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Negotiating a facility agreement for a corporate borrower: checklist

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A checklist of key points for a borrower's lawyer to consider when reviewing a facility agreement prepared by the lender's lawyers.

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Scope of this checklist

Where a company is being provided with loan facilities by a lender, the lender's lawyers usually prepare the facility agreement. Therefore, the facility agreement will typically be drafted to protect the lender's position and may contain a number of onerous obligations for the borrower. That said, it is becoming increasingly common on private equity sponsored deals for the sponsor's/borrower's lawyer to prepare the first draft of the facility agreement (often based on a detailed long form term sheet).

This checklist identifies some key points for a borrower's lawyer to consider when reviewing a facility agreement. It is designed with shorter form facility documentation in mind (although many of the key points are equally applicable to longer form facility documentation).

Scope for negotiation

Generally, the larger the facility and the more creditworthy the borrower, the more scope the borrower will have to negotiate amendments. Small corporate borrowers may find lenders refuse to accept amendments to the facility agreement or that amendments may have a cost impact that either the lender or borrower is unwilling to accept (for example, higher legal costs). Even in this case, consider the points raised in this checklist with the borrower, in order to pick up on errors in the facility agreement or at least so that the borrower is aware of the risks it is running in accepting terms of a facility agreement that larger borrowers would usually not accept.

The scope for negotiating a facility agreement may also be affected by market conditions at the time of the transaction (for example, whether there is a surplus of available funds for lending from various potential lenders or not) and whether it is a "new money" deal or a refinancing (in the latter case, a borrower may be hamstrung by what it has agreed previously unless it can present a particularly strong case for requesting amendments).

Conditions precedent

- Conditions precedent are requirements that the borrower must satisfy before the loan is made. They are often contained in a schedule to the facility agreement (for example, see Standard document, Facility agreement: Schedule 1). Even though the facility is signed by the lender and the borrower, the lender will not be obliged to lend unless the conditions precedent are all satisfied (see Standard document, Facility agreement: Clause 4.1) In certain cases, the lender may waive a condition precedent to allow a loan to be made with the waived condition having to be satisfied at a later date (with failure to satisfy at that later date being an event of default). In doing this, the lender has turned the condition precedent into a condition subsequent. For more information on waiving conditions precedent, see Standard document, Condition precedent waiver letter.
- Do not assume that the conditions precedent are non-negotiable. Many will be common to most loan financings, but they should always be tailored to the relevant transaction.
- Review and discuss the conditions precedent with the borrower at an early stage of the transaction to determine whether the borrower will be able to comply with them. Try to avoid conditions precedent which are non-specific or subjective in nature, as well as "sweeper" conditions (that is, "any other matter

or thing which the lender may in its sole discretion consider necessary or desirable in connection with the facility agreement and the transactions contemplated thereby and thereunder").

- Prioritise any conditions precedent that require the involvement of a third party (for example, a letter from the borrower's insurance broker or an exiting lender on a refinancing) and take steps to ensure that the relevant document or item will be satisfied in time for completion.
- Where the loan is being drawn down in one amount, the conditions precedent will normally be satisfied simultaneously with signing of the facility agreement. However, there may be a delay between signing of the facility agreement and satisfaction of conditions precedent, for example, where an acquisition is being financed and there will be a split exchange and completion but the borrower requires certainty of funding from the point of exchange. In that case, if the facility is intended to be committed, it is important to ensure that any further documentary or other conditions precedent to be complied with after signing are within the borrower's control to satisfy or are "in agreed form" as between the lender and the borrower at exchange (with "agreed form" meaning that the relevant condition precedent is in a form satisfactory to the lender and which, if provided to the lender in that form at completion, will satisfy the condition precedent in question). Alternatively, ensure that any further conditions precedent are as objective as possible, for example, with items being to the reasonable satisfaction of the lender rather than in its sole discretion.
- Review the borrower's constitutional documents and consider what changes to its articles of association may be required by the lender. For example, if the lender will be taking security over the borrower's shares, it may want to disapply any provisions giving the borrower a lien over its shares or giving the directors discretion to refuse to register a share transfer (see Practice note, Taking security over shares and debt securities: Restrictions in issuing company's articles of association).

Commercial terms

Check the key commercial terms of the facility agreement against any agreed term sheet and/or with the borrower. These will normally include:

- The margin payable on the loan (which may move up or down during the life of a transaction if the borrower meets certain financial performance targets and/or if the borrower achieves sustainability/ESG (environmental, social and governance) targets).
- The interest periods and interest payment dates.
- The repayment dates and amounts.
- The amount and timing of any fees payable on the facility. Fees may include an arrangement fee, a commitment fee or non-utilisation fee, a prepayment fee (which would typically be calculated as a percentage of the amount prepaid) and, on a syndicated lending transaction, agent and security agent fees.
- Any security being provided.

The commercial terms of a facility agreement may also be informed by other background factors applicable to the transaction. For example, any availability period for drawing the facility should tie in with any completion schedule under any related share purchase agreement or with any requirement to obtain any third party consent for the wider transaction. Consider also the contents of any due diligence reports, as these may describe what plans the borrower has in mind in the future, and these may inform what flexibility may be required under the facility documentation in order to accommodate any planned transactions.

Borrowers of floating rate loans should check what benchmark rate is used bearing in mind that many lenders will be transitioning away from LIBOR products in the near future to floating rate loans based upon a risk-free rate (for example, SONIA). It is beyond the scope of this checklist to detail the possible alternatives here, but borrowers should be aware that different lenders may opt to determine the interest rate differently and they should ensure that they are comfortable with how that determination is made. For more information on LIBOR transition, see Practice note, Interest rate benchmark reform: reform of existing rates.

Voluntary and mandatory prepayment

- Most facility agreements allow for voluntary prepayment, where the borrower can elect to repay some or all of the loan early (see Standard document, Facility agreement: Clause 8.2). Check with the borrower whether it might need or want to exercise this right and if so, that the facility agreement allows for voluntary prepayment at the times and in the amounts required. There is no right to prepay unless the agreement provides for it. Often, prepayments are allowed without payment of any premium but occasionally voluntary prepayments (particularly if made during the early life of a facility) do carry a prepayment fee. If a prepayment fee or premium appears in your facility agreement review the drafting carefully to ensure the fee is acceptable to the borrower.
- Facility agreements typically require that the facility is repaid on the occurrence of certain specified events. This is known as mandatory prepayment.

- The events that trigger mandatory prepayment in full usually include illegality (where it becomes illegal for the lender to lend to the borrower or to comply with its other obligations under the facility agreement) and a change of control of the borrower. In the case of illegality, check the timing for the relevant prepayment. Often it will be upon the lender's immediate demand, but if possible flexibility should be sought to allow, in the alternative, the prepayment to be made on the last day of the applicable interest period (to avoid break costs) or otherwise no earlier than the latest date prescribed by law. Check and discuss with the borrower the definition of change of control to ensure that it will not inadvertently be triggered in circumstances where the borrower would not expect to prepay, for example, on a reorganisation where the borrower still remains under the same ultimate control, where shareholders transfer shares between each other or where shares are issued to an incoming minority shareholder.
- Facility agreements also often require mandatory prepayment of the facility in part when the borrower receives certain proceeds, such as disposal proceeds where an asset is sold, and insurance proceeds where the borrower makes an insurance claim. It is important to review these provisions with the borrower, as certain carve-outs will probably be needed (for example, to exclude proceeds of assets disposed of in the ordinary course of the borrower's business, or the proceeds of insurance claims where these are to be used to replace or reinstate a damaged asset). The borrower may also wish to only have to prepay relevant proceeds once they exceed an agreed amount, with the borrower only prepaying the excess above the agreed amount.

Taxes

- The facility agreement is likely to include various tax clauses, including a gross-up provision, which will normally provide that if the borrower is required to deduct tax from payments that it makes, those payments will be grossed up so that the lender receives a sum equal to the sum that it would have received had no tax been deducted (see Standard document, Facility agreement: Clause 11.1). For a discussion of a gross-up provision, see bullet point "What are the tax consequences of the transaction?" in Checklist, Preliminary issues for the borrower's board.
- The tax provisions are likely to be designed to protect the lender and may be onerous for the borrower to comply with. For a more detailed discussion of tax issues in facility agreements, see Practice note, Tax issues in loan agreements: negotiating guide.
- The borrower should consider taking specialist tax advice on these provisions, particularly if either the borrower or the lender is not a UK entity. The borrower should also note that if the facility is freely assignable without the borrower's consent, any future lender may be a non-UK entity resulting in a requirement to gross up at some point in the future. Facility agreements sometimes restrict lenders on assigning the facility to lenders (or branches) in jurisdictions that may trigger a tax gross-up (though these provisions can be complex), or give the borrower the right to prepay if a gross-up is triggered. For a summary of the tax issues that frequently arise in corporate loan transactions, see Practice note, Tax for banking lawyers.

Representations and warranties

- A facility agreement will typically include extensive representations by the borrower in favour of the lender. Work through these to determine whether the borrower is able to give all the representations. For more information on representations, see Practice note, Finance documents: representations and warranties.
- Seek to water down the representations, for example by including references to materiality (see Practice note, Material adverse change (MAC) clauses in finance documents: "Watering down" representations and covenants), or to the borrower's knowledge and belief, where appropriate. Discuss with the borrower whether any specific carve-outs need to be made (for example, a particular piece of ongoing litigation may need to be disclosed to the lender and carved out from any "no litigation" representation). For more information on borrower concerns when negotiating representations, see Practice note, Finance documents: representations and warranties: Borrower concerns.
- It is important to check when each representation is deemed to be given. It is normal for all representations to be given on the date of the facility agreement. Often, certain repeating representations are deemed to be repeated on key dates throughout the life of the facility (for example on the first day of each interest period). For information on when representations are given, see Practice note, Finance documents: representations and warranties: When are representations given?.
- It is important to check whether the borrower is expressed to give the representations in relation to just itself or in relation to itself and its subsidiaries or in relation to itself, its subsidiaries and other members of its corporate group. The borrower may be willing to give representations in relation to itself and its subsidiaries (on the basis it should have relevant knowledge), but the borrower may not feel it is appropriate or reasonable for it to give representations in relation to the activities of the wider corporate group. For more information on who gives representations, see Practice note, Finance

documents: representations and warranties: Who makes representations and warranties?.

- Check repeating representations carefully to ensure that they will remain correct when repeated. It is not usually appropriate for all representations to be "repeating". For example, a representation that no security exists over the assets of the borrower should not normally be repeated, as the facility agreement is likely to contain a separate "negative pledge" clause (see Negative pledge) that controls what security the borrower can grant over the course of the facility. Similarly, a representation that no material litigation is ongoing should not be repeated as it will be beyond the borrower's control to ensure compliance with it. For more information on repeating representations, see Practice note, Finance documents: representations and warranties: When are representations given?.

Negative pledge

- The facility agreement is likely to include a negative pledge clause, restricting the borrower from granting security or permitting security to subsist in favour of creditors other than the lender. For more information on negative pledges, see Practice note, Negative pledges in loan transactions.
- Check what security the borrower has granted that will need to stay in place (including a check of the borrower's mortgage index at Companies House), and what security it may need to grant in the future, to ensure that these items are carved out from the negative pledge as "permitted security".
- Always include certain ordinary course transactions (such as liens arising by operation of law) as permitted security (for a definition of permitted security, see Standard document, Facility agreement: Clause 1.1).
- As any security documents entered into in connection with the facility are also likely to include a negative pledge clause, make sure that the negative pledge in the security documents mirrors the negative pledge in the facility agreement.

Restrictions on dividends, acquisitions, borrowings and disposals

- A lender may seek to restrict a borrower's ability to pay out dividends. This is especially common where money is borrowed to finance an acquisition or other expansion and where the lender expects a significant proportion of its money back before the shareholders reward themselves. If a borrowing is to support ongoing operations, a lender will normally allow dividends to be drawn but may impose conditions such as compliance with financial covenants when last tested, and no other default under the facility and/or a "look forward" test, where, for example, the borrower's finance director certifies that based on its current projections the borrower will be able to meet financial covenants for the next year even if the payment is made. In addition, a lender may also seek to cap the aggregate amount of dividends in any financial year at an agreed amount. Scrutinise any restrictions carefully with the borrower.
- It is common for a borrower to be restricted in terms of acquisitions it can make. This is often a negotiated point. The lender will be concerned that major acquisitions may make the borrower a very different-looking business from the one it has assessed and approved for funding and that a bad buy may destroy its profitability. The lender will want a right to veto major acquisitions even if the reality is that in most cases it will be consulted and will approve acquisitions, only using such a veto in an extreme case.
- A lender will usually want to restrict other borrowings (even if it has first-ranking security from a borrower) because significant other borrowings carry an increased risk of insolvency of the borrower especially where large sums may be accelerated and incapable of immediate repayment. It is normal to carve out ordinary course trade credit, intra-group debt and various other operational borrowings such as finance lease obligations, sometimes also allowing for a "basket" of a certain aggregate amount for other miscellaneous financial indebtedness. Ensure, along with the borrower, that actual and anticipated borrowings and indebtedness of all kinds are permitted. For an example of a covenant restricting borrowings, see Standard document, Facility agreement: Clause 16.4. It should also be noted that the distinction between finance leases and operating leases was eliminated for accounting periods beginning on or after 1 January 2019 as a result of the new international accounting standard on leases, IFRS 16. IFRS 16 requires all leases to be reported on a borrower's balance sheet as assets and liabilities, subject to certain exemptions (for more information, see Legal update, New lease accounting standard, IFRS 16).
- Disposals will also be restricted, for obvious reasons. In a secured facility, the security document will prohibit disposals of fixed assets, though sometimes the borrower should seek an exception for assets it will intend to dispose of in the ordinary course (for example, obsolete equipment, or real estate units if, for example, it is a business in the housebuilding sector). In an unsecured facility, disposals will normally be restricted to aggregate limits in a financial year, and there may be an obligation to apply proceeds towards repayment of the facility (see Voluntary and mandatory prepayment). For an example of a covenant restricting

disposals and information on matters to consider when negotiating a disposals covenant, see Practice note, Finance documents: covenants: Disposals.

Financial covenants

- The facility agreement may include financial covenants that measure the financial health of the borrower by reference to a range of metrics (see Practice note, Financial covenants and Standard clauses, Financial covenants: facility agreement). These are designed to act as an early warning system for the lender, so that if a financial covenant is breached the lender is alerted to potential financial difficulties on the part of the borrower before a payment default.
- Financial covenants are often drafted to include complex defined accounting terms. Work through the financial covenants and definitions with the borrower, and check that they reflect how the borrower is expecting the covenants to be tested and/or that any financial ratios are consistent with any financial model prepared in connection with the transaction. Definitions of key terms often require clarification and discussion, for example, cashflow (determined by working back from the earnings figure in the relevant accounts and adding non-cash expenses and cash in which is not recorded in the accounts as a profit, and deducting non-cash profits and cash out which is not recorded in the accounts as an expense) and tangible net worth, as well as the impact of the new international accounting standard on leases, IFRS 16. So, too, exceptional items, as a borrower may contend, for example, that the effects of COVID-19 on its business constitute an exceptional item which should not be taken into account when calculating its EBITDA.
- Check that the timing of testing of the covenants and the testing periods referred to are correct. Sometimes testing periods during the first year after drawdown can cause issues because it may not be appropriate to refer to data before the drawdown and the testing period after drawdown may be very short and vulnerable to unusual fluctuation.

Events of default

- Most facility agreements can only be terminated by the lender on the occurrence of certain specified events of default and for so long as the same are continuing. For more information on events of default, see Practice note, Finance documents: events of default.
- The events of default section is one of the most important in the facility agreement to negotiate (for an example of an events of default clause, see Standard document, Facility agreement: Clause 18). The borrower will want to try to agree as much leeway as possible to limit the circumstances in which the lender can terminate and demand repayment, enforce any security or take other enforcement action.
- Seek to negotiate grace periods during which defaults can be remedied before they become events of default allowing termination of the facility. It is normal to include a short grace period for non-payment (where this has been caused by an administrative or technical problem) (see Standard document, Facility agreement: Clause 18.1), and a longer grace period for other defaults, except for very serious events such as insolvency which would typically be an immediate event of default (see Standard document, Facility agreement: Clause 18.2). For more information on borrower concerns when negotiating events of default, see Practice note, Finance documents: events of default: Borrower concerns.
- There will almost always be a cross-default provision, allowing the lender to call a default if any other borrowings are in default (see Standard document, Facility agreement: Clause 18.6). The borrower will want to ensure that a cross-default is only triggered on an event of default under another facility (rather than a potential event of default) and to negotiate an appropriate *de minimis* limit on borrowings that can trigger a default to exclude, for example, a default on a minor photocopier finance lease. The borrower may also wish to exclude from the scope of the cross-default provision entirely intra-group debt and debt which is subordinated to the lender on the basis that the providers of these types of debt are either unlikely to call a default in respect of that debt or, if they can call a default, they will be prevented from terminating and demanding repayment of that debt in the subordination arrangements agreed with the lender. For more information on cross-default clauses, see Practice note, Finance documents: events of default: Cross-default.
- The borrower may wish to seek a right to cure breaches of the financial covenants by the injection of equity from an investor; this is known as equity cure. The lender may be amenable to this but will typically wish to control how (and how often) any such cash injection is applied, and when the equity cure right can be exercised. For further information, see Practice note, Acquisition finance: debt for buyouts: Financial covenants.
- Where possible, seek to water down the events of default by reference to materiality (for example, a misrepresentation made by the borrower will only amount to an event of default if it is incorrect or misleading in any material respect) or monetary thresholds (for example, a creditors' process affecting any assets of the borrower will only amount to an event of default if it affects assets with a specified

minimum aggregate value). It may be possible to limit some events of default to the obligors or material group companies only, rather than have them apply to each and every member of the corporate group. In some cases, rather than referring to materiality or a monetary threshold, it may be appropriate for a particular event of default to only apply where it will have (or is reasonably likely to have) a material adverse effect (see Material adverse effect). For more information on borrower concerns when negotiating events of default, see Practice note, Finance documents: events of default: Borrower concerns.

- In some cases, a borrower may prefer for an event described as an event of default to be labelled as a mandatory prepayment event instead (for example, a change of control event of default may be redefined as a mandatory prepayment event to try and avoid triggering cross-defaults under other loan facility documentation or other contracts).
- The Corporate Insolvency and Governance Act 2020 (CIGA 2020) has introduced a new moratorium procedure to give borrowers in financial difficulty formal breathing space from creditor pressure to pursue a rescue plan – this new moratorium can be found in Part A1 of the Insolvency Act 1986. CIGA also introduced a new restructuring plan to provide borrowers encountering financial difficulties with the ability to propose a compromise or arrangement with its creditors and members to restructure its financial affairs. Borrowers may see changes to insolvency events of default to deal these points. For more information on CIGA 2020, see Practice note, Corporate Insolvency and Governance Act 2020: toolkit and tracker.

Material adverse effect

- Many facility agreements include a definition of "material adverse effect" (see Practice note, Material adverse change (MAC) clauses in finance documents: "Material Adverse Change" and "Material Adverse Effect" definitions). The definition itself is often heavily negotiated by the lawyers acting for the lender and the borrower.
- The term "material adverse effect" tends to be used throughout the facility agreement to dilute certain representations, undertakings and events of default (see Practice note, Material adverse change (MAC) clauses in finance documents: Use of the MAC concept in facility agreements). The principle is that, in the case of less material obligations, these should only apply if non-compliance with them would have or be likely to have a material adverse effect on the borrower, the lender's security or its rights and remedies under the facility documentation. The borrower will want as many obligations as possible qualified by reference to material adverse effect.
- In addition, the term "material adverse effect" also normally appears in a material adverse change clause in the events of default (see Practice note, Finance documents: events of default: Material Adverse Change). This typically provides that it will be an event of default where "any event occurs (or circumstances exist) which, in the [reasonable] opinion of the Lender, has or is [reasonably] likely to have a Material Adverse Effect".
- Ensure that the definition of "material adverse effect" is drafted as narrowly and as objectively as possible. Consider if any wording could be added to deal with the effects of Covid-19 (see Practice note, COVID-19: Issues for corporate borrowers: Material Adverse Change (MAC)).
- For more information on negotiating material adverse change clauses for borrowers, see Practice note, Material adverse change (MAC) clauses in finance documents: Points to note for borrowers when negotiating MAC clauses.

Security documents

- In addition to the facility agreement, if the facility is to be secured then the security documents may well impose onerous obligations on the borrower and any other security provider.
- As with the facility agreement, review representations and undertakings contained in any security documents and consider whether any should be qualified, for example, by references to materiality.
- In some cases, obligations contained in the facility agreement may be duplicated in the security documents (for example, see Negative pledge). Where this is the case, either remove those provisions from the security document or conform them with the equivalent agreed clauses in the facility agreement. It is common to include an "override" provision in the facility agreement and a security document, which provides that in the case of inconsistency between the facility agreement and a security document, the facility agreement prevails. Draft this override provision carefully to ensure it reflects the spirit of what is intended, that is, the borrower should not have fought hard for exceptions and qualifications to go into the facility agreement only to have those undermined by standard and non-negotiable provisions of the security documents.
- Floating charge clauses in security documents are likely to change in a manner which is friendly to borrowers because CIGA 2020 provides that:
  - a lender can no longer give notice to crystallise a floating charge where the borrower is subject to the new Part A1 moratorium; and
  - provisions for automatic crystallisation of floating charges triggered by the borrower being subject to the new Part A1 moratorium are void.

- For more information on the Part A1 moratorium, see Practice note, The moratorium under Part A1 of the Insolvency Act 1986.

Assignment

- A borrower will invariably be prevented from assigning any rights or transferring any obligations under the facility agreement, and almost always a lender will have the freedom to assign its rights and transfer its obligations or enter into a sub-participation in respect of the facility documentation (for more information on sub-participation, see Practice note, Trading performing loans: overview: Sub-participation). Make the borrower aware of this provision and discuss whether it wants to negotiate it, for example, by:
  - seeking a consent right or a consultation right before any assignment, transfer or sub-participation which involves the transfer of voting rights;
  - restricting potential assignees, transferees and sub-participants to financial institutions or a finite group of lenders (a "white list");
  - preventing any assignment, transfer or sub-participation to a specific group of lenders (a "black list");
  - seeking a right to approve an assignee, transferee or sub-participant (perhaps with a proviso that its consent will not be unreasonably withheld or delayed and that it will be reasonable for the borrower to withhold its consent to the potential assignee, transferee or sub-participant in certain agreed circumstances (for example, if the potential assignee, transferee or sub-participant is a competitor of the borrower or someone in a substantially similar business area)); or
  - requiring the lender to assign, transfer or sub-participate a minimum amount of the loan.

  A lender is likely to resist such requests and will certainly (and justifiably) resist any attempt to limit its rights to assign, transfer or sub-participate while an event of default is continuing or where the assignment is to another entity within the lender's corporate group.
- For more information on assignment and transfer provisions in a facility agreement, see Practice note, Loan transfers: contractual restrictions and consent requirements.

Amendments and waivers

- Most facility agreements include provisions detailing how amendments can be made to them or waivers obtained where the obligors are unable to comply with their terms. In the case of bilateral facility agreements, these attract relatively little attention, but with multi-lender facility agreements there is potentially more room for negotiation.
- With multi-lender facility agreements, there will often be a concept of "Majority Lenders", being the relevant constituency of lenders who can sanction certain kinds of amendments or waivers without the consent of all of the lenders. Typically, the Majority Lenders will comprise those lenders who hold two-thirds or more of the loan commitments. If the Majority Lender threshold is set above this level, a borrower will likely want to review that.

  There will then be a list of exceptional matters which cannot be amended or waived without the consent of all of the lenders, typically because they are seen as being so fundamental to the lending relationship that they go beyond what the Majority Lenders alone can approve. These "all lender" decisions typically cover matters such as changes to the maturity date, the interest rate, an increase to the commitments and changes to certain key provisions of the loan agreement. If there are any matters listed as "all lender" consent items but which you consider should fall within the authority of the Majority Lenders to approve or not, consider re-visiting this with the lenders.
- Finally, a borrower negotiating a multi-lender facility agreement from a position of strength might seek to introduce certain provisions which make it easier to obtain lender consents where they become necessary. These include "snooze you lose provisions" (where the commitment of a lender is ignored for voting purposes if a lender declines to respond to a waiver or amendment request within a prescribed notice period) or defaulting lender concepts (where a lender who is subject to, for example, an insolvency proceeding or who has failed to comply with their funding obligations under a facility agreement is disenfranchised for voting purposes under the facility agreement).