

Scope - Worksheet

Title Slide

Slide 2

This nugget looks at the questions,

- can activities of the borrowers' shareholders and sister companies result in the removal of the loan, and
- once this loan agreement has been signed, will the activities of the borrowers' shareholders and sister companies be restricted?

This question of the scope of the agreement is of strategic significance to the borrowers group. As far as the Obligors are concerned, they do not want their financing withdrawn because of the acts of shareholders and sister companies over which they have no control. From the perspective of the parent and sister companies, they do not want their businesses hampered by a borrowing from which they may derive little benefit.

Scope

The issue is:
To what extent should activities of other group members impact on the loan to sub 1?

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graph TD; Parent[Parent] --- Sub1[Sub 1]; Parent --- Sub2[Sub 2]; Parent --> Dollar[$]; Lender1[Lender 1] -- "$25 mil loan" --> Sub1;
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Lender 1
\$25 mil loan

Sub 1

Sub 2

Parent

The Lenders will almost invariably want to have the right to be prepaid if there is a change of ownership of the borrower – but will they want more?

For example, might the lenders want to extend any of the loan undertakings or events of default to encompass the parent or other group members?

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The first issue to consider is whether the loan agreement imposes any restrictions on changes in the ownership of the borrower. Lenders are almost always concerned about the identity of the borrower's ultimate parent (or, if it is a public company, the identity of any controlling shareholder) and will therefore require the right to be prepaid if this changes. This will probably be the case even if the loan is not dependent on support of any type from the ultimate parent.

The reasons are

- The possibility that a change in ownership or control might cause the lender to exceed its internal ceilings as to amounts which it can lend to different industries or countries
- The possibility that following a change of ownership or control, the new shareholders might change the company's strategy, and
- The idea that the identity of the ultimate shareholder, even if that shareholder is not supporting the loan in any financial way, is a key aspect of the credit decision – lenders like to know who they are lending to and not to be forced to lend to entities without making a positive decision to do so.

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This issue is so important that many lenders insist on being able to be paid out of the loan on change of ownership or control even if the Majority Lenders are happy with the

Here is clause 8.2

- If [[_____]] ceases to control the Company
 - [a Lender shall not be obliged to fund a Utilisation;]
 - if [the Majority Lenders so require]/[a Lender so requires and notifies the Agent ...], the Agent shall, by not less than [___] days notice to the Company, cancel the [Total Commitments]/[Commitment of that Lender] and declare [the participation of that Lender in] all outstanding Loans, together with accrued interest, and all other amounts accrued under the Finance Documents immediately due and payable, whereupon the [Total Commitments]/[Commitment of that Lender] will be cancelled and all such outstanding amounts will become immediately due and payable.

The question of whether any other undertakings (such as the negative pledge) should relate to the ultimate shareholder is more debateable, and we will return to that shortly.

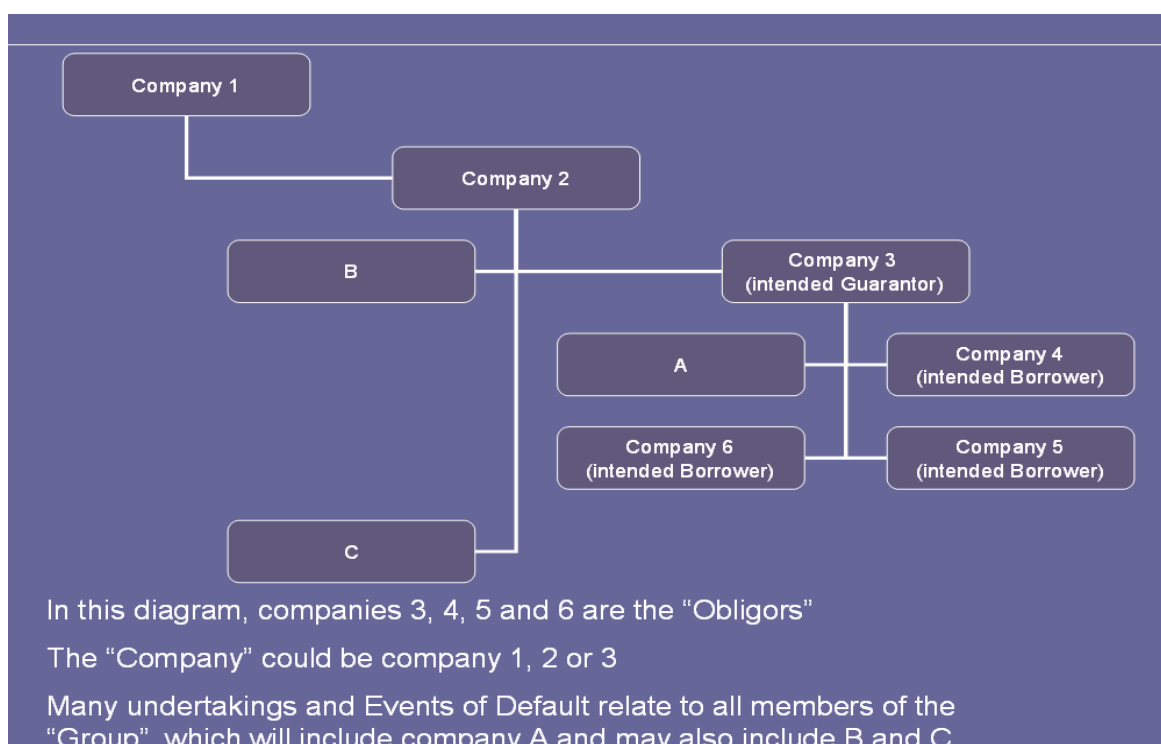
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At this point we need to make a distinction between different concepts used in the Loan Market Association loan agreement. That document defines

- “Company” as the parent company of the Group. (We will leave aside for the moment the question of whether the Company will be the ultimate shareholder of the Group or just the parent of any relevant sub group).
- The Group is then defined as the Company and its Subsidiaries
- The Obligors are the members of the Group which, at any given time, have either borrowed or guaranteed part of the loan.

This raises 2 questions

- Should the Company be the top Obligor in the group (ie the highest company in the group which is responsible for repayment of the loan) or should it be a company at some higher level in the corporate structure? and
- Why should any of the provisions of the agreement relate to Group members which are not Obligors.



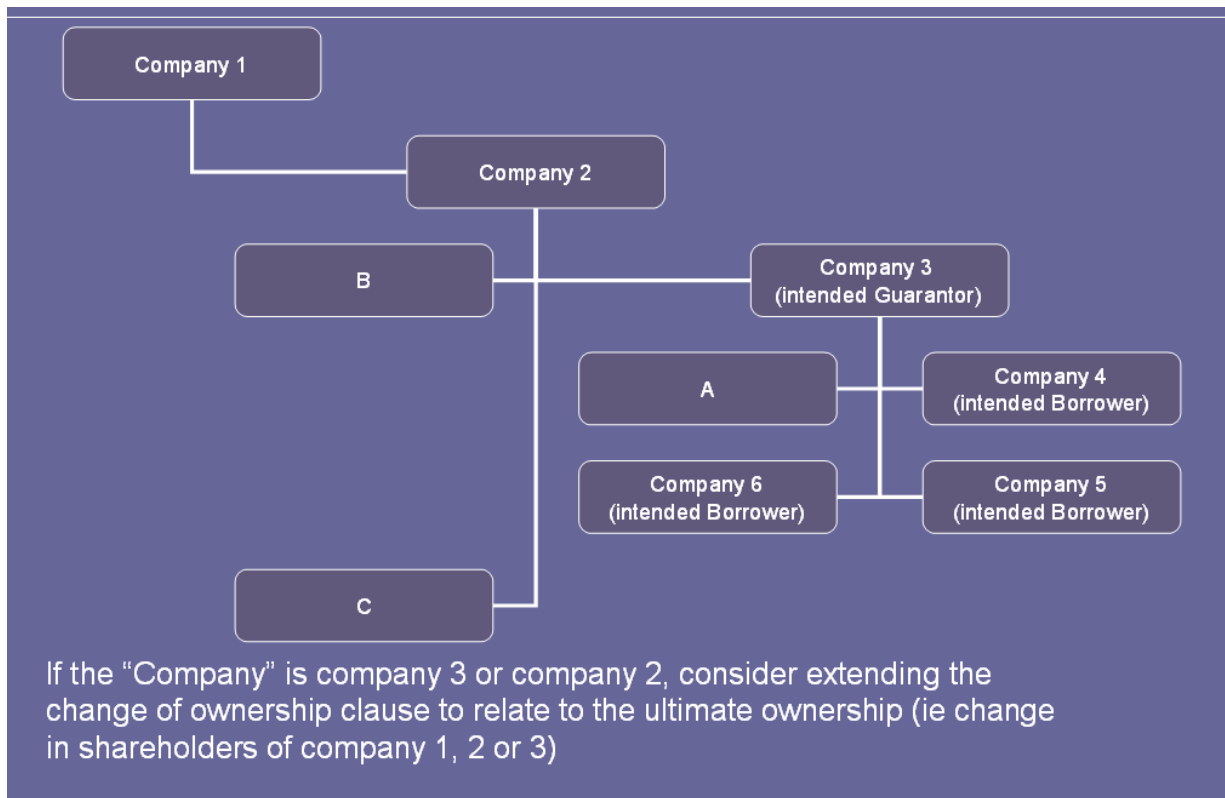
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Of course the obvious answer to the first question is that it depends on both the borrower's needs and the lenders' credit decision. The facility is available to the Company and its Subsidiaries so the Company needs to be at whatever level in the corporate structure as is necessary to ensure that the loan can be used by all companies which the group intends to have use of the facility.

From the lenders' perspective, depending on the type of transaction and the nature and identity of the group, they may have looked only at parts of the group in making their credit analysis. For example, some groups insist that each subdivision must raise finance on its own merits and without support from the ultimate parent, so as to expose those subdivisions to the rigours of the market alone. In those cases the lender will not have included the ultimate parent in the credit assessment.

In general, the Company should be the parent company of the part of the group which the lenders considered in their credit decision, so as to ensure that problems in that part of the group create an event of default but that problems in parts of the group which were not relevant to the credit decision do not. (Note, it is likely, but not inevitable, that the Company will be an Obligor, since if they were relevant for the credit decision, the lenders are likely to have required a guarantee from them)

Wherever the Company is not the ultimate holding company the lenders ought to think about the change of ownership clause and consider whether it should relate only to change in shareholders of the Company or whether it should relate to change in ownership



If the "Company" is company 3 or company 2, consider extending the change of ownership clause to relate to the ultimate ownership (ie change in shareholders of company 1, 2 or 3)

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That deals with the definition of the Company. The next question is whether any provisions in the Loan Agreement should relate to Group members which are not Obligor.

The Borrower's starting point is that they should not – if a company is neither a borrower nor a guarantor, the lenders have no recourse to it so ought not to be concerned about any issues relating to it. Of course there are circumstances where that argument is incorrect, for example if a problem in one part of the group might give rise to reputational problems in another part.

This is reflected in the Loan Market Association Loan Agreement, which has some provisions which relate to all Group members – whether or not they are Obligor – for example, the cross default clause.

Nevertheless the borrower ought to look carefully at all provisions relating to companies which are not Obligor and consider whether those are appropriate.



● *The key undertakings in the LMA agreement relate to all Group members, including*

- Negative pledge*
- No disposals*
- No merger*
- No change of business*
- Cross default*
- Insolvency*
- Enforcement of judgements*

● *Can you think of issues which might justify this?*

● *And circumstances in which it might not be justified?*

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The borrower might also ask for some companies to be excluded from the scope of the Agreement altogether.

The most common examples are minor subsidiaries and non recourse companies. (Non recourse companies are essentially vehicles, usually in the context of project finance, which operate projects but which are only liable to repay the financing for the project out of project assets. So default in payment of the financing for that project will have no adverse repercussions on the vehicle). The argument is that even if these are wound up, or fail to pay financings, that is not relevant to this loan

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The next issue to consider is whether the lenders are looking only at a group credit risk or whether they are also concerned about the financial position of individual members within the group.

For example, if lenders are structurally subordinate in relation to creditors of some group members then as far as possible, they will want to minimise the assets retained in those group members. This is discussed in the nugget on structural subordination, and, as we see in that nugget, will impact on such things as

- where financial ratios are tested
- the definition of material adverse change and
- whether to allow intra group transactions such as asset disposals

APPENDIX

These clauses are taken from the Loan Market Association investment grade loan agreement. To find the meaning of any defined terms which are not defined in this worksheet, have a look at the LMA Defined Terms.

THIS AGREEMENT is dated [_____] and made between:

- (1) [_____] (the "**Company**");
- (2) **THE SUBSIDIARIES** of the Company listed in Part I of Schedule 1 as original borrowers ([together with the Company] the "**Original Borrowers**");
- (3) **THE SUBSIDIARIES** of the Company listed in Part I of Schedule 1 as original guarantors ([together with the Company] the "**Original Guarantors**");
- (4) [_____] [and [_____]] as mandated lead arranger[s] ([whether acting individually or together] the "**Arranger**");
- (5) **THE FINANCIAL INSTITUTIONS** listed in Part II and Part III of Schedule 1 as lenders (the "**Original Lenders**"); and
- (6) [_____] as agent of the other Finance Parties (the "**Agent**").

IT IS AGREED as follows:

SECTION 1 INTERPRETATION

1. DEFINITIONS AND INTERPRETATION

1.1 Definitions

In this Agreement:

"Additional Borrower" means a company which becomes an Additional Borrower in accordance with Clause 25 (Changes to the Obligors).

"Additional Cost Rate" has the meaning given to it in Schedule 4 (Mandatory Cost formulae).

"Additional Guarantor" means a company which becomes an Additional Guarantor in accordance with Clause 25 (Changes to the Obligors).

"Additional Obligor" means an Additional Borrower or an Additional Guarantor.

"Borrower" means an Original Borrower or an Additional Borrower unless it has ceased to be a Borrower in accordance with Clause 25 (Changes to the Obligors).

"Group" means the Company and its Subsidiaries for the time being.

"Guarantor" means an Original Guarantor or an Additional Guarantor, unless it has ceased to be a Guarantor in accordance with Clause 25 (Changes to the Obligors).

"Holding Company" means, in relation to a company or corporation, any other company or corporation in respect of which it is a Subsidiary.

"Subsidiary" means [a subsidiary within the meaning of section 1159 of the Companies Act 2006]/[a subsidiary undertaking within the meaning of section 1162 of the Companies Act 2006]/[].

8. **PREPAYMENT AND CANCELLATION**

8.1 **Illegality**

8.2 **Change of control**

(a) If [] ceases to control the Company/[any person or group of persons acting in concert gains control of the Company]:

(i) the Company shall promptly notify the Agent upon becoming aware of that event;

(ii) [a Lender shall not be obliged to fund a Utilisation;]

(iii) if [the Majority Lenders so require]/[a Lender so requires and notifies the Agent within [] days of the Company notifying the Agent of the event], the Agent shall, by not less than [__] days notice to the Company, cancel the [Total Commitments]/[Commitment of that Lender] and declare [the participation of that Lender in] all outstanding Loans, together with accrued interest, and all other amounts accrued under the Finance Documents immediately due and payable, whereupon the [Total Commitments]/[Commitment of that Lender] will be cancelled and all such outstanding amounts will become immediately due and payable.

(b) For the purpose of paragraph (a) above "control" means [].

[For the purpose of paragraph (a) above "acting in concert" means []