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Negotiating Facility Agreements and Bonds

Presenters:

Jim Ho, Partner, Cleary Gottlieb Steen & Hamilton LLP

Nicole Kearse, Senior Legal Counsel, African Legal Support Facility

alsf.int
clearygottlieb.com

Negotiating the key provisions of loans and bonds

- The key provisions outlined in this presentation are open to negotiation and their forms as provided by the banks should not be taken at face value.
- A borrower or issuer’s negotiating power will depend on its credit rating; those with a higher credit rating will have more room to dictate or resist the terms as presented.
- Terms can be “sticky”. It will be more difficult to depart from terms if those terms have been agreed in precedent deals.

Representations and Warranties

WHAT IT IS	— Statements by the borrower that are true on the closing date and when repeated — Used as basis for the lender to lend — Certain statements are confirmed by legal opinions provided by external counsel
WHY IMPORTANT?	— Form basis for lenders' credit decision — Encourage prompt disclosure by borrower — Allocation of risk and protect lenders from liability
WHEN MADE?	— Signing date of the facility agreement — Repeating representations: • Date of each utilisation request • Utilisation date • First day of each interest period (English law style) — What are repeating representations? • All / fundamental representations • Turn representations into undertakings? Avoid overlaps with covenants
CONSEQUENCES OF BREACH	— Event of default — Drawstop

Types of Representations and Warranties

BASIC REPRESENTATIONS	— Obligations assumed constitute legal, valid, binding and enforceability obligations — Power and authority to enter into and to perform obligations under the finance documents — Necessary authorisations received — No conflict with constitution or laws, regulations or other (material) obligations / agreements
CREDIT-RELATED REPRESENTATIONS	— No litigation — Compliance with law
TAX-RELATED REPRESENTATIONS	— No filing or stamp taxes — No withholding taxes – note interaction with tax gross-up provisions
INFORMATION / FACTUAL REPRESENTATIONS	— No misleading information — No material adverse change (MAC) — No event of default is continuing
REPRESENTATIONS SUPPORTING LENDERS' COMPLIANCE	— Sanctions — Anti-bribery, corruption and anti-money laundering — No adverse consequences

Drafting for a sovereign – Key differences from corporates

REPRESENTATIONS

- Standard corporate provisions that are not applicable to sovereigns
  - Due incorporation
  - Financial statements
  - Insolvency and “centre of main interests”
  - Ownership
  - Good title to assets
- Additional provisions that may be included
  - Full faith and credit of the sovereign
  - Public procurement rules
  - Treaty obligations
  - Immunity
  - Facility is within scope of budgetary limit
  - IMF and World Bank membership
  - Not within scope of debt relief legislation
  - No currency control or valid foreign exchange authorization

- NB: Look for potential carve-outs to reps (e.g., no litigation, but for scheduled litigation). Add materiality to the borrower’s knowledge language where appropriate.

Covenants

RULES OF ENGAGEMENT

— Undertakings:
  - Positive (“must / shall do”)
  - Negative (“No [Obligor] shall…”)

SOVEREIGN BORROWER’S OBJECTIVES

— Minimise compliance costs

— Ensure covenants are achievable and do not interfere with day-to-day operations

— Limit scope for acceleration

— Retain flexibility for amendments and waivers

EXAMPLES OF COVENANTS

— Borrower profile:
  - Comply with laws
  - Obtain authorisations

— Maintain lenders’ status / priority:
  - Negative pledge
  - *Pari passu* ranking
  - Further assurance
  - Restrictions on financial indebtedness

— Compliance with laws
  - AML / Sanctions / Anti-Bribery
  - Environmental Laws

Drafting for a sovereign – Key differences from corporates

COVENANTS

— Standard corporate provisions that are not applicable to sovereigns
  - Financial covenants
  - Delivery of financial statements
  - Restrictions applicable to corporates (*e.g.*, no mergers)

— Additional provisions that may be included
  - Delivery of information made available to the IMF
  - Delivery of budget statement
  - Compliance with special rules (*e.g.*, Equator Principles for project finance)
  - Compliance with public procurement rules
  - Use of proceeds
  - Comply with borrowing limits and requirements of IMF and World Bank

The *Pari Passu* Clause

WHAT IT IS

- Ensures equal ranking of unsecured creditors
  - Prevents the borrower from subordinating the lenders under the facility to other lenders
  - Two limbs - internal and external:
    - Internal: The lenders under the facility will rank equally among each other
    - External: The loan will rank equally among other unsecured debt of the borrower
  - The borrower will prefer a very narrow and accurate definition of the outstanding debts to avoid restrictions imposed by the lenders on the assets and incurrence of new debt
    - For example: The borrower may argue that the loan should rank equally with other external indebtedness (foreign currency and/or foreign law), but not with local currency and/or local law indebtedness, since the lenders in foreign currency should only be concerned with preserving the sovereign's foreign currency holdings for the repayment

The Sharing Clause

WHAT IT IS

- Prevents discrimination by the borrower among lenders by paying some of them and not others.
  - If one lender recovers a higher percentage of its pro rata share than others, it must share the excess among the lenders.
  - Borrower will not be able to pay in full any lender until it has paid all lenders in full

SECTION 2.13. Sharing of Payments. If any Lender shall obtain on account of the Loans made by it, any payment (whether voluntary, involuntary, through the exercise of any right of setoff, or otherwise) in excess of its Pro Rata Share, such Lender shall purchase from the other Lenders such participations in the Loans made by them, as shall be necessary to cause such purchasing Lender to share the excess payment in respect of such Loans.

Negative Pledge

WHAT IT IS

- Prohibition to dispose or create security interests (e.g., mortgage, charge, pledge and liens).
  - Intended to avoid the creation of preferences over the assets of the borrower in favour of third parties.
  - Differences between bond-style negative pledge and loan-style negative pledge

Negative Pledge: So long as any bond remains outstanding (as defined in the Agency Agreement) the Issuer will not, save for the exceptions set out below … (Exceptions) create, incur, assume or permit to subsist any Security upon the whole or any part of its present or future assets, undertakings or revenues to secure: (i) any of its Public External Indebtedness; (ii) any Guarantees in respect of Public External Indebtedness; or, (iii) the Public External Indebtedness of any other person; without at the same time or prior thereto securing the bonds equally and ratably therewith or providing such other arrangement (whether or not comprising Security) as shall be approved by an Extraordinary Resolution of bondholders …

What is the difference?

Pari Passu: Each lender is *ranked* equally with unsecured/unsubordinated debt of the borrower (but not payment obligation).

Sharing Clause: Any recovery will be shared proportionally amongst the lenders under the facility (on a pro-rata basis).

Negative Pledge: Prevents borrower from incurring secured debt to the detriment of the lender(s) subject to exceptions.

Events of Default

Various events upon occurrence of which the lenders become entitled to:

- Accelerate the loan or cancel commitments
- Claim under guarantees and enforce security

Default vs Event of Default

- "Expiry of a grace period, giving of notice or making determination"
- "Continuing" events of default – waived and / or remedied?

EXAMPLES OF EVENTS OF DEFAULTS	NEGOTIATION TOOLS
— Payment defaults — Misrepresentation — Breach of other obligations — Cross-default v cross-acceleration — MAC — Creditors' process — Repudiation — Illegality — Litigation — IMF membership cessation	— Grace period — Materiality thresholds — Dollar amount thresholds — Remove those that are not applicable to sovereigns (*e.g.*, insolvency, audit qualification)

For more information, please refer to Chapter 2, 1.10 of the Level 2 ALSF Sovereign Debt Handbook.

The Cross Default/Cross Acceleration

- **What it is**: A default/acceleration under another financial arrangement constitutes an event of default under the credit agreement.
  - Protects the lenders from the potential non-repayment by borrower / challenges to repayment by borrower
  - Allows lenders to react in a timely manner

> Cross-Default. Any Loan Party fails to make any payment beyond the applicable grace period, if any, whether by scheduled maturity, required prepayment, acceleration, demand, or otherwise, in respect of any Indebtedness (other than Indebtedness hereunder) having an aggregate outstanding principal amount (individually or in the aggregate with all other Indebtedness as to which such a failure shall exist) of not less than the Threshold Amount…

- **Negotiation Points**:
  - Lenders will favor a cross default while borrowers a cross acceleration
  - Borrower might want to further limit the cross default/acceleration clause to payment terms (and not just any clause)
  - Lenders will want a lower dollar threshold whereas borrowers will prefer a higher threshold amount

Sovereign Immunity

WHAT IT IS

- Sovereign immunity states that a sovereign will not be subject to the jurisdiction of the courts of other nations without their consent.
- Confers:
  - Immunity from adjudication/suit
  - Immunity from enforcement and execution
- Codified in:
  - The Foreign Sovereign Immunities Act 1976 in the United States (for New York law agreements)
  - State Immunity Act of 1978 in the United Kingdom (for English law agreements)
- Exceptions:
  - When the State acts in a "commercial" capacity or when the State consents to a waiver
  - Lenders to a borrowing sovereign State will want to obtain an express waiver of sovereign immunity
  - Carve-outs: assets located in the country, diplomatic premises/property, central bank assets/reserves, military assets, and assets forming part of the cultural heritage of country

Collective Action Clauses ("CACs") and Credit Facility Amendments

- Bond CACs are contractual provisions that set out voting procedures for amending the terms of the bonds.
- Amendments to credit facilities may be made by the consent of the relevant lender(s).

CACs

- CACs permit a majority or supermajority of holders of a multi-creditor debt instrument, such as a bond, to modify key terms such as payment terms.
- CACs can therefore potentially neutralise prospective holdout credits.
- Traditionally, CACs were often "two limb": where a modification needed the approval of (i) holders of 50% principal amount of each series, as well as (ii) holders of 66% of aggregative principal amount.
- Recently the model CAC in the EU has shifted to "single limb" CACs: whereby the approval of holders of 75% of aggregate principal amount of outstanding bonds is needed for a modification across multiple series of bonds.

Credit facility amendments

- In a bilateral loan, a borrower may request with the consent of the lender to modify key provisions such as the size of the facility, repayment terms or the financial covenants.
- In syndicated loans, amendments will require majority, supermajority or unanimous lender approval.
- Amendments to a credit facility can be documented in an amendment and restatement agreement.
- If the request is for a temporary change or one-off waiver of an Event of Default, such a change to a credit agreement can be dealt with in a waiver letter.