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Loan Market Association Issues Revised Intercreditor Agreement

While the revised agreement provides some optional clauses that are beneficial to mezzanine creditors, many concerns still remain unresolved.

The Loan Market Association (LMA) has issued a revised form of the Intercreditor Agreement for Leveraged Acquisition Finance Transactions (Senior/Mezzanine), which took effect on 14 September 2012.¹ This is the first wide-ranging revision of the Intercreditor Agreement since its initial publication in 2009 and limited update in 2010.

Following the financial crisis and cases such as *IMO (Car Wash)* and *European Directories*, it has become clear that the interests and contractual positions of senior and mezzanine creditors can significantly diverge in the context of a corporate rescue or restructuring. As a result, mezzanine creditors are now focusing on obtaining greater rights under intercreditor arrangements to protect their interests. While the LMA has addressed the concerns of mezzanine creditors in certain areas, it has largely done so through the inclusion of optional clauses and much still remains open for negotiation. This article examines some of the key areas of concern for mezzanine creditors in the context of the revised Intercreditor Agreement.

Enforcement

The most complex (and contentious) area of concern is the ability to enforce, by way of disposal of the business and the related release of the security, debt and guarantee claims of mezzanine creditors. Although the market has now generally accepted that mezzanine creditors will not be structurally subordinated and will lend at the same level as the senior creditors, the revised Intercreditor Agreement still allows for the disposal of assets (a concept that now encompasses an appropriation of assets) and discharge of liabilities without the mezzanine creditors' consent. Additionally, greater powers have been given to the security agent to accept noncash consideration (e.g., senior debt claims) upon enforcement. The key decisions regarding whether to accept such noncash consideration, whether to realise it for cash prior to distribution, and the appointment of a financial adviser to carry out a valuation of such noncash consideration are all within senior creditors' control.

The existing obligation on the security agent to take reasonable care to obtain fair market value on an enforcement disposal has been supplemented by further options requiring the security agent to take reasonable care to obtain a fair market price and/or imposing an absolute obligation to obtain a fair market value/price. There are further optional provisions that set out what methods are deemed to satisfy the fair market value/price requirement. These include the delivery of a fair-value opinion from an independent financial adviser or a disposal made pursuant to an auction or "other competitive sales process".

Even in circumstances where mezzanine creditors can force through these optional provisions, the fair-value opinion is only one possible alternative, and it is unclear whether or not mezzanine creditors would be allowed access to the opinion. Additionally, there are no prescribed terms for the basis of valuation (whether on a going concern or break-up basis) and no approval or consultation right for mezzanine creditors in relation to the

1. The revised Intercreditor Agreement, as well as the LMA's User Guide and memorandum explaining the revisions, can be accessed at <http://www.lma.eu.com/documents.aspx?c=37#c60>.

appointment of the financial adviser. There could also be disputes as to what constitutes a competitive sales process. As a result, previous mezzanine creditors' concerns regarding enforcement largely remain, including the concern that an enforcement sale could result in the senior creditors instructing the business to be sold (with best value simply being what the senior creditors will pay for the business), with the end result being that mezzanine creditors are forced to release their security and/or liabilities where value is being destroyed.

Senior Refinancings and Senior Headroom

A new framework has been included in the Intercreditor Agreement—a Qualifying Senior Facilities Refinancing—pursuant to which new facilities that meet prescribed criteria (including size and tenor) can refinance the initial senior facilities without requiring amendment of the Intercreditor Agreement or mezzanine creditors' consent. A further assurance provision has been included to allow for the release, amendment, and retaking of security in the context of a Qualifying Senior Facilities Refinancing.

The “Senior Headroom” concept can now be restricted to the senior facilities amount immediately before the refinancing (i.e., to take account of amortisations), as opposed to the original day-one amount. Senior Headroom is also now extended to encompass a capped yield increase, which can itself include a cap on senior fees. However, uncapped increases to the senior margin following a market flex are still permitted and mezzanine creditors may find this hard to defend if senior arrangers indicate a willingness to underwrite transactions. Therefore, although there is further clarity on what constitutes additional senior financing and such provisions restrict the creation of a super priority class of senior creditors without mezzanine consent, the caps and options within the Senior Headroom will still be subject to detailed negotiation.

Expenses

The revised Intercreditor Agreement now provides for the recovery of mezzanine expenses relating to restructuring advice or a valuation notwithstanding the occurrence of a mezzanine payment stop (although there is an optional exclusion to the extent the expenses relate to disputing any aspect of a distressed disposal or sale of liabilities). The amount of these expenses is subject to a cap to be agreed upon and is conditional on there being no senior payment default. Such condition means that, in many restructuring scenarios, it remains the case that mezzanine creditors may be precluded from fully exploring their contractual and statutory rights with separate professional advisers or from disputing the outcome of a distressed disposal to which they did not consent.

Mezzanine Payment Blocks and Other Mezzanine Rights

No substantive changes have been made to the concept of a mezzanine payment stop event. This, along with the time limits on such blocks and the ability to issue successive stop notices for unrelated defaults, remains subject to negotiation. Rights to inject further mezzanine debt as an “equity cure” if the private sponsor has failed to do so and the ability to convert mezzanine claims into equity or to create and enforce a share security at a level above the borrowing group, thereby depriving the private sponsor of its residual economic interest, will continue to be considered on a deal-by-deal basis and are likely to be unattractive in many instances to both the senior creditors and the private sponsors.

Conclusion

The ideal scenario for mezzanine creditors is to obtain a position similar to or better than a high-yield deal. This has not been achieved in this latest draft of the Intercreditor Agreement. Much will still depend on the percentage of mezzanine debt being put into the deal and how determined the mezzanine creditors are in forcing through, and perhaps improving upon, many of the optional provisions that have been included in the revised LMA Intercreditor Agreement. In light of this, it seems likely that the intercreditor arrangements for mezzanine creditors are likely to continue to be agreed upon on a fairly bespoke basis, and the class divisions between senior and mezzanine creditors may arguably remain as blurred as ever.

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