Changes to Credit Agreements Since the Financial Crisis

During the global financial crisis of 2007-2008 and in its wake, credit agreements changed to address newly discovered weaknesses, additional regulations and other developments that merited technical changes. Below, we have attempted to collect all such changes in one place.[1]

Changes in Control

Most credit agreements state that a "Change in Control", and therefore an Event of Default, occurs if an insurgent slate of directors wins a proxy battle and takes control of the board of directors. Some credit agreements go further and state that the outgoing board of directors cannot approve the insurgent slate after the vote has occurred in order to avert the Change in Control. This latter provision has become known as "dead hand proxy put" language. In 2014, a Delaware Chancery Court stated that lenders may be liable for aiding and abetting a breach of the outgoing directors' fiduciary duties by including dead hand proxy put language in a credit agreement under certain circumstances. Credit agreements should therefore now omit such language.

Changes in Law

Following the passage of the Dodd-Frank Act, the Loan Syndications & Trading Association (the "***LSTA***") promulgated model provisions in 2011 to clarify that the definition of "Change in Law" (which is used for determining whether a borrower must gross up lenders for new costs) should include requests, rules, guidelines or directives resulting from either Dodd-Frank or Basel III, regardless of the date enacted. These provisions have become market standard.[2]

Deemed Consent to Assignments

To limit a borrower's ability to unduly delay the assignment of loans, a borrower should be deemed to consent to an assignment to an Eligible Assignee unless the borrower objects in writing within ten business days after receiving notice of the proposed assignment. (Note: The LSTA recommends five business days, but market practice has instead settled on ten.)

Defaulting Lenders

In 2011, following the insolvency of Lehman Brothers, the LSTA issued revised and substantially augmented model provisions to address defaulting lenders. These provisions have become market standard and should be incorporated in all credit agreements – even for term loans only (with appropriate adjustments).

[1] This list focuses on necessary *technical* changes – not *negotiated* terms – and therefore does not delve into newer concepts that may or may not be included in particular credit documents based on negotiations between borrowers and lenders.

[2] The LSTA's model credit agreement provisions are available on the LSTA's website at www.lsta.org by subscription only. Market standard provisions that parallel the LSTA provisions are available in numerous publicly filed credit agreements, and Orrick is happy to provide such publicly available language upon request.

EBITDA

During the loan buy-back wave shortly following the financial crisis, some borrowers attempted to increase their EBITDA with accounting gains realized from repurchasing their own debt at below par. To preclude this, credit agreements should exclude the "net after tax gain or income from the early extinguishment of indebtedness" from the calculation of EBITDA.

EU Bail-In Provisions

As a result of "bail-in" rules that became effective in most EU-member countries in early 2016, European financial institutions must give contractual counterparties notice that the institutions' liabilities are potentially subject to write-down, conversion to equity or modification under powers exercised by relevant government authorities, and to obtain their counterparties' acknowledgment of such powers. The LSTA promulgated model language for compliance with these bail-in rules, which have become market standard in U.S. credit agreements.

Exclusive Jurisdiction

Following a series of lawsuits filed in Texas and other regimes inhospitable to lenders, jurisdiction provisions in credit agreements and other loan documents should now state that borrowers must submit to the exclusive jurisdiction of state or Federal courts sitting in the Borough of Manhattan, New York, and consent to venue in such courts as well.

FATCA

In general, the Foreign Account Tax Compliance Act ("***FATCA***"), enacted in 2010, imposes a 30% withholding tax on foreign financial institutions and other specified foreign entities that fail to comply with certain information reporting and withholding obligations. Since compliance with FATCA is generally within the control of a lender, the LSTA promulgated model language stating that withholding taxes imposed under FATCA are ineligible for the gross-up and tax indemnification provisions of credit agreements, and requiring lenders to provide information necessary for borrowers and administrative agents to fulfill their obligations under FATCA. These changes have become market-standard in most respects.

Federal Funds Effective Rate

To reflect revisions to the Federal Reserve Bank of New York's calculation methodology, the definition of "Federal Funds Effective Rate" should be revised to strike the phrase "arranged by Federal funds brokers" that was previously included in most credit agreements.

Foreign Corrupt Practices Act

As increased FCPA enforcement continues to garner headlines, credit agreements now include a representation and ongoing covenant that credit parties, their subsidiaries and their representatives have complied, and will continue to comply, "with the U.S. Foreign Corrupt Practices Act, as amended 15 U.S.C. § 78dd-1, et seq., and any other applicable anti-bribery or anti-corruption laws", and will maintain policies and procedures for compliance with those laws.

Going Concern Language

Many credit agreements state that the borrower's audit report may not include a "going concern qualification" or words of similar effect. However, going concern language in an audit report does not constitute a qualification under the relevant accounting standard (SAS 59), and some borrowers who received such language in their audit reports argued that no default occurred because their audit reports remained unqualified. As such, credit agreements should mirror the language from the accounting standard and refer instead to "explanatory language casting doubt on the borrower's ability to continue as a going concern".

Lease Accounting

In February 2016, the Financial Accounting Standards Board issued new lease accounting rules that substantially change GAAP in connection with accounting for operating leases.The rules, which begin taking effect in 2019, have the potential to distort many of the financial metrics used in credit agreements. Therefore, many new credit agreements "freeze" the accounting treatment of operating leases under the existing methodology.

LIBOR

In early 2014, administration of LIBOR was transferred from the British Bankers' Association to the ICE Benchmark Administration Limited. LIBOR definitions should be updated appropriately.

LIBOR Backstops in Alternate Base Rates

To prevent the arbitrage of reference rates during periods when LIBOR spikes, the alternate base rate should be defined to ensure that borrowings based on that rate are never cheaper than LIBOR-based borrowings. This is typically accomplished by inserting language in that definition starting that if one-month LIBOR plus 1% would be higher than the othe reference rates, the alternate base rate will instead be based off one-month LIBOR plus 1%. (Additional technical provisions for calculating LIBOR under these circumstances are also needed, because there will not be three days' notice, as per other LIBOR calculations.)

MFN Comparisons

In older forms, the "MFN" requirements for incremental facilities compare the spread above LIBOR on the incremental facility to the spread above LIBOR on the existing facility. Given the prevalence of LIBOR floors, this language should be revised to incorporate the effect of differing LIBOR floors into the MFN calculations. Indeed, many credit agreements now go further, and calculate the MFN on a full yield-to-yield basis (*i.e.* including up-front fees and OID).

Notice of Hedging and Cash Management Arrangements

Lenders entering into hedging or cash management arrangements that are intended to be secured under the credit facility are now often required to provide advance or concurrent written notice to the administrative agent of such arrangements. This requirement eliminates the administrative hassle of confirming with each lender whether or not it has such arrangements each time a determination of the amount of secured obligations outstanding is required.

OFAC Sanctioned Countries

The countries or regions currently subject to comprehensive sanctions by OFAC include Cuba, Iran, North Korea, Sudan, Syria and the Crimea region. In 2012, OFAC began easing sanctions against Burma/Myanmar, and in 2011, OFAC lifted sanctions against Serbia and Montenegro. In 2016, the LSTA promulgated model language, which has generally been accepted by the market, with a representation and ongoing covenant that credit parties, their subsidiaries certain and of their representatives are not sanctioned persons or the target of any sanctions, the proceeds of the loans will not be used to violate sanctions or to fund, finance or facilitate any business with any sanctioned person or in any sanctioned country, and the borrower will maintain policies and procedures for compliance with sanctions.

Overriding Fair Value Elections

To prevent borrowers from marking down certain types of liabilities for purposes of calculating financial covenants, credit agreements should include a provision that requires borrowers' and their subsidiaries' indebtedness to be deemed to be 100% of the outstanding principal amount thereof. This can be effected by stating that for purposes of determining compliance with any financial covenant, the effects of FASB ASC 825 and FASB ASC 470-20 on financial liabilities should be disregarded.

Participant Register

Certain non-U.S. lenders rely on the so-called "portfolio interest" exemption to receive interest from loans free of U.S. withholding tax. This exemption requires that the loans be in registered form (which the administrative agent's loan register typically ensures). In light of concern that silent participations might require the same exemption, lenders selling such participations are now required to maintain a register, which they must disclose only if necessary to establish that the loan participation is in registered form.

Prepayments and Excess Cash Flow

Credit agreements typically provide that amortization payments reduce the overall amount of “Excess Cash Flow”, thereby ratably reducing the portion owed to the lenders and the portion retained by the borrower. Unlike amortization payments, voluntary prepayments typically reduce only the lenders’ portion of Excess Cash Flow. Increasingly, borrowers can apply voluntary prepayments against upcoming amortization payments in direct order of maturity and some borrowers have realized that by making amortization payments the day before they’re due as voluntary prepayments, they can deduct the amortization payment entirely from the lenders’ portion of Excess Cash Flow, instead of ratably. To prevent this abuse, credit agreements with this dynamic should treat voluntary prepayments the same as amortization payments for Excess Cash Flow purposes, unless those voluntary prepayments are applied against principal due in future calendar years.

Prepayments and Financial Coverage Ratios

The same tactic described above can also be used to manipulate financial coverage ratios where the denominator includes scheduled payments of principal. A similar fix should therefore be applied: treating voluntary prepayments the same as amortization payments for such purposes unless those voluntary prepayments are applied against principal due in future calendar years.

Rolling on a Cashless Basis

Primarily to make it easier for CLOs to remain lenders following refinancings, the LSTA promulgated model provisions permitting lenders to exchange, continue or roll over all or a portion of their loans in connection with any refinancing, extension, loan modification or similar transaction permitted by the terms of the credit agreement, pursuant to a cashless settlement mechanism approved by the borrower, the administrative agent and the applicable lender. Even for non-CLOs, this mechanic can be useful where the lenders in a refinancing transaction overlap, but are not coterminous with, the lenders being repaid.

S&P

S&P’s formal legal name has changed to “Standard & Poor’s Financial Services LLC, a part of McGraw-Hill Financial”.

Swap Guarantors

In implementing the Dodd-Frank Act, the U.S. Commodity Futures Trading Commission issued rules which have been interpreted to require that, subject to certain exceptions, each guarantor of a swap must be an Eligible Contract Participant (an “ECP”). Because loan guarantors are also often swap guarantors, lenders should ensure that guarantees are properly drafted to exclude any guarantee of swap obligations by an entity that is not an ECP at the time the swap is entered into. The LSTA has promulgated model provisions for excluding non-ECPs from swap guarantees, which have become market standard.

Yield Protection

In 2014, a New York bankruptcy court refused to enforce a make-whole provision against a borrower whose debt had been automatically accelerated upon bankruptcy. This was because the credit agreement did not expressly state that the make-whole would be triggered upon acceleration. Following this decision, credit agreements should expansively define triggers for yield protection, including repayments, prepayments, accelerations or mandatory assignments (*i.e.* yank-a-banks) for failing to consent to amendments. The acceleration language should also clearly state that the yield protection becomes payable immediately prior to any automatic acceleration caused by a bankruptcy event.

Zero Floors for Reference Rates

In light of historically low reference rates, credit agreements should guard against the risk that LIBOR or the alternate base rate turns negative by deeming those rates to be zero if they would otherwise be lower.