addition to executing a pledge agreement, a transfer as a security interest note should be inscribed in the shareholders' registry book of the corporation. Share certificates are commonly issued (Article 293 of the Commercial Code). However, the transfer of the rights of a shareholder is done by a note in the shareholders' registry book (Article 296 of the Commercial Code). The agreement must be governed by Venezuelan law (Articles 20, 27 and 37 of the International Private Law Act).

3.7 Can security be taken over inventory? Briefly, what is the procedure?

A security interest can be taken over inventory by way of a chattel mortgage (Article 30 of the Chattel Mortgage and Pledge Without Transfer of Possession Act) or pursuant to an arrangement with an authorised general warehouse and delivery of warehouse certificates (in accordance with the General Deposit Warehouses Act).

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A security interest can be granted to several creditors and for different transactions. However, if different creditors are receiving a security interest with respect to different transactions, ranking of the security interest and inter-creditor agreements may be necessary.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The notarisation charges for documents creating a security interest are not calculated based on the type or value of the assets but rather on the particulars of the document (e.g. number of pages). Registrations of security interests, however, generate fees that are calculated based on the value assigned to the security interest. The registration fees will be calculated pursuant to a progressive rate of up to 0.60% (Article 83 of the Public Registry and Notary Act).

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

When authorisations are required, the procedure may be a lengthy one. Registration of complex transactions may also require extra time. When the assets are located in different jurisdictions, the security interest document may need to be registered in all of the registries with jurisdiction over the different locations, which may prove to be a long process.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Chattel mortgages and pledges without transfer of possession can only be created in favour of qualified secured creditors, including foreign banks authorised by the Superintendency of the Banking Sector Institutions (Article 19 of the Chattel Mortgage and Pledge Without Transfer of Possession Act). To request such an authorisation, a draft of the security interest document must be presented.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There is no problem in creating a security interest with respect to a revolving credit facility. Priority of mortgages will be set by the date of registration.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Mortgage documents must be registered. Registration must be done in the registry office with jurisdiction given by the location or the type of asset. Pledges are to be executed before a notary or a counterpart of the pledge agreement must be filed with a notary soon after.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company
Guarantees and security interests can be provided to support financing for the acquisition of shares, except that there is a prohibition on making loans or giving a security interest for the acquisition of its own shares. The prohibition originates from the provision regarding Treasury shares, which establishes that the company cannot purchase its own shares except with amounts corresponding to retained earnings (Article 263 of the Commercial Code). A more evolved and far-reaching provision is found in the Securities Market Act of 2015 (Article 72).

(b) Shares of any company which directly or indirectly owns shares in the company
Case law has expanded the above-mentioned prohibition to preclude transactions that attempt to bypass the prohibition by using interposed persons.

(c) Shares in a sister subsidiary
The comment for (b) above applies here as well.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

A security agent could be created, empowering such agent to act on behalf of all the secured lenders. However, the secured interest must be created in favour of the secured lenders. The security agent may also serve as the payment agent and be authorised to receive payments and to make distributions of such payments among the secured lenders.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above, which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable. See the answers above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Notice must be given to the debtor and the guarantor if an assignment of a loan takes place (Article 1550 of the Civil Code and 150 of the Commercial Code). The transaction documents may establish additional conditions for the transferability of a loan.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interest payments are subject to withholding tax when made to foreign lenders (Article 9 (3) of Decree 1808 of 1997). Interest payments to local banks are not subject to withholding tax (Article 10 of Decree 1808). Guarantee and proceeds of enforcing a security interest are not subject to withholding tax, unless deemed allocated to the payment of interest.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Currently, there are no tax incentives for foreign lenders. From time to time, exonerations are given to induce the financing of projects in certain economic sectors. Interests on loans made by foreign financial institutions are taxed at the rate of 4.95% (Article 52 of the Income Tax Act). Other rates may apply because of tax treaties. The stamp taxes and fees that are to be paid for the documentation of a loan or a security interest are the same for local and foreign lenders.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Income originating from loans made to Venezuelan borrowers is subject to Venezuelan income tax at a rate of 4.95% (Article 52 of the Income Tax Act). The borrower is to withhold the tax when making the interest payments. If the guarantor or the owner of the security interest is a Venezuelan corporation, no Venezuelan tax will apply to the loan solely because of such circumstance.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are no significant costs associated with the execution of documentation related to a loan, guarantee or security interest, except that the registration of the security interest will entail the payment of registration fees based on a progressive tariff of up to 0.60% of the value of the security interest (Article 83 of the Public Registry and Notary Act).

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are none.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Venezuelan courts will recognise a foreign governing law if it is selected as the governing law of a contract (Article 29 of the International Private Law Act). Venezuelan courts will enforce such a contract in Venezuela. However, there may be some exceptions for national interest contracts and public policy reasons (Article 151 of the Constitution and Article 5 of the International Private Law Act).

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Passing of a foreign judgment requires a procedure before the Supreme Court (*exequatur*), which excludes the examination of the merits (Articles 53 of the International Private Law Act and 850 of the Civil Procedure Code). For arbitral awards, the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards will apply.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

A procedure for collection of amounts due may take up to approximately two years, depending on the defences and appeals that the defendant raises during the court procedures. An *exequatur* procedure, for the passing of a foreign judgment, may take between one and two years and the enforcement against assets of the defendant in Venezuela may take between six months and one year.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Venezuelan enforcement procedures will require a public auction (Articles 550 to 584 of the Civil Procedure Code). Notices to the Attorney General's Office will be required if there is a risk of interruption of a public service (Article 99 of the Attorney General Organic Act). The existing foreign exchange market constraints are one of the major obstacles to effectively realising the proceeds of the security interest being enforced.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

This is not applicable. In non-commercial litigations, the foreign plaintiff may be required to post a bond (Articles 36 of the Civil Code and 1102 of the Commercial Code).

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

If the debtor has a positive net worth but has liquidity problems, it may apply for a moratorium (Article 898 of the Commercial Code). While in moratorium or in a bankruptcy procedure, the enforcement of rights against the debtor would be suspended, except that the suspension would not apply to the enforcement of a security interest (Articles 905, 942 and 964 of the Commercial Code).

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Venezuela is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The secured lender would be limited in its ability to collect from the bankruptcy assets, other than the collateral, if the collateral is not sufficient to satisfy its claims (Article 1047 of the Commercial Code). If the collateral is not sufficient to satisfy the debt, the bankruptcy effects will apply to the remaining debt, including that interest stops accruing on the bankruptcy declaration date (Articles 943 and 944 of the Commercial Code).

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

There are debts that are preferred by law (privileged creditors, Article 1867 of the Civil Code; labour debts, Article 151 of the Labour and Workers Act), even above the preference corresponding to secured creditors. Security interests granted during the so-called suspicious period may be set aside. A suspicious period may be up to two years and 10 days (Articles 936 and 945 of the Commercial Code). The suspicious period begins 10 days prior to the date on which the court establishes that the insolvency commenced. Payments on unmatured debt or in kind made during the suspicious period may be annulled (Article 945 of the Commercial Code).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Banks, insurance companies and brokerage houses are excluded from bankruptcy and subject to a similar procedure carried by the Superintendency of the Banking Sector Institutions (Articles 240, 247 and 257 of the Banking Sector Institutions Act), the Superintendency of Insurance Activity (Articles 98, 101 and 107 of the Insurance Activity Act) or the National Securities Superintendency (Article 135 of the Securities Market Act), respectively.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

No (Articles 1844 of the Civil Code and 542 of the Commercial Code), except for retention rights (Articles 122 and 148 of the Commercial Code) and the collection of credits given as collateral (Article 538 of the Commercial Code).

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, provided that it is a commercial transaction and the exceptions for national interest contracts (Article 151 of the Constitution), Venezuela real estate or public policy (Article 47 of the International Private Law Act) do not apply.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, subject to the same conditions mentioned in question 9.1.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no eligibility requirements for lenders. However, the nature of the lender may be relevant for the purposes of determining the applicable income tax regime (e.g. a 4.95% tax rate applies to interest payments to foreign financial institutions, a 34% tax rate on net income of non-bank lenders (absent a tax treaty provision) and a 40% tax rate applies on net income of local financial institutions). There is no need for the lenders to be licensed or authorised to do business in Venezuela. They do not need to be a licensed bank in the jurisdiction of incorporation.

There are differences between the authorisations required to be a beneficiary of a chattel mortgage and pledge without transfer of possession, depending on the type of lender. No authorisation is required if the lender is a local bank. Authorisation from the Superintendency of the Banking Sector Institutions will be necessary if it is a foreign bank. Authorisation from the Ministry of Agriculture or the Ministry of Communications may be needed for certain security interests in favour of other types of lenders.

For trusts created in Venezuela, the trustee must be a local bank or insurance company, authorised to operate as such and to serve as a trustee by the Superintendency of the Banking Sector Institutions and the Superintendency of Insurance Activities.

11 Other Matters

11.1 How has COVID-19 impacted document execution and delivery requirements and mechanics in your jurisdiction during 2020 (including in respect of notary requirements and delivery of original documents)? Do you anticipate any changes in document execution and delivery requirements and mechanics implemented during 2020 due to COVID-19 to continue into 2021 and beyond?

The COVID-19 pandemic has prompted the government to issue orders restricting activity, including the working days and hours of government offices, including notaries and registries. It is foreseeable that restrictions will continue, albeit in a moderate fashion, during 2021.

11.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Special consideration must be given to the difficulties of converting local currency to foreign currency.

Special attention must be paid to the existing and prospective sanctions, particularly from the United States, which, directly or indirectly, may affect some borrowers.

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